Q3 2012 Earnings Call

Company Participants

- John Neal, Group CEO
- Neil Drabsch, Group CFO

Other Participants

- Andrew Adams, Analyst
- Brett Le Mesurier, Analyst
- Daniel Toohey, Analyst
- James Coghill, Analyst
- Jan van der Schalk, Analyst
- Kieren Chidgey, Analyst
- Richard Coles, Analyst
- Ryan Fisher, Analyst
- Siddarth Parameswaran, Analyst
- Toby Langley, Analyst
- Unidentified Participant, Analyst

Presentation

Operator

Ladies and gentlemen. Welcome to the QBE market announcement. During this event, all audio lines will be on mute-mode, with questions and answers after the presentation. I'd like to remind everyone, this conference is also being recorded.

I'd now to hand over to CEO, John Neal. John, please go ahead.

John Neal {BIO 15681439 <GO>}

Morning, everyone. John Neal here. I also have Neil Drabsch, our Group CFO, in the room. If I may, I would like to make some opening remarks. And then hand over to questions.

Firstly, I would l like to apologize to our many shareholders for this profit warning. And for the decision to again lower our insurance profit margin forecast for 2012. This decision has been taken after a thorough review of our businesses at the end of October. And is based on quarter 3 data from our businesses worldwide.

We have a clear obligation to ensure that the market is fully informed under our continuous discloser requirements. And in the insurance industry, it's sometimes difficult to quickly estimate the impact of a loss event or, for example, to forecast the likely impact of changes in interest rates on our assets.

Today's market release is a genuine attempt to quantify our position today and, more importantly, to forecast where we expect to be at year end.

Superstorm Sandy is shaping up to be one of the largest storms or hurricanes in US history. And whilst we anticipate such events, we are now using allowances that could have substantially off-set the impact of prior year claims upgrades we have taken. And notably for our US program run-off business.

It is still very early to be assessing the full impact of Sandy. And the insurance market is probably weeks, if not months, away from accurately estimating the final insured costs of this catastrophic and complex loss event.

Our initial view is that Sandy could exceed $20 billion insured loss. And based on this assumption, we have provided for a claims cost to QBE of up to our retentions for our property and casualty business, underwritten in the US, which are $300 million; and, in addition, we have allowed $85 million for our retentions under the reinsurance business, written out of both London and New York; and a further $15 million [ph] for marine losses.

Our retained claims cost for this event may be lower. However, at this stage, we consider it prudent to assume the net claims cost to QBE will be $400 million, or in the range of $350 million to $450 million.

The US drought will cause substantial claims under our US multi-perils crop insurance portfolio. Whilst, again, it's early to determine the actual claims cost, we now anticipate making using of our extensive reinsurance arrangements for this class of business and are projecting a combined operating ratio for this portfolio of 102% to 103% of net earned premium of around $1.2 billion [ph] of premiums for our crop business.

In a normal year, we would expect this business to produce an insurance profit margin in the range of 13% to 15% of net earned premium.

The US drought conditions. And resulting shortage of grain, will undoubtedly result in higher commodity prices and a significant increase in our crop premium pool in 2013.

The cost of our large individual risk claims, which we deem to be in excess of $2.5 million for any one risk claim, including an allowance of $107 million for claims occurring in the months of November and December. And our $155 million provision for incurred but not reported claims at year end, is now actuarially forecast to be around $600 million, or approximately $100 million above previous expectations.

This increase in the frequency of large individual risk losses is out of line with previous years.

So the combined costs of Superstorm Sandy, the US crop and drought claims. And other large individual risk and catastrophe claims are estimated to be $1,865 million for the full year, or 12% of projected net earned premium; thereby exceeding our original large individual risk and catastrophe allowance for the year by 1.5%.

A full reconciliation of these numbers is set out in the attachment to the market release.

In the second half, we have re-organized our North American businesses and established dedicated divisions and infrastructure to manage respectively our specialist bankers' lender placed portfolio, QBE First; our multi-peril crop and agricultural products, QBE NAU; our inwards reinsurance business, QBE Re; and our intermediary business, which, in turn, comprises major brokers' program, regional and some specialist lines.

As part of that structure, I initiated and supported the establishment of a dedicated team to manage portfolios in run-off and under remediation. In so doing, we replicated the successful run-off structures that operate in Australia and our European division.

As is often the case, when separately managing a run-off portfolio, detailed claims reviews have identified potential shortfalls in reserves that otherwise would have emerged in future periods as claims are settled.

In my experience, it is best to provide for this likely outcome upfront in order to enable the business to move forward on a more certain footing. Consequently, we have decided to increase provisions for this portfolio by $180 million. And principally for our program business.

At the half year, we reported a prior year undiscounted central estimate claims development of $117 million, mainly representing claims upgrades for the Christchurch earthquake. And Thai floods that occurred in 2011.

Including the previously mentioned $180 million upgrade for the North American run-off portfolio, we also consider it prudent to provide a further $83 million to cover further possible prior year claims upgrades. This results in a $380 million charge for prior year claims development for the full-year 2012, or 2.4% of projected net earned premiums.

Risk margins are maintained at levels to provide a buffer against uncertainty in the discounted claims central estimate. Our aim is also to maintain a probability of adequacy for our outstanding claims of more than 85%.

Based on projections and assumptions on the likely level of the central estimate of the provision for outstanding claims at year end, we consider a further $125 million will be required to maintain an appropriate level of risk margins.

The Board approved management to proceed with an offer of up to $500 million by way of an issue of subordinated convertible securities; not dissimilar to securities repaid in May this year, however, with terms that we believe comply with APRA's Basel III criteria under its GPS 112 guidelines.

We have commitments for $500 million. And will issue these securities shortly and then advise details of their terms. The securities should achieve equity credit for regulatory purposes. And the proceeds will be used to repay short-term borrowings and increase the capital of our US subsidiaries affected by the upgrade to provisions.

So in summary, the key items affecting the lower insurance profit margin guidance. And to give you a reconciliation with our previous forecast of better than 92% combined operating ratio, are as follows.

Our large individual risk and catastrophe allowances now take account of Superstorm Sandy at $400 million; allow for such claims in the remaining two months of the year of $357 million; and include a further prudent IBNR provision of $175 million; prior year claims development of $380 million, or 2.4% of net earned premium, which in turn is inclusive of a $83 million allowance for any further prior year claims development; a provision of $125 million to reinstate risk margins to ensure we maintain a probability of adequacy of 85% or better.

A summary of these adjustments and their impact on our previous forecast is as follows. We have 1.5%, or $233 million, for additional large risk and catastrophes. We have 1.2% of net earned premiums, or $180 million, set aside for North American program and run-off business. We have a further provision of 0.5%, or $83 million, for other prior year developments. And we have 0.8% of net earned premiums, or $125 million, for risk margin top ups.

That's a total of $621 million, or 4%, of net earned premiums. Based on these adjustments and allowances for movement in discount rates, we now expect the full-year combined operating ratio to be between 96% and 97%.

Together with investment yields on policyholders' funds. And with some allowance for credit spread deterioration, we are anticipating achieving a yield of 3.7% and so, with a premium period held of approximately 1.3 years, we expect the insurance profit margin at December 31, 2012, to be around 8%.

We now anticipate a net profit after tax before amortization of in excess of $1 billion.

Full-year amortization charges of identified intangibles are forecast to be around $180 million after tax.

We can advise that a preliminary assessment of our attritional claims ratio in the current half indicates a further solid improvement.

We do consider the large individual risk and catastrophe allowances for the balance of the year to be reasonable. And the -- based on the assumptions of allowances advised in today's release, we do not anticipate any further meaningful prior year development in the US, or elsewhere.

Thank you. We're now prepared to take questions on today's release.

Questions And Answers

Operator

Nigel, please ask your question again.

Q - Unidentified Participant

Right, okay. Just, first of all, was on the crop business. Obviously, there you're flagging an assumed 67% attritional net loss ratio. Previously, you've talked about an assumed combined ratio in the low 80s. So are those two numbers consistent?

A - John Neal {BIO 15681439 <GO>}

Nigel, we've assumed the run rate attritional claims ratio for crop is 67%. Accordingly, the expenses on top of that are 6%, which would give you a 73% combined ratio. Then there's a 13% allowance normally for catastrophe claims, giving 86% for a combined ratio in a typical or normal year; and that equates to the 13% to 15% insurance profit margin that we would anticipate.

So just to run through that again, it's 67% attritional; 6% for expenses; and a 13% allowance for catastrophes in a normal year, 86% combined operating ratio.

Q - Unidentified Participant

Okay. Then just picking up, obviously, at the half year you said you were pretty comfortable with the balance sheet strength. At the US briefing, we said that a 50 million provision for run-off was adequate. Three weeks ago, you said that the 12% insurance margin you were on track for.

There's obviously a few question marks there as to why the last three weeks have proved to be so significant. And I appreciate that was before the Sandy loss. But that is 2.2% to 2.9% in net earned premium. So can you just, maybe, explain why. And I appreciate you said it was based on the September quarter numbers, things have changed so materially over the last three weeks?

A - John Neal {BIO 15681439 <GO>}

Yes, I can. I think the first point, new hit has been Superstorm Sandy. I think we are, if not the first, the second insurer into the market with an estimate of the loss on Sandy, which has been difficult. And it's still too early, in many ways to call, that loss, hence, we've assumed that our various retentions will be used in full in calling the loss.

I think in seeing Sandy come through. And the realization of crop at $355 million above that attritional ratio, it took us, naturally, to a forecast for November and December. And to prudently allow for both large individual risk and cat claims for the balance of the year. And that, in turn, brought us to large risk and claims allowances for the full year at 12%; 1.5% outside the top of our margins. That was factor one.

Factor two was then conducting a second review on the run-off portfolios of the program business and ensuring that we got a fair line of sight around what we expected the claims to be here. We came to, again, an early conclusion on that work, where we're carrying pretty substantial reserves at $1.1 billion, almost half of which are IBNR, that it would be appropriate to carry another $180 million against those reserves.

And some uncertainty, recognizing that these claims will take many years to settle, drew us to the conclusion that we should provide a further $83 million against any likelihood prudently for any further deterioration.

So a combination of those three factors, which was 1.5% more for additional large risk in cats, 1.2% for North American program and run-off business. And then that $83 million, or 0.5%, for prior year, we felt puts us outside of our forecast for the year and in a position where we should revise our forecast to an 8% insurance profit margin on a combined ratio of 96% to 97%.

Q - Unidentified Participant

Okay. Thank you.

Operator

Thank you very much, Nigel. James Coghill, UBS.

Q - James Coghill {BIO 14006200 <GO>}

Sorry, my earlier question had been partly addressed when you responded to Nigel. But perhaps, just to get into a little bit more detail on that, John, on this run-off portfolio, what exactly has changed? Is it just a view on potential future underlying claims inflation for some of those claims? You say it's IBNR. And what changed in three weeks, relative to the messages that came out at the Investor Day, that have led to this $180 million decision to top up?

A - John Neal {BIO 15681439 <GO>}

Right, we set the team up at the beginning of July, James, to begin a review of each and every claim that was sat within that run-off portfolio. It's, in fact, 6,002 claims.

We've segmented business into three categories; business that we put into run-off some while ago, business that we put into run-off in the last 18 months. And business that's been put into run-off in the last 12 months and very much we'd regard as business as usual. We have changed the TPAs on the first two categories of business. And we've carried out our own independent review of their opinion on the reserves. And I think, as I said in the opening of the call, we felt that we could have coped with any small deterioration in these losses had we had a very benign catastrophe year.

I think recognizing Sandy coming in. And as I think I said in my opening remarks, in my experience these types of losses tend to get worse, not better, we felt it prudent to make a call on the reserves and, hence, put another $180 million aside, which is a substantial sum against the original provisions that we were holding.

Our experience in Australia and in Europe, where we have separate run-off divisions, is that these claims are most effectively managed by a dedicated and separate team and that once the initial process of estimating is taking place we can have confidence in the provisions that are being held. And this is the position I feel we are in now.

It's been three months to complete the exercise.

Q - James Coghill {BIO 14006200 <GO>}

Okay. John, just on the $600 million large and cat losses that you've flagged, you made a comment in your opening remarks there that you felt frequency was just unusually high for some those large individual risk claims. Could you, perhaps, expand on that? And could you also express a view on whether you still feel that 10.5% allowance into next year is adequate?

A - John Neal {BIO 15681439 <GO>}

Yes. The large individual risk claims, in many respects, are the hardest to estimate. I think as you've seen in the release, our actual reported large individual risk claims, including IBNR, is, in fact, $338 million.

What we've done is set up tracking modules using conventional actuarial techniques, Bornhuetter-Ferguson, to look at those losses against previous years. Against that track, actuarially, it would suggest that the losses will settle at or around $600 million. To be fair, that's still a very uncertain position. And you can see, in November/December we've allowed for another $107 million, i.e., substantially more than we've seen in the first 10 months of the year.

So the prediction, at $600 million, is exclusively actuarially driven and, really, come the end of the year we'll have a clearer line of sight as to whether that is actually what we expect to happen, or whether that's just a statistical blip we're seeing at the moment.

The reason I said that I thought it was unusual is I don't see any sign in the underwriting of the account, or in the type of large individual risk losses that we're seeing, that would tend to suggest anything's happened in the shape of the business to push those reserves out.

I think when you see a fuller margin guidance on 2013, we are still looking at allowances at 10.5% of net earned premium for large individual risk and cat claims. And we still consider that in normal circumstances that will be sufficient.

Q - James Coghill {BIO 14006200 <GO>}

Thank you.

Operator

Ryan Fisher, Goldman Sachs.

Q - Ryan Fisher {BIO 3487027 <GO>}

Just a few smaller questions, I think. First of all, with the $83 million, would it be possible to give us an idea as to which parts of the portfolio/geographies that related to.

A - John Neal {BIO 15681439 <GO>}

The short answer is, Ryan, it's the US. I think I felt it was important, particularly as we were going through our Q3 review process and constructing our plans for 2013, we had a look at all of our businesses.

I think as I said earlier on, it would be the run-off businesses that would be those that you'd looked most closely at. And I'm very confident the run-off teams that we already have in place in Europe in Australia. So the issue is really in the US.

Q - Ryan Fisher {BIO 3487027 <GO>}

Great, thank you. And in relation to that run-off book, could you give us a feel for how much of that run-off book is long tail versus short tail. And roughly what the average period of those claims would you expect it to be?

A - John Neal {BIO 15681439 <GO>}

It's roughly 35% long tail, 65% short. Some of the long tail business came with the Praetorian acquisition. And there is some workers' comp business in there so it is very long tail in nature. So if you look at the total book at $1.1 billion gross, you're talking about five-plus years; five to seven years to settle.

Q - Ryan Fisher {BIO 3487027 <GO>}

Great, thank you. And one, just quick update from the recent conference presentation. Within the 8% margin estimate, is the adverse discount rate impact still the same number, I think is what Neil flagged at that conference?

A - Neil Drabsch {BIO 2093435 <GO>}

Hi, Ryan. At the conference, Ryan, when we were -- at that point in time, the actuaries were flagging a much higher discount rate that was predominantly driven by some of the huge variables we're seeing out of our Argentinean business. Since then, because this is heavily formula-driven in a market that has less strength, let's say, in the way that you determine risk margins, that actually has settled down. And I'm expecting that figure to be below 1% full year. And that's now (multiple speakers).

Q - Ryan Fisher {BIO 3487027 <GO>}

Great, thank you. And that leads into the final thing I was going to ask which, Neil, was, with the current goings on in Argentina, can you give us just an idea as to how that book is invested, the extent to its local versus outside the country and sovereign versus other?

A - Neil Drabsch {BIO 2093435 <GO>}

Yes. It's a good question, Ryan. Being aware of some of the problems in that country at the moment. And particularly the way the government's reacting, I think we're well ahead of the curve in that one. And we made sure that -- for example, if you are holding US bonds in that territory, effectively, the government forced a settlement back to pesos. So we had converted all our securities that were in pesos so they matched to our liabilities. And we're pretty comfortable with the quality we've booked [ph]. And particularly the book that we acquired from the HSBC acquisition.

So all in all, it's a fairly stable book. It's in pesos. And matched volatility is there in the sense that we see credit spreads moving. But the book's relatively short for our purposes.

Q - Ryan Fisher {BIO 3487027 <GO>}

Great, thank you. That's all from me.

Operator

Kieren Chidgey, Deutsche Bank.

Q - Kieren Chidgey {BIO 7268946 <GO>}

I've got a couple of questions. Just starting on the reserves, obviously, all those top ups you're flagging relate to the US. The last couple of years, however, we've seen pretty good releases out of Europe and Australia; are you suggesting that's come to an end?

A - John Neal {BIO 15681439 <GO>}

I think, Kieren, at this point in the cycle we're not expecting to see any material releases out of Europe or Australia. So in both respects, we consider the reserves to be at least adequate. But we're not expecting significant prior year releases from these two territories.

Q - Kieren Chidgey {BIO 7268946 <GO>}

Okay. And the issues relating to this run-off portfolio and the other top ups, the $83 million elsewhere in the US, obviously, a fair amount of the US business ends up in Equator

Re. Is there any flow through impact on Equator Re reserves? Have you undertaken any additional analysis there?

A - John Neal {BIO 15681439 <GO>}

Yes. We have. There is a flow through with some quota share treaties in place for Equator Re. And the flow through for Equator is approximately $60 million. It's included in the estimates for the forecasts, MCR [ph], obviously.

Q - Kieren Chidgey {BIO 7268946 <GO>}

Yes. All right. And just on the balance sheet, I'm just wondering whether or not you can give us a feeling for where you're expecting the MCR coverage in gearing to be at 31, 12 [ph].

Just given the $500 million, some of that will be, obviously, used to repay debt. If you could just give us a feeling for where those metrics might end up. And how comfortable you are with where they will be sitting relative to requirements from rating agencies.

A - Neil Drabsch {BIO 2093435 <GO>}

Hi, Kieren. The debt/equity ratio will be just over 40% on the basis that we'll, as we normally do before the year, will retire some short-term bank debt. Any excess from this one, in fact, we have a $220 million net settlement early -- next year with a bond. So it effectively can be used to offset it. But in the meantime, that will be held. So the debt/equity will be slightly above 40% at the close of year end.

In relation to MCR, this particular security follows exactly the terms that were agreed between IAG and APRA so we have expectations that that will meet APRA criteria on that basis. We would expect to see the MCR and PCA models over 1.6 times.

In relation to the two primary rating agencies, S&P and A.M. Best, we've been in contact with them. And we're comfortable with their positions. Their positions tend to take a prospective view, as well as the current one. And they have our data at this point in time, which, as John indicated, for 2013 the fundamentals of this portfolio look quite strong. And we'll -- they've yet to come back and comment fully. But there may be something from them over the next week or so.

Q - Kieren Chidgey {BIO 7268946 <GO>}

Okay. And the PCR [ph] and the MCR coverage multiple fund or a logic [ph] basis that you'd flagged at a recent presentation, to what extent do they allow for prospective DRPs because clearly -- presumably, the dividend, the final dividend, falls off the back of this?

A - Neil Drabsch {BIO 2093435 <GO>}

Under the PCA model, their dividends are now out so it doesn't take into account any provision for future dividend, where under the old MCR model that does.

Q - Kieren Chidgey {BIO 7268946 <GO>}

Is there an allowance for expected DRP take up?

A - Neil Drabsch {BIO 2093435 <GO>}

No because the PCA, if -- its not relevant because they don't take into account any dividend; and in the MCR, yes, they do. So if it was 40%, for example, at the last dividend, they'd assume a similar ratio.

Q - Kieren Chidgey {BIO 7268946 <GO>}

Okay. And a final question just on the size of the Sandy loss, which seemed a little bit large, I thought. I thought your US win retention of around 300 was more aimed at a very sizeable Gulf storm event. Could you just talk about why your risk exposures on that upper North East Coast are leading to what is such a higher than expected loss?

A - John Neal {BIO 15681439 <GO>}

Sure. I think there's a few points to bear in mind here. Even at $400 million, this is not our maximum event retention. So we're two-thirds of the way to our maximum event retention. So you could get a larger loss in the US. So its not the largest loss that we would model.

If you look at New Jersey, its the sixth-largest state in the US so you've got a massive population there. And I think the storm characteristics were quite unusual with the cold weather fronts coming the other way, which really trapped Sandy for longer than you would have anticipated over the three states hit hardest.

It's interesting that our lead modeling agency is RMS. And you remember a lot of talk about them upgrading their version model to 11. That is all about storm surge, which is exactly what happened in this loss. And even today they have not released their model for the loss. So I think they are, likewise, anticipating that the losses will be greater than are being indicated.

So I'm saying today I think the losses will be north of $20 billion. I genuinely would not be surprised to see the loss go much higher than that figure; the damage is very substantial.

Q - Kieren Chidgey {BIO 7268946 <GO>}

And the flow on impact on premium rating changes, obviously, you're flagging your expectation you'll see some further strengthening post that. The market commentary seems to be a bit more mixed, with some expecting only more localized loss impacted-type rate hardening. Can you just give us a feel for why you're more confident on rate increases more generally across the US?

A - John Neal {BIO 15681439 <GO>}

Sure. I think you might have heard me say before that even when we saw things last year, like the Japanese earthquake and tsunami, in my experience, its only a major loss in the

US that step changes pricing globally.

I do think this is a major loss. And I do think it will sustain the rate increases that we're seeing. And certainly, for the property classes. And most specifically property in the US, you will see prices move forwards. I think we, along with other local players, are already moving our rates forward.

Q - Kieren Chidgey {BIO 7268946 <GO>}

Okay. Thank you.

Operator

Andrew Adams, Credit Suisse.

Q - Andrew Adams {BIO 20116222 <GO>}

Just a couple of questions. Firstly, on your NEP number, $15,570 million, does that include any reinsurance reinstatements? Or is there any implicit GWP downgrade in that number?

A - John Neal {BIO 15681439 <GO>}

We don't have any reinsurance reinstatement premiums of any note. There are small reinstatements on the marine and in within reinsurance books. But the main worldwide treaties encompass reinstatements paid upfront so there is no meaningful assumption [ph] of reinstatement premiums in there.

Q - Andrew Adams {BIO 20116222 <GO>}

So is that on a lower than expected GWP? Or that's just the earning pattern you did expect?

A - John Neal {BIO 15681439 <GO>}

Just the earning pattern that we did expect. The premium, both gross written and net earned, is in line with the forecast that we've had in the market recently.

Q - Andrew Adams {BIO 20116222 <GO>}

Okay. Great. Also, the $125 million risk margin update. So that brings you to a POA of 85%, or over 85%?

A - John Neal {BIO 15681439 <GO>}

It's -- we're still working through the detail of the numbers. But we believe it will be over 85%. Our target is 86%.

Q - Andrew Adams {BIO 20116222 <GO>}

Yes. Then just also, I guess, is this -- so on the large claims, the detail you went through, the $600 million large claims, there's only $338 million reported. And you've come up with actuarially modeled and come up with $600 million. Can you explain how this was treated previously? And how it will be treated going forward?

Just thinking, if the $338 million you do load it up, what does it mean for next year's weather claims? If the IBNR doesn't eventuate, do we get that release in the weather claims or your large amounts next year, or does that come through in underlying? Just trying to work out, firstly, how this change from previously and how we should expect to see that progress into next year.

A - John Neal {BIO 15681439 <GO>}

The first thing, what I've done is I wanted to set up a model so we can track a forecast against large individual risk claims. You might recall that we do buyer protection against large individual risk claims of $200 million, excess of $400 million. That in itself is in excess of a franchise of $5 million. So its quite a complex reinsurance treaty. So I'm very keen to track it to make sure that the reinsurances are appropriate for the cover.

I think the second point in terms of the allowances is we'll take a good look at the year end as to what the actual large individual risk and catastrophe claims come out. We've allowed what looks like a very reasonable sum of $250 million for catastrophe claims in November and December and, as I'm saying, we've modeled $600 million, or around $600 million, for the individual risk claims.

So I think once we get to the end of the year I'll have another good look at them and make a fair assessment, firstly, of what the cost is against full year 2012. And, therefore, what level of IBNR we should be carrying; and then secondly, whether we need to amend our 10.5% allowance.

I have to say that, looking at them now, I'm of the mind that 10.5% is adequate. And that -- certainly, in the planning numbers we've put forward for 2013, that's what we continue to allow. And I'm happy to do that.

Q - Andrew Adams {BIO 20116222 <GO>}

But just to clarify. So the specific example of $600 million, if we reporting our FY '10 or '11 results, that number would have only been $338 million?

A - John Neal {BIO 15681439 <GO>}

No. So the actual allowance was roughly $100 million less. So we were around about $500 million including IBNR for large individual risk claims. That's the assumption within that overall allowance of 10.5%.

Q - Andrew Adams {BIO 20116222 <GO>}

Okay. Then that $100 million, say, in the previous example, if that moved up or down each year, does that come through in that large --?

A - John Neal {BIO 15681439 <GO>}

It does.

Q - Andrew Adams {BIO 20116222 <GO>}

Effectively, does that offset next year as you don't use it?

A - John Neal {BIO 15681439 <GO>}

Would it impact the quantum of the allowance? I think if we didn't use we would still carry 10.5% as an initial allowance.

Q - Andrew Adams {BIO 20116222 <GO>}

Okay. Great. Thanks.

Operator

Siddarth Parameswaran, JPMorgan.

Q - Siddarth Parameswaran

A couple of questions, if I can. Just, firstly, on the attritional loss experience, could you just comment on how that has tracked; whether that's still in line with expectations?

A - Neil Drabsch {BIO 2093435 <GO>}

Hi, Sid. The attritional is starting to -- we've had a look at the end of September and that number's starting to come down, as we would expect it to. We're starting to see the benefits of pricing come in and with the mix of the business at the moment between Prop [ph] and Balboa, particularly in the US, that's having a positive impact on it. But overall, pricing is the major benefit and so its starting to come down.

Q - Siddarth Parameswaran

Okay. Great. Can I just ask about whether you've had any discussions with S&P about this downgrade yet? And in particular, just bearing in mind that they are changing their capital standards potentially. And also that they made some reference, I think, at the start of the year saying that they thought that the capital levels were not commensurate with, I think, basically the rating that they'd given QBE at the time, which I think was A+. And whether --

At the time, I think they were talking about -- I think, from memory, they basically said that as long as QBE hit their profit margin guidance for the full year they would be happy to maintain the rating. But given that we've had a substantial downgrade this year, just wondering whether you've had any recent discussions with them.

A - Neil Drabsch {BIO 2093435 <GO>}

Sid, we have constant discussions with our rating agents, as we do with our regulators. We are aware of their models. And we carefully model where we are currently and prospectively.

As I said earlier, the rating agencies do take a prospective view. We have been in contact with the rating agencies. And they are aware of our position. And prospectively. And the actions that we've taken in relation to this particular subordinated convertible that we've put in place as well.

Q - Siddarth Parameswaran

Okay. And just one last question, just on super imposed inflation. You've obviously seen -- just across your portfolios, for different reasons, we've seen upgrades occurring. What are your comments as to what is actually happening with super imposed inflation in your different markets? I think previously you were saying there's signs of none anywhere. But just any updated thoughts?

A - John Neal {BIO 15681439 <GO>}

I think the previous comments we've made on super imposed inflation consistent. We're not seeing any exaggerated inflation in the book.

And this update that we've been talking about today is just really a combination of three sets of circumstances; its Superstorm Sandy; its the increased allowances that we're running through to the year end for large individual risk and cat as we see it going through the year end; and the review that we've undertaken and completed on the US run-off business. So its not in any way a reflection of any step change we see in inflation on the liability books.

Q - Siddarth Parameswaran

Okay. Great. Okay. Thank you very much.

Operator

Richard Coles, CIMB.

Q - Richard Coles {BIO 16129434 <GO>}

Just wondering if you can talk us through. I'm still a bit confused how we need to think of your gen IBNR balance, which was $265 million at the first half, going forward. And how we consider that. Is that going to run at a $200 million level going forward? Or is that -- how do we consider that from here on?

A - John Neal {BIO 15681439 <GO>}

I think in the first half I might have said, with the half-year results, its very difficult at a half year trying to take a view on appropriate IBNR for large individual risk and cat claims literally halfway through a year. So the call that we made at the half year was to put through an 8% allowance for large individual risk and cat claims based on NEP, which was our run rate average over time.

When we get to the year end, we do take a very detailed view as to what we anticipate can occur as claims develop. Generally speaking, your catastrophe claims are well flagged by that point in time. So you'd only carry a nominal sum of money against catastrophe losses.

A complication is individual risk claims, which we would run actuarial models to support the IBNR we're holding. So at present, that $175 million that we're forecasting at year end, the vast majority of that, almost all of it, $155 million, would relate -- are large individual risk claims.

A - Neil Drabsch {BIO 2093435 <GO>}

And just to put that into context, Richard, at the end of last year we were carrying just over $130 million, rather than our nominated $175 million.

Q - Richard Coles {BIO 16129434 <GO>}

Yes. No. Thanks for that. That's great. Cheers.

Operator

Daniel Toohey, Morgan Stanley.

Q - Daniel Toohey {BIO 16751863 <GO>}

Just a question. On the strengthening of risk margins, what cash rate are you assuming for Australia?

A - Neil Drabsch {BIO 2093435 <GO>}

I don't know, Daniel, to be honest. But the cash rate would be -- is probably roughly round about the same rate we're using at the moment.

So actually, what -- that trigger is driven predominately by our actuaries taking our September actual numbers. And we're forecast that [ph] (inaudible), presuming at this stage that there won't be any material movement in the discount rates and inflation rates.

Q - Daniel Toohey {BIO 16751863 <GO>}

Okay. And the 3.7% yield that you're targeting for FY '12, what is the current run rate on the yield in terms of trying to think through to '13?

A - Neil Drabsch {BIO 2093435 <GO>}

Well there's a couple of ways you have to look at that. So that yield at December 31, 2012. And the 3.7% is based on, obviously, we had a very strong run this year.

But the underlying portfolio, though, is now, on a clean basis, running probably only around about 2%, or even slightly lower. So I've indicated to the market that going into next year around 2.4% net is probably about the best you could do in that portfolio [ph]. And that's probably the safest, I'd say, you should use for your model.

Q - Daniel Toohey {BIO 16751863 <GO>}

Okay. And just on the forecast losses that you're expecting in November and December. So you'll probably get the $357 million, would it be right to be annualizing that? If I annualize that, it would say that the budgeted losses would be somewhere around 13.7% of net earned premium. It would seem pretty conservative.

A - John Neal {BIO 15681439 <GO>}

No. What we tend --

Q - Daniel Toohey {BIO 16751863 <GO>}

How have you gone about determining what the losses are for November and December?

A - John Neal {BIO 15681439 <GO>}

We tend to do -- we tend to weight both to peril and geography in terms of where we expect the allowance to fall. So we're looking geographically at what perils we think can occur and then weighting the allowance to different parts of the year.

So obviously, the most exposed quarter is Q3 with the US hurricane season. So recognizing that the last quarter of the year is exposed to either storms in Australia or Northern Europe, we tend to carry a slightly higher weighting in the last quarter of the year. So that's why the allowances look larger than you would think if you did them on a pro rata basis.

Q - Daniel Toohey {BIO 16751863 <GO>}

Okay. All right. Thanks very much.

Operator

Ryan Fisher, Goldman Sachs.

Q - Ryan Fisher {BIO 3487027 <GO>}

Just something Kieren said earlier just triggered my memory. Neil, or John, with the thoughts for the dividend, the full-year dividend for 2012, should we just straight up think about the payout ratio on revised outcomes? Or is there going to be any endeavor to look through some of the noise?

A - Neil Drabsch {BIO 2093435 <GO>}

Ryan, its a bit hard to call. And I think the best thing for modeling, you should just use your payout ratio, which is the -- what the Board state at the beginning of the year, as a criteria.

Clearly, the Board will have some time to think about this and give better guidance once we've got the results.

Q - Ryan Fisher {BIO 3487027 <GO>}

Okay. Thank you.

Operator

Toby Langley, Nomura.

Q - Toby Langley {BIO 15924432 <GO>}

I've got a question about goodwill. You've got about $2.3 billion sat over the North America business. Has this appraisal of the North American operations caused you to look at that figure again? And does your -- I think John said that there was $180 million of post-tax amortization expected for the full year, does that include any goodwill expected write-down?

A - Neil Drabsch {BIO 2093435 <GO>}

At the half year, we did an extra $50 million for some of our US business, which was the result of the US restructure, which John's referred to in here. And we did at the half year. That was particularly targeted at some of the identifiable component parts.

And I think I actually did a small slide, you'll see at the half-year presentation, there's about $1.4 billion that you should focus on of the total carry of the global goodwill figure. And that $1.4 billion is being amortized over around a seven-year or eight-year period. And so we've escalated that based on some of the restructuring work that we've taken into account.

In that $180 million, we've assumed a slight increase, perhaps, on that $50 million for the full year over and above what I would classify as a normal amortization before tax of around about $170 million a year. For this year, that figure could be somewhere up around $270 million. And that incorporates full allowance for the US restructure.

Q - Toby Langley {BIO 15924432 <GO>}

So its just a one-off acceleration that you're not changing the gray unit of the curve?

A - Neil Drabsch {BIO 2093435 <GO>}

No.

Q - Toby Langley {BIO 15924432 <GO>}

Okay. Thanks.

Operator

Jan van der Schalk, CLSA.

Q - Jan van der Schalk {BIO 4168372 <GO>}

I want to draw out some positives, if I can. And I was really looking at the rate increases, John, that you are talking about and suggesting that might occur after this loss.

Now the context of this question is that I don't think a $20 billion sum insured loss in the US is very large at all when, if you look in RMS, you see the 1-in-100 loss is about $120 billion in Florida and California. So I guess I'd like to know how much do you think rates are going to go up by. And, specifically in case of your portfolio, how much do rates need to go up by for it to produce a consistent insurance margin that you're targeting?

A - John Neal {BIO 15681439 <GO>}

Yes, Jan, if I look at it in reverse order, I think you're right, you can model very substantial losses in the US. And a 1-in-450 year loss is almost $200 billion. So just the sheer scale of sum insureds in the US can drive large losses.

In my estimation. And its a very early call, I think Superstorm Sandy will be probably the third largest storm or US hurricane that the insurance industry has actually seen. So I do think it is a big loss. And I think as it develops it will only get bigger in my opinion. But I'll be judged over the coming months on that comment.

We were forecasting rate increases of 5% to 6% for 2013 prior to Sandy. So we expect those rate increases to go up. It's difficult for me to say at the moment by how much.

Clearly, from our own portfolio, as far as the property business is concerned, those rate increases will need to be comfortably in excess of 10%. But its certainly going to take me a little while to settle down, have a look at the books of business in detail, really get a sense as to how the market's reacting. And ensure that we've got the right level of rate increase.

Just one final point on that is we do run for pricing purposes full absorption cost models. So the cost of reinsurance, the predicted allowances for cat losses. And attritional losses are run through that model so it does force the right price. So we have already begun to re-price some of our business.

Q - Jan van der Schalk {BIO 4168372 <GO>}

And if I may, to follow up, if the market doesn't respond and prices don't go up, are you prepared to let business go? And how much do you think this might hit the top line?

A - John Neal {BIO 15681439 <GO>}

The short answer is, yes. If we can't get the right price for the business, we would let business go. I don't actually see that happening to a significant degree.

So we are talking about modest growth. I think, again, we flagged that recently for 2013. We're still talking about single-digit growth in 2013. So our focus is absolutely on getting the right price for the capacity we put into the marketplace. I do think we'll get good rate increases coming through. But if they're not sufficient, Jan, then we won't write the business.

Q - Jan van der Schalk {BIO 4168372 <GO>}

Thank you.

Operator

Brett Le Mesurier, BBY.

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

A few questions. Firstly, how much premium will not be renewed as a result of that portfolio being put into run-off?

A - John Neal {BIO 15681439 <GO>}

Brett, its -- if you take it through, if you look at what we've done over the last 12 months on the program business, you're talking about approximately $400 million of premium, albeit the business that's been run-off is business that we've cancelled over periods of time.

So some of it was discontinued in and around the time of the acquisition of Praetorian; some of it was cancelled two years ago. And some in the last 12 months. The actual business that we've reviewed and terminated in the last 12 months is approximately $400 million.

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

Okay. And you've run the capital raising, you said that you would get equity credit for it. So being a debt deal, I presume what you're referring to is that the debt will be raised at the holding company level and used to subscribe for equity in the US subsidiary and that's how you'll get the equity credit. Is that the right understanding?

A - Neil Drabsch {BIO 2093435 <GO>}

That's it in practical sense, Brett. At the Group level, of course, its -- we're looking at using a Group model to give an indication of capital credit.

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

Right. And lastly, you mentioned that the coverage of the MCR would be about 1.6 times after this capital raising. Could you tell us what proportion of that 1.6 times would be provided by ordinary equity?

A - Neil Drabsch {BIO 2093435 <GO>}

I think in the presentation I gave at Citi I gave an indication of the Tier 1 level. I think that's probably the best way; you can use that as a model. But that's well up around the 120% level.

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

Okay. Thank you.

Operator

Ladies and gentlemen. I'd like now to hand the call back over to the speakers for closing comments.

A - John Neal {BIO 15681439 <GO>}

Okay. Thank you, everybody, for dialing in today. Once again, can I say how disappointed we are to be passing this news to the market and our shareholders.

We do appreciate that there are a lot of questions. And that not all of those questions will have been asked on this call. We are happy to take any questions that did not get answered or wanted to be asked offline. So we're still happy to take questions.

So again, thank you very much for dialing in.

Operator

Thank you very much. Ladies and gentlemen. That ends our teleconference. Thank you for joining. Please disconnect your lines. And have a great morning or afternoon. Thank you for joining.