QBE Insurance Group Ltd Updates on Portfolio Simplification, 2019 Reinsurance Renewal and Three-Year Operational Efficiency Initiative Call

Company Participants

- Inder Singh, Group CFO
- Patrick C. Regan, Group CEO & Executive Director

Other Participants

- Andrew Buncombe, Insurance and Diversified Financials Analyst
- Ashley Dalziell, Equity Analyst
- Brett Le Mesurier, Senior Analyst of Banking and Insurance
- Daniel P. Toohey, Executive Director
- James Coghill, Executive Director, Deputy Head of Research of Australia & New Zealand and Insurance Analyst
- Matthew Dunger, Research Analyst
- Nigel Pittaway, MD of Insurance and Diversified Financials Equity Research and Lead Insurance Analyst
- Ross Curran, Research Analyst

Presentation

Operator

Thank you for standing by. Welcome to the QBE Insurance Group's 2019 reinsurance renewal and 2019 to 2021 operational efficiency program conference call. (Operator Instructions) I would now like to hand the conference over to Pat Regan, CEO. Please go ahead.

Patrick C. Regan {BIO 15131018 <GO>}

Thank you. Good morning, everybody. And thank you for joining us on the call today. This morning, I'm primarily going to be talking you through both our 2019 reinsurance renewal and our 3-year operational efficiency program. Before I do that, let me give you a very brief update on full year 2018. And really mainly just to say, I'm very comfortable with how the underwriting results is planned out for the year. No change to our previous updates. No change to our guidance. And including on large risk and cat, we still have significant headroom in our aggregates even after U.S. wildfires and everything else. And even on investments, there's obviously been very significant market volatility over the last months. And notwithstanding that, our investment result is held -- holding up well. We now expect a full year net investment return around the midpoint of our 2.25% to a 2.75% target range, including the add-back for discount rate benefit. And probably just as importantly, our projected fixed income running yield for next year is unchanged.

Now if I could turn you on to Slide 3. Let me give you a tiny bit of context on our overall strategic agenda before we get into the reinsurance. A significant opponent of our agenda has been simplifying QBE's portfolio of businesses. We had too much volatility. We've existing portfolios, regions and countries where we lacked scale and/or didn't have a clear and realistic plan to achieve an acceptable rate of return. We've also reduced our cat exposures quite significantly. In that vein, I'm pleased to announce today we've entered into a sale agreement with respect to our insurance operations in Puerto Rico, Indonesia and the Philippines with these sales expected to complete early next year. Together, these represent around $100 million of gross written premium. And achieving profitability in each of these business has proved challenging for us. And both Puerto Rico and the Philippines carry significant cat exposure.

Following these sales, QBE's portfolio rationalization is now complete. Completing the simplification of our portfolio has been a critical step towards improving the quality and consistency of our underwriting profits. And I'm delighted with what we've been able to achieve in the 12 months. With our disposal program now complete, momentum around premium rate increases, the underwriting performance improvement, the 2019 reinsurance program in place and our new efficiency program underway, I think we have all the ingredients in place to drive further performance improvement and the path to a sustainable double-digit ROE.

If I can ask you to turn forward to Slide five then on a summary of the reinsurance program. That's what we said to you before, the group's large risk and cat aggregate treaty, it is what we call the GLRC, has served us well over the last four years. During the softening premium rate cycle and at the time where QBE was experiencing some significant claims volatility, the aggregate treaty has helped stabilize performance.

For a variety of reasons, however, the GLRC is no longer the right structure for QBE. This year, we've rolled our cell view process globally as we've initiated our group-wide Brilliant Basics programs, both with the aim of improving the quality and consistency of our underwriting results. Our efficient ratio is improving meaningfully and our large individual risk claim frequency is reducing. At the same time, we've been more forensic and disciplined around our approach to cat exposure, only accepting cat risk where we're paid an appropriate risk premium. Asset sales have also contributed to reduced exposure, including Latin America, which had earthquake, flood and mudslide exposure; North American personal lines, hail and tornado; Puerto Rico, wind and flood; and the Philippines, wind. We've also significantly reduced line sizes in nonpeak cat exposed locations, such as PG. With the group's underwriting portfolio and consistency of performance improving, a more conventional out-of-the-money reinsurance structure is more appropriate. As the cost of large individual risk and cat claims reduce, we believe this structure offers shareholders greater returns over the medium term.

We invested -- reinvested most of the reinsurance cost savings from the GLRC into significantly greater cat protection and lower large individual risk retention, which in summary, the peak perils, that's North America and Australia, New Zealand, our cat retention falls from $600 million to $400 million. The nonpeak perils, that's primary therefore, outside of North America and Australia, cat retention will fall even more significantly from $600 million to only $100 million. Then allowing for Equator Re's 50% quota share now, the group's net retentions are in fact much lower as I will demonstrate in a moment.

We'll also increase the cat limit we purchase up to $2.9 billion from $1.8 billion currently and will also buy cat aggregate reinsurance treaty to protect us against frequency of medium-sized cat claims. And we will also reduce exposure to single individual risk claims from $100 million to $50 million.

If you turn then on to Slide 6, I've got a little bit more detail there on the cat program. And again, a few pages -- features are now -- some of which I mentioned before, peak retention falling from $600 million to $400 million as you can see on the left-hand side of the slide there and even greater reduction for nonpeak. And whilst that nonpeak primarily relates to events outside of North America and Australia, New Zealand, it also -- it does include -- nonpeak definition includes hail and bushfires in Australia and North America. The increase in the limit as we show there from $1.8 billion to $2.9 billion that we've bought. And the cat aggregate treaty, which protects against the aggregate cost of cat events greater than $10 million with the retention of just over $500 million.

I thought it is interesting on Slide seven to show some quantification of what both the combination of the portfolio simplification agenda coupled with the new reinsurance programs has. And I think the impact, as you can see, is really quite significant there. A 1 in 20 and 1 in 200 probable maximum loss or PML, for example, for Australia's cyclone falls about -- by about 20% and 35%, respectively. For Australia, New Zealand, quake falls 1 in 20 by 20%, 1 in 50 (sic) (1 in 200) as you can see there, by 50%. Similarly, for North American quake by 10% and 25%, respectively. And North American windstorm, 20% and 25%, respectively.

Slide eight then just shows you the risk program with half the per risk retention from $100 million to $50 million and that further reduces to $25 million after 350 million claims in a single year. And at the same time, we've increased the limit purchased to $250 million from $200 million previously.

If you turn on to Slide 9, we're trying to show you here some examples of how the Equator Re 50% quota share works in practice. I'm really pleased to say, our reinsurers have backed us by increasing that quota share in Equator up to 50% for 2019. Obviously, our divisional retentions for cats and large risks are significantly lower than our group retentions with the residual being retained at Equator Re. As a result, the 50% quota share significantly reduces our large risk and cat volatility. And I've shown some simple examples I hope here of how this works in practice. So first for a large risk claim, for example, in the scenario we have here of a $75 million North American factory fire, which hopefully would be pretty unusual in itself, the net cost to QBE would only be $30 million with only $10 million of that retained by North America.

Similarly, by way of example, the $2 billion Queensland cyclone would only result in a net cost to QBE of around $240 million, $237.5 million exactly in my example there. A $1 billion hail claim in Sydney would result in a net cost to the group of around $90 million. I hope you'll agree that's all a fairly significant positive impact to the program.

Then finally beyond reinsurance if you turn to Page 10, I'll give you some summaries of the overall implications there. But firstly, I should say that QBE was the first 2019 global program to the market this year. And we're pleased with the -- to have completed the placement at, I think, attractive pricing terms and probably almost certainly better than the people who are coming to the market now. The capital credit for the 2019 structure is stronger than the 2018 credit with an incremental capital benefit of around $200 million for S&P. And around $100 million for APRA PCA benefit due to a lower ICRC capital charge.

From a P&L perspective, the 2019 program will cost around $125 million less than the expiring program. However, as I've mentioned before, since the new program does not provide the same recovery certainties at GLRC, in 2019, we're going to budget for an increase in our net allowance for large risk and cat claims to increase to $1.4 billion from $1.2 billion for 2018. That, therefore, gives you a net of those reinsurance cost savings. We can budget for a net P&L headwind of around $50 million to $100 million in 2019. Notwithstanding that P&L headwind, we remain confident of achieving improved operating ratio in 2019 opposed to 2018, reflecting the rank increases we're achieving, the ongoing improvement in the group's attritional claims ratio and our recently started expense work.

And we do believe our budgeted allowance for large risk and cat claims will fall over time on the back of all the cell review work and the Brilliant Basics program improving our risk selection. It's also worth noting that the reinsurance structure is likely to deliver a better P&L outcome in both very extreme cat years and very benign cat years.

Let's just move us forward on to our expense program on Slide 12. Let me start with the headlines. We're targeting over $200 million of gross cost savings earned by 2021, at least $130 million of net cost savings fully earned by 2021 from a current cost base of around $1.8 billion and an expense ratio of 14% by 2021, which compares, if you go back to 2016, to 17% and 2017 of 15.7%. This allows inflation, modest underlying business growth and facilitates further investment in things like Brilliant Basics, digital capabilities and technology.

When to implement most of expense savings in 2019 and 2020 and the earning of the $130 million of next cost savings is expected to accrue fairly evenly across the 3-year period. To achieve efficiency savings, we expect to incur around $95 million of one-off restructuring charges that will be reported below the line, therefore, not impacting the combined operating ratio.

Again, as shown on Slide 12, the restructuring cost will be incurred across 2019 and 2020, albeit more heavily weighted into 2019. Give you a little bit more on those. So on Slide 13, it's previously known to you, we've now completed our portfolio simplification and that gives us a solid platform to build upon. Some of the disposals either directly or indirectly facilitated a more efficient QBE. For example, Latin America, which had an expense ratio of around 23% or North American personal lines, which had significant systems on operational complexity. Of course, simply operating in 9 less countries will also make a massive difference for operational complexity. This has already allowed us to significantly simplify our regional footprint. We will retain a more focused operation in Asia, while removing layers of administration cost that were in place for the emerging markets region. And supporting only 3 divisions going forward will allow us to have a leaner, a more activist model for our group head office. Within the divisions, we'll make operations more effective and streamlined, consolidate technology tools, reduce our IT run costs and reengineer and automate processes.

We're investing in a number of small-scale digital technology initiatives. None of these digital and technology initiatives are individually material. But collectively, those are for our Brilliant Basics agenda, a better underwriting of pricing as well as better outcomes for our customers and our brokers. It also allows us to retire numerous legacy applications, thereby reducing our IT run costs.

Our operating efficiency road map doesn't include any silver bullets but is rather based on the many small discrete efficiency enhancing projects. If you turn on to Slide 14 then, just give you a bit more detail on how we expect to achieve the $200 million-plus of gross savings. We have a clear set of initiatives to achieve the outcomes. And most importantly, to ensure our people engaged, accountable and will be measured on their performance. These savings are fully built into our 3-year plans.

I think it's helpful that the program work is represented by a large number of small efficiency initiatives spanning all of our operations and all of our divisions and under the 5 major categories. Firstly, North America. Efficiencies in North America are expected to contribute roughly 1/3 of the overall gross savings. Our North American business was built by numerous bolt-on acquisitions that made it difficult to leverage scale or greater synergies. Significant work has been undertaken over the last few years to arrive at a more sustainable and integrated core business, including the sale of Mortgage & Lender Services, exiting around 100 programs, outsourcing micro SME business. And more recently, the sale of the personal lines business.

And the last point here is important with the sale of one of the personal lines business over the next 12 months, we're able to significantly reduce cost that's previously supported this highly complex business. That in conjunction with the migration for our commercial P&C business on to a single underwriting platform will enable us to decommission a significant number of legacy policy and claims admin platforms, rationalizing from multiple platforms currently. This rationalization also enables a more seamless workflow and how we price and select risk as opposed to what can be quite manualer processes -- the manual processes to that. And this also significantly improves our Brilliant Basics capability and outcomes for customers and brokers.

Second, as I mentioned, a simplified operating model with fewer regions, less countries and smaller regional group head offices. We now have 9 less countries and just 3 regions. As we announced in October, aligning the remaining Asian operations, Hong Kong, Singapore, Malaysia and Vietnam, to our newly named international division and Pacific Islands' operations to Australia Pacific helps to remove the regional layer of administration with minimum customer disruption. At the same time, we align strong capability of our European underwriting function with the business we write in Asia. We're also sharing some of our corporate functions between group head office in Australia be it better leverage and scale, one example of that is our communications and marketing teams.

And in Australia itself, we've also recently announced a move to an updated and more streamlined operating structure that better aligns to how we do business. And at the same time, delivers a net reduction in headcount. On process excellence, look, while we successfully created a large service center in the Philippines and that clearly gave us some significant rate efficiencies, we now need to turn our attention more to process quality and process engineering and automation, where we believe there's significant opportunity. We'll look first at our focus on our operations and functions in Australia. But the opportunity exists across the entire group. And what we'll do is, we'll target a series of small projects that reengineer processes end-to-end. One example of that -- just one example. But one example is used of hyper science technology, which is one of our insurtech investments, where we're looking to automate the processing and posting of medical certificates for our Australian CTP business. In other parts of the group, we're building robots to automate payments. For example, in Europe, where we're automating simple payment for windscreen repairs and higher payments to save processing effort and improved aged debt turnaround times.

Or in North America, where we're implementing a virtual claims adjusting model to reduce the cost to fast track property inspections of between 30% and 50%. Fourthly then, we have technology. Our technology costs represent nearly $400 million per annum or around 20%-or-so of our total cost base, just under. We need to reduce this cost, while at the same time, make investments to use best available technology in the future. And in this regard, we'll focus on delivering a current clean modern estate. This means, simplifying our technology estate, while building capability that enhances our customer experience. The most obvious example of this is the one I talked before, where we're rationalizing the number of systems we use in North America and consolidating on to our existing Majesco platform. And also with technically a digitally enabled and data-rich environment, which includes an infrastructure enabling a better connection with our customers and our operating platforms as well as the focused data strategy.

Rather than building all that functionality to our core systems, we're focused on a more modular architecture by the use of APIs that will allow us to innovate faster and at a lower cost. We'll also automate processes, improving the structural processing in place for our Europe and Asia, for our low complexity, higher volume business. And in places like Europe and Australia, we're looking to digitize some of our customer broker tools to allow for more easy access and exchange of information.

Last bucket is more tactical savings. We still think there's some low-hanging fruit here. To give you a couple of examples, QBE has been a pretty politic user of consultants over a number of years. Having built up more internal capability, we're now significantly reducing our use of consultants. In fact, any form of material consulting charge requires my prior approval going forward.

We're also -- second example, we're also continuing to drop down travel costs both through tighter procurement. But also better use of video technology -- videoconferencing technology to replace travel. To give you an example, half of my global executive team meetings are now entirely held by PC. To give you a sense of that, our 2018 travel and entertainment cost across the group is around $50 million. We're also consolidating our real estate footprint. You'll have seen recently maybe, we've consolidated our Parramatta sites into a single QBE site. We'll also look to consolidate our group head office and the Australian business into a single site hopefully in 2020.

So in conclusion, I'm really pleased with the progress we've made in 2018. This group has completed a disposal program, I'm very pleased with the successful placement of our 2019 reinsurance program. And together with today's expense announcement, represent important building blocks for the next stage of our performance improvement.

Thank you. And with that, we're happy to take questions.

Questions And Answers

Operator

(Operator Instructions) Your first question comes from James Coghill from UBS Investment Bank.

Q - James Coghill {BIO 14006200 <GO>}

I have just a few quick ones from me. So the first one relates to that combined ratio and the comment that you made for financial '19. It's quite pointed. But I presume what you mean by that is that your guidance range will actually improve in '19 relative to '18. Could you just clarify that? Because we obviously don't know the number in '18 to evaluate that yet.

A - Patrick C. Regan {BIO 15131018 <GO>}

Yes. That would be a fair characterization, James.

Q - James Coghill {BIO 14006200 <GO>}

And on the below-the-line costs that you've flagged, $95 million. So just going back to 2016, you were CFO. And those expenses were absorbed through the underwriting lines. So I'm just wondering why the change now, perhaps Inder is a more persuasive CFO than you were back then.

A - Patrick C. Regan {BIO 15131018 <GO>}

Look, we're with -- as I've announced, we've put in place a series of things to try and improve the company. I don't need to go through them all now. We think an important component of that is a pretty comprehensive expense improvement program. There's elements of that, that will require some onetime investments and that's what's the $95 million is for.

Q - James Coghill {BIO 14006200 <GO>}

I guess, for future programs, that will be the accounting treatment that you adopt?

A - Patrick C. Regan {BIO 15131018 <GO>}

No. Look, it's disclosed and treated in that way, James, because it's meant to be onetime. It's not meant to be a recurring.

Q - James Coghill {BIO 14006200 <GO>}

Okay. Then just a question on the new sales allowance, the $1.4 billion. So as we understood at the old -- under the old program, in a normal year, you would probably hit the aggregate by $200 million to $300 million. And so I'm just struggling to understand why the new allowance is at $1.4 billion and that's increased by $200 million, if you just take into account how much your cat retentions and your large risk retentions have actually reduced. And it just doesn't -- it doesn't seem to stack up and I would have thought that, that number would have been lower just given how all those individual items have improved?

A - Patrick C. Regan {BIO 15131018 <GO>}

Obviously, how much we're into the aggregates could vary year-on-year. And obviously, in 2017, we were through the top of the aggregates. What we try to do is, is put together a sensible budget. It's a budgeted number, probably the first thing I'd say, it's a budgeted number for 2019. James, we -- as I mentioned, we believe all the work we're doing on cat and large risk frequency will bring down that budgeted allowance over time. But as we move into -- it's our first year after the GLRC, where we got much greater frequency of allowance as we're moving into 2019. So we're putting together what we hope is a sensible budget for 2019. I think for a little bit of time we expect a small P&L headwind and that's essentially what we've got.

Operator

Your next question comes from Nigel Pittaway from Citigroup.

Q - Nigel Pittaway {BIO 3406058 <GO>}

Just -- first of all, just a question on the opponent comment you made on the investment return. Obviously, that guidance has come down a bit from a month ago, when I think you were at the sort of high end of the range, including the discount rate adjustment at the midpoint. Presuming that's a combination of equities and overseas spreads, that's cool with that. So first of all, is that correct? And secondly, do you have any protection against any further moves as we go through to the end of the year?

A - Patrick C. Regan {BIO 15131018 <GO>}

Inder, do you want to pick that one up for me?

A - Inder Singh {BIO 20594382 <GO>}

Sure. Nigel. So I mean, mostly in terms of volatility what we're seeing is the equities markets come off a little bit, what we're seeing also is the credit spreads widening a bit. And we're also seeing U.S. yields, in particular, come down a little bit from the levels we saw a matter of weeks back. So I mean, our guidance really is consistent with all the different moves we've -- we're seeing and we haven't got any specific protection in place. We're pretty comfortable that we'll be within the range that Pat referred to earlier.

A - Patrick C. Regan {BIO 15131018 <GO>}

Yes. Look, it's a tiny bit off from where we were a month ago. But obviously, the markets have been very significantly moving in that period of time. We remain pretty conservatively positioned, Nigel.

Q - Nigel Pittaway {BIO 3406058 <GO>}

Yes. Okay. Fair enough. Moving on then. Just coming back to, obviously, the increase in the large loss allowance. Presumably within that, the cat allowance component has gone down and the risk component allowance has gone up. Would that be a fair assumption?

A - Patrick C. Regan {BIO 15131018 <GO>}

Yes, reasonably so. The cat allowance will be a little less than half of the total allowance.

Q - Nigel Pittaway {BIO 3406058 <GO>}

Okay. And so clearly, what's happened here is our -- the real exposure to risk losses has gone up quite considerably. And obviously, sort of globally, the frequency of risk losses has actually been going up. So can you make some comments on that? Has your experience dithered from that global experience? And how has your experience on those sort of risk losses has been tracking of late?

A - Patrick C. Regan {BIO 15131018 <GO>}

Gosh, there's a lot of questions in there. The -- I mean, different classes. So I'm talking globally for the insurance industry, not QBE firstly. Certainly, different classes have seen increased loss trends, whether that be things like commercial motor, whether that be things like financial lines. Obviously, as I mentioned in my previous answer to James, what we're trying to do is we come off kind of having a certainty of the GLRC. We're trying to budget for a sensible structure where you have less certainty around recovery. So we're trying to set a budget for risk losses and cat losses that does that. We're seeing improving trends on our large loss risk frequency. So -- as well as the cat exposures I saw -- as showed, reducing. We are seeing improving trends reasonably broadly across the group and reasonably broadly across the different types of lines of business. So -- and hence my comment that we expect with the work that we're doing, a continuation of those improving trends and therefore, hopefully, we can reduce our budgeted allowances in -- as we go forward.

Q - Nigel Pittaway {BIO 3406058 <GO>}

Okay. I mean, I think it effected. Obviously, risk retention has gone up a lot. So obviously, it's an important facet. But yes. Then just finally, I mean, sorry if you mentioned this before.

But with those restructuring expenses going below the line, will they be looked through in terms of the payout ratio?

A - Patrick C. Regan {BIO 15131018 <GO>}

Look, that's -- well, that's a matter for the board as we get into in 2019. I think, look, what I would say is, we -- as I mentioned in the script, we do expect profitability to go up -- underwriting profitability to go up. And obviously, from a capital perspective, we've got a little bit of an enhancement from the new structure as well.

Q - Nigel Pittaway {BIO 3406058 <GO>}

Okay. So there's no decision yet on whether the $65 million will be preop?

A - Patrick C. Regan {BIO 15131018 <GO>}

No formal decision from the board yet. No.

Operator

Your next question comes from Matthew Dunger from Bank of America.

Q - Matthew Dunger {BIO 20863237 <GO>}

Can I ask how much of the cost savings are coming from exiting Indonesia and the Philippines in terms of stranded costs that will be left with the business once you sell those businesses?

A - Patrick C. Regan {BIO 15131018 <GO>}

The smallest amount possible, almost 0, Matthew.

Q - Matthew Dunger {BIO 20863237 <GO>}

Okay. Okay. And are the cost savings largely headcount driven? And are you able to give us a sense of the mix between the cost of what's underwriting versus support function related as well?

A - Patrick C. Regan {BIO 15131018 <GO>}

Look, we've given you directionally a sense of that in the pie charts. So we've put a couple in. So we showed a pie chart of our current cost profile by division and then by types of costs underwriting distribution technology, et cetera. As I said, it's certainly not all headcount related we think, whether it be cost of travel, the cost of IT, cost of consultants, cost of real estate, there's a lot of nonpeople-related costs that we're going after. Then if you look on Page 14, we've given a sense of -- for the type of costs, if you like?

Q - Matthew Dunger {BIO 20863237 <GO>}

Okay. Great. And just lastly, to what extent were the reinsurance efficiencies and cost initiatives factored in when you set your $1 billion buyback target?

A - Patrick C. Regan {BIO 15131018 <GO>}

Well not explicit. I mean, that was -- gosh, that was what, two years or a little bit more ago. So it wouldn't have been factored in at that point in time, Matthew.

Operator

Your next question comes from Andrew Buncombe from Macquarie Group.

Q - Andrew Buncombe {BIO 19921333 <GO>}

Guys, 3 questions on the reinsurance program, if I can, please. Just firstly, just interested to know the structure of the deductible on the new aggregate coverage. Is that on a franchise basis again?

A - Patrick C. Regan {BIO 15131018 <GO>}

Inder, do you want to pick that one up from me?

A - Inder Singh {BIO 20594382 <GO>}

No. It's not. It sits on a parallel grounds basis.

Q - Andrew Buncombe {BIO 19921333 <GO>}

Okay, cool. Then the second question, just interested in what sort of LMI cover you have for 2019 vintages?

A - Patrick C. Regan {BIO 15131018 <GO>}

Yes. Look, interesting question, Andrew. We -- nothing we've specifically purchased part of this renewal. We probably will look at a couple of options. I'm assessable, I should say, with -- I'd repeat the comments I previously made. I don't know, there's a little quick update on this at the UBS Conference. We're writing half the new business than we were, the proportion of interest-only significantly down, the proportion of investor is significantly down. The proportion of greater than 90% LVRs is very significantly down. So we're feeling comfortable about the business. We're writing to a lot smaller. We may look at things like acquire the share on the new business in 2019. So that's the only thing that I think we'd look at.

Q - Andrew Buncombe {BIO 19921333 <GO>}

Okay. Great. Then the last one from me. Just interested what the reinsurance cover looks like in '19 for the U.S. crop portfolio?

A - Patrick C. Regan {BIO 15131018 <GO>}

So basically, the same as it's looked for the last few years. You'll remember the biggest participant is obviously U.S. federal government. And they basically take the lion's share with good years. So once you get a combined ratio kind of in the 80s or better and then they obviously take a similarly at the back end. So very much as before.

Operator

Your next question comes from Ross Curran from Deutsche Bank.

Q - Ross Curran {BIO 17605313 <GO>}

Just a quick question on your comments around very modest and selective premium growth over the next three years. Can you just reconcile that comment with the rate increases that you're seeing in the Third Quarter? Why are you being cautious on the outlook for premium growth over the next three years?

A - Patrick C. Regan {BIO 15131018 <GO>}

That's a good question, I think you're asking where I'm. I've been doing cell reviews in Europe. So it's actually 10:00 at night where I am, Ross. But thank you for asking. Look, as you've -- and good question. We've budgeted prudently. That's the -- we are -- as we updated at the UBS Conference, we're seeing about 5% rate increases across the group year-to-date. Nothing different to that to signal today. Look, I'd be kind of modestly optimistic, probably a little more than modestly optimistic, we will carry some of that positive momentum into 2019's. But look, you wouldn't thank me for budgeting for big premium or top line increases over the next few years to get to an expense ratio. So we've deliberately been pretty prudent.

Q - Ross Curran {BIO 17605313 <GO>}

Can I ask maybe more specifically around your Lloyd's business and how you're going with your expectations for premium over the next year given the Lloyd's Decile 10 program?

A - Patrick C. Regan {BIO 15131018 <GO>}

Yes. Look, I mean, it's all helpful. I mean, at one level, our business wasn't very impacted by that business planning process. Sort of as you'd imagine, Ross, the -- that we do a very similar kind of process in all of our cell reviews in Brilliant Basics. So it didn't put a lot more process into our business planning but is into other companies. So that is applying more market discipline and that's -- look, I'd say, it feels like it's helping market pricing, look, it'd be more competent saying that as we get into '19. But it looks directionally helpful.

Operator

Your next question comes from Daniel Toohey from Morgan Stanley.

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

Yes, just a couple of questions on the expenses and then maybe be one on reinsurance. Just quickly on expenses, you talk around the admin line currently being around about $1.8

billion, you'll save $130 million. So ignoring the commentary on sort of top line and how that rolls through to the actual ratio, should we be thinking about FY '21 being about $1.67 billion. So you're essentially absorbing inflation over and above that as well?

A - Patrick C. Regan {BIO 15131018 <GO>}

Correct. Yes. That's fair, Dan.

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

Okay. Just on that ...

A - Patrick C. Regan {BIO 15131018 <GO>}

It'll be a net reduction to all absorbed inflation in the ...

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

Yes, yes. Okay. So we'll just put $1.6 billion, well, Ideally, I would say $1.67 billion in FY '21. Okay. That's clear. The U.S. personal line sales is -- and I guess, the way I understood that was sort of a trigger or I guess a driver that would deliver a lot of the restructuring out of the U.S. in the savings reduction. So is delivering those North American targets contingent on the U.S. personal line sale? And maybe secondly, if you can just give us an update on how that is progressing?

A - Patrick C. Regan {BIO 15131018 <GO>}

Yes. Look, we're done. So we're done on all of the sales now, Dan. So we have -- the second piece of that we completed what a month ago, Inder?

A - Inder Singh {BIO 20594382 <GO>}

Yes.

A - Patrick C. Regan {BIO 15131018 <GO>}

So -- and it does, as you're quite right to remember, it's a big facilitator with super operationally complexity with personal lines, used a number of old legacy platforms, both underwriting and claims. And with that going, that will over the next number of months allow us -- really that we've got all of the specialty business on a modern system called Majesco and we need for the core commercial P&C business on to Majesco as well and then that enormously simplifies the technology stack and processes that go with this. So yes -- so those sales are done and that facilitates the process.

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

Right. Okay. Well that's good. And just, I guess -- just probably coming back to James' question on the cat budget being up, your net retention on events is sort of down, you increased it. And the overall cat tower has gone up, you're derisking and portfolio sales should improve some of the cat experience. Your PML has come down as well. So -- and then you've got the benefits coming through on the capital and the upfront S&P rating. So is there any conservatism or anything in that budget sitting? I guess just trying to get a feel for the driver of the increase of our expectation there. And notwithstanding, the cost of the program has also come down by $125 million.

A - Patrick C. Regan {BIO 15131018 <GO>}

Yes. But we've tickled for a while that we expect a slight P&L headwind as we come off the GLRC and onto the new structure. And what we're doing today is giving a little bit more kind of specific quantification of that, nothing kind of different. I think it is very much as we said before, the GLRC gave absolute kind of certainty of what that large risk in cat is. By the nature of the new structure, which I'm really pleased with, you have slightly more uncertainty of how -- about the shape of cat and risk. And therefore, a little bit more uncertainty on your recoveries and your net costs. So we've put together a budget we think that reflects that. It gives us a slight P&L headwind, which we're confident will offset with other underlying improvements. Not really anything more than that, Dan.

Operator

Your next question comes from Brett Le Mesurier from Shaw and Partners.

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

Pat, you mentioned that the 2019 structure was fully placed for two years. So 50% of that. So 50% is not placed for two years. And you also referred to the fact that you avoided the pricing uptick for the 50% that was placed for two years. So what is the extent of that uptick that's going to affect the 50% if it's not placed for two years?

A - Patrick C. Regan {BIO 15131018 <GO>}

Well Brett, it would be interesting to see how the market plays out on it. So I think we feel good that we were into the market early. So that was a bit of good judgment and obviously, a bit of luck as you do these things, they go both ways. And I think, look, we're glad that we put 50% of it on a 2-year renewal as opposed for a 1-year renewal. I don't know -- well, we don't think we'll see big price increases. But we might see small single-digit price increases in the market. We'll see -- we'll know better over the next couple of months, I think.

Operator

Your next question comes from Ashley Dalziell from Goldman Sachs.

Q - Ashley Dalziell {BIO 20853789 <GO>}

I just wanted to come back to the comment around the top line outlook, the modest and selective premium growth. Are you talking there on a -- on an underlying basis? I suppose, i.e., ex a headwind from North America personal lines, these are the parts of Asia that you've mentioned this morning. Or is it inclusive of those business disposals?

A - Inder Singh {BIO 20594382 <GO>}

Yes. Ashley, it's Inder here. Yes. So effectively on an underlying basis, as we look over the three years, just to give you some reference point for the expense ratio.

Q - Ashley Dalziell {BIO 20853789 <GO>}

Okay. All right.

A - Patrick C. Regan {BIO 15131018 <GO>}

As I said the -- this isn't the kind of the back doorway of me reintroducing top line guidance. For the same reason, I didn't do it before. It's just prudently budgeted for the expense ratio in 2021. We didn't want to rely on that heroic top line assumption?

Operator

There are no further questions at this time. I will now hand back to Pat for closing remarks.

A - Patrick C. Regan {BIO 15131018 <GO>}

Cool. Thank you. Well look, I really appreciate everybody coming on the call. Look, I think we're -- as I said before, I think we're pleased with how 2018 is playing out. I think we're pleased with the 2019 placement and congrats to my team here on getting that program away. I think that gives us a good start into 2019. And we think we can deliver some further performance improvement into 2019. And we look forward to seeing you all to deliver the full year results in February. Speak to you'll soon.