Q2 2014 Earnings Call

Company Participants

- John D. Neal
- Patrick Charles Regan

Other Participants

- Brett Le Mesurier
- Daniel P. Toohey
- James Coghill
- Jan van der Schalk
- Kieren Chidgey
- Nigel Pittaway
- Siddharth Parameswaran

MANAGEMENT DISCUSSION SECTION

John D. Neal {BIO 20988613 <GO>}

It's always a queue, isn't it, when the music is turned off. Welcome everybody to QBE's Half Year Results Announcement this morning. I'm joined today by Pat Regan, our Group CFO. And between the two of us, we'll take you through a brief presentation and then quickly hand over to questions and answers.

So, over the past two years, our focus has been on three things critically, one, stabilizing earnings predictability. Second is transforming QBE for the medium term. And the third is assembling quality leadership teams both at our head office here in Sydney and around the world.

What I'd like to do is just take a couple of minutes to measure the progress that we've made against these objectives. First and foremost, we are and must remain an underwriting business. And I think you'll see that in the results today in the improvement in our attritional claims ratio, which for third consecutive half year has shown signs of improvement. And equally, we've not hesitated to sacrifice top line to ensure that performance can be achieved.

And when you get the chance to go through our divisional results, you'll see strong performances coming in from Australia and New Zealand with a combined operating ratio of 86.9%; Equator Re, our captive reinsurer, with a combined ratio of 89.9%; Asia Pacific that continues to grow at a compound annual growth rate in excess of 20% is still hitting bottom-line expectations with a combined operating ratio of 91.7%; and our European business, perhaps, in the most challenging market conditions still producing a very solid combined operating ratio of 95.6%.

We're also pleased to report that our North American business has returned to profitability. This is pre and the quota share reinsurance arrangements it has with the internal captive and as we fore shared it on the July 29, we're extremely disappointed with the action that we needed to take in Latin America, but we're decisive in the money that we put aside for prior accident year claims development.

Second point here is that it's a simple reality that every modern insurer can demonstrate an ability to control or reduce cost, while improving the service standards that we provide to both our customers and the brokers with whom we deal with. And we're certainly no exception in that respect.

Our Group Shared Service Center is now established in two locations in the Philippines, Manila and Cebu and that's created significant flexibility in our operational capability. And we're absolutely on track to meet the cost reduction measures that we put in place, which is a $250 million saving on the expense line and $90 million of procurement costs, most of which are claims-related costs.

You'll see in a moment our expense ratio is slightly up and that's obviously impacted in ratio terms by the reduction in net earned premium and we can confirm that our reinsurance program, again, numbers you'll see in a moment, is set to deliver a $200 million saving this year on a risk-adjusted basis.

From a capital perspective, our debt-to-equity ratio has improved through the half year and our PCA multiple is broadly unchanged. Obviously, today we announced a range of measures that will position our capital metrics very strongly, both with regulators and rating agencies around the world, as well as enhanced flexibility, the increased capital will give us to leverage better value in the yield on the investment side of the equation, more of that in a moment.

Our diversity by product and geography holds us in very good stead to deliver organic growth where we think market conditions permit, of which the best example for us currently is in Asia. And equally we are not being hesitant in ensuring that we maximize the value of the relationship with our global trading partners with whom we connect across each of our divisions in developing our bancassurance franchise here in Australia, in Asia and in the U.S. and thinking more intelligently about the way in which we can serve our multinational clients.

We've been very pleased in the past two years to have attracted top quality talent both in our divisions and also most recently in our head office with the appointment of Pat Regan as Group CFO, Jason Brown as our Group CRO, Peter Horton as General Counsel and Mike Emmett as our Group Executive In-Charge of Operations.

So, looking at our financial results for the half year, the results are very much in line with what we explained to the market on the July 29. You will note that gross written premium is down 10% and net earned premium slightly less by 5%.

The majority of the change in income is as a result of our own actions as we've looked not only over these six months, but over the past 12 months to remediate and improve the underlying performance of our business, and also partially due to further contraction in the income derived from the U.S. lender-placed insurer.

You will note that the net earned premium reduction is less and that's a reflection of reduced reinsurance costs that I referred to on the previous slide, where our reinsurance expense ratio is now actually fallen beneath 12% and sits at 11.9%.

So our combined operating ratio for the half is 96.5% with an insurance profit margin of 7.6%, net profit after tax of $392 million. And we are declaring a dividend today of A$0.15, which fully franked. Our dividend policy is unchanged with an intention to payout 50% of cash profit, weighted 40%-60% interim to final and hence the dividend of A$0.15. We are also saying today as part of the capital plans we are announcing that there will be now discount for dividend reinvestment.

So just looking at some of the highlights for the underwriting performance, you will see that premium rate increases are around 1% overall, slightly down on where we expected them to be at this point in the year and really reflecting some tightening in market conditions globally. I think conditions in Europe are certainly challenging, particularly on some lines of business, reinsurance in international markets and I think you saw some increased competition come through in the July renewals here in Australia.

On our underlying insurance business, Pat Regan will deal with the attritional loss ratio on a slide that he will show you, and show you the level of improvement there, but we are very pleased to see that continue to tick down, which to us is the clearest indicator of the performance results that we put in place across all of our businesses.

Large risk and catastrophe claims at 9.9% were slightly up on the half year allowances, but again, as you will see in a moment, our allowances for the full year, or more importantly for the second half, are still intact. And our acquisition costs are always higher in the first half of the year, not least because of the weight of crop premium that comes in, in the second half and also impacted by the reduced net earned premium.

So the insurance profit margin was 7.6%, very much helped by an above planned investment margin contribution of 4.1% at the half year and we will look in detail in a moment at the adjusted insurance margin of 10%.

Capital position was ticking up nicely, net tangible assets up 14%, debt to equity down for 44.1% to 38%, but clearly the activity around those metrics will be substantially accelerated by the announcements that we've made today and there is the dividend fully recorded at A$0.15, which is a cash payout on the half year of roughly 42%.

So just looking at our insurance profit margin analysis, the way I prefer to look at this in many respects is to look at the reported margin and the prior year development. We're not expecting further adverse development in our reserves. We were extremely frustrated and disappointed by the action we took in Latin America but, frankly, were decisive in what we did. So the reality is the aggregate of these two items probably give the strongest indication in the half year of what you should expect on the insurance margin.

The reality is there are a myriad of items that we could put into a slide such as this to adjust changes to achieve an adjusted margin, and we picked out the ones that I think are most pertinent, particularly from the analysts' perspective. So the ones I would call out are item three on here being risk-free rates. So the adverse discount rate impact through the half year was $118 million. That was a positive impact 12 months ago of $177 million.

I previously referred to item four, which are large risk and catastrophe claims. For us, we're not troubled by the cost of those claims through the half year. The allowances that we've set aside we still consider to be appropriate and adequate for the full year, but clearly slightly above the seasonal allowance of 8.5%. And then the final item being the investment contribution, which is 1.1%, ahead of plan.

So just looking at the capital plan that we've announced today, it's a four-point plan that's designed to significantly and comprehensively improve our key capital metrics. So the first item to talk about here is asset sales, and you'll see the reference to a partial sale of two of our Australian agencies and the sale of a number, in fact, a majority of our North American agencies.

Our agency businesses are highly valued. But in reality, from QBE's perspective, we value the underwriting that comes with these agency businesses in that no regulator or rating agency will give us any capital recognition for ownership of the agencies. So whilst we're interesting in divesting the agencies, we will retain control of the underwriting and that's 100% of the underwriting in long-term deals.

We'll also complete the sale of our Central and Eastern European business through the second half of this year and we've made the decision to retain our middle market business in North America.

I've heard one or two people suggest that that might be through lack of interest. I can assure you complete the reverse its true, we were overwhelmed by the interest in that business frankly and the parties that were interested in making an acquisition of it.

What we've seen through the half year is the performance stabilize, client retention rates are now back to the levels that we were targeting and the claims ratio is doing exactly what we needed to do.

So we have three key areas to address on that business. One is to further enhance the relationship we have with our distribution partners. The second is to smarten up the technology that we use for point-of-sale underwriting and sales of product and the third is to take more cost out of that business, but as such we value it and consider it a key component of our North American plans going forwards.

So the second component of the capital plan that we announced today was the targeted partial IPO of a minority stake in QBE, LMI, Australia, and then there is mortgage insurer business which is slated for 2015.

Again, I don't know there are many of you study the stat results for LMI. The results are truly outstanding for this business. It is incredibly capital intensive, particularly when you compare it to traditional property and casualty business and the business has significant growth ambitions. It's growing very well over the past two years.

We consider that these ambitions for growth are better supported by a broader shareholder base, but notwithstanding that, QBE will remain the majority shareholder in LMI.

The third element we've announced today is the capital raising of $750 million or approximately $750 million being $600 million by an institutional placement and $150 million for retail shareholders of our share placement plan. The proceeds of the capital raising will be primarily used to repurchase and cancel the remaining $500 million of convertible securities, which are already EPS diluted in the calculations for QBE's stock.

We thought this was an important measure to take as part of the plans that we put in front of people today, as we look to improve the transparency, and if you like, the simplicity of the way in which we're constructing our balance sheet going forwards. And as I mentioned, earlier on the discount for dividend reinvestment is cancelled as part of this process and part of this transparency.

The fourth item is some structuring around our debt, so in the second half of this year we will be raising $700 million qualifying Tier 2 subordinated debt and taking the opportunity to repay $400 million of senior debt that is not permissible for capital purposes, particularly from the rating agencies' perspective. The end result of this and Pat Regan will discuss this in more detail as it's significantly step changes all of the key metrics from a capital measure point of view on our balance sheet.

And the final item that we wanted to cover off was the reinsurance we've secured for our medical malpractice reserves in Italy and Spain. These reserves are some of the most complex in property and casualty insurance, incredibly long tail can take up to 30 years to settle. And we've successfully reinsured these reserves at approximately book value.

But you will see later on is this has an impact because it's a reinsurance transaction on our net earned premium, but has a corresponding impact exactly the same number as the reinsurance cost comes off our incurred claims line. So we're saying it's broadly P&L neutral, in fact it's slightly beneficial but obviously comes through with a positive impact for the company's probability of adequacy.

So, if I may, I'll hand over to Pat Regan.

Patrick Charles Regan {BIO 15131018 <GO>}

Thank you. Good morning everybody. Let me first say I'm delighted to be here for my first results session as the QBE's CFO.

Obviously, there's two big topics for me to talk to you today, our half year results and our capital plan. And let me start first with a few comments on the capital plan. I think it's fair to say that we've looked at this as an opportunity to reset the way we approach our balance sheet, both to have higher and more resilient capital levels and to substantially improve our rating agency metrics. Indeed on our own internal analysis, we believe that we have what will be a healthy buffer in excess of an A-plus rating on S&P as an example.

As to why we're doing this, well, I think a few reasons really. Number one, it positions us in capital ratios much more in line with our global pay group. We now will have the ability to withstand a very broad range of reasonably downsize scenarios and still have good capital metrics.

The addition capital will create some opportunities to add additional yield from our assets, what should be a good and attractive incremental ROE. We'll obviously have more capital flexibility and optionality and over time, that will allow us to take advantage of growth opportunities as they arrive.

Backing all that out, we have set today more new and more stringent capital target ratios, so you can see an increase in the PCA ratio up to 1.7 times to 1.9 times versus our 1.56 times for the half year and reduction in gearing targeted at 25% to 35% versus what at the yearend was 44% and is 38% for the half year.

Lastly, I just want to flag on this slide, a theme I'm going to talk a little bit more about as time goes on, which is the concept of free cash flow. What I mean by free cash flow is the dividend from the businesses to head office. Going forward, we're going to measure that both in terms of the absolute dollars of those remittances, but also the ratio of dividends up to post tax profits, or what I will call, the remittance ratio.

And the idea is obviously healthy growing levels of free cash flow, both allow us to grow an external dividend, give us financial flexibility, but also allow us to allocate capital where our best growth opportunities arise.

And we will start setting some internal remittance ratio targets in 2015 and I do think actually the diversified nature of our group portfolio, plus things like our use of our internal captive Equator should make this as strength of the group as we go forward. As I say more on this in the future.

Back to the capital plan then, slide 11, shows you the pro forma impact of those capital plan initiatives over the period to the end of 2015. On the left-hand side, PCA multiple, on the right-hand side the debt to equity ratio. In aggregate, the initiatives deliver around $1.5 billion in cash and depending on which metric you are measuring, a little in excess of that in incremental capital.

Taking the PCA multiple as an example, you will have noted our prescribed capital amount is around $6 billion, just over at $6.2 billion, so each incremental 0.1% on the PCA multiple is equivalent to just over $600 million. Hence the moment from 1.56 times to in excess of 1.8 times is equivalent to $1.5 billion, all other things being equal.

It is worth reminding there's a couple of things we've also factored in, obviously some earnings retention over the period to 2015. We've also factored in a move to allow us to move up to 15% our risk assets and we've factored in the incremental capital charge for doing that.

Now you can just about see on my side here, the by-design, we are not reliant on anyone single one of the initiatives. It is a broad basket of initiatives that allow for the capital improvement. Having said that, we are confident on our ability to execute each of them individually. Again, back to PCA that pro forma increase is therefore split roughly just under one-third from the agency sales, slightly over one-third from the impact of the placements/SPP/Tier 2. And therefore, just under one-third from anything else, including the IPO of LMI.

As we indicated we expect to complete the agency sales this year and therefore roughly two-thirds of our improvement should be completed by the year-end 2014 with the remainder come through in 2015.

Lastly, just as a note on the PCA, you all have noticed now, prescribed capital amount went up a little bit at the half year and that was primarily to move from almost no risk assets at 31 December up to about 5% at the half year, a couple of other movements as well.

On the right hand side on gearing, each incremental $500 million reduction in debt is worth about 4.5 points on our gearing ratio. Or said another way, each incremental $500 million in our equity base is worth about 1.5% reduction in the gearing ratio. And again, following that math means you can realistically get a little under 30% gearing by the end of 2014 from the agency sales capital placement Tier 2 et cetera.

Further impact of that might come through in 2015 and then really the impact on gearing will depend on how much of that incremental cash we use to pay down incremental debt versus holding at the center, versus using for growth opportunities.

It's probably also worth noting the reduction in tangible gearing as even more pronounced, I've spared you yet another waterfall chart on that, but to give you sense of that, the equivalent of a 10% reduction in gearing is worth about a 20% reduction in tangible gearing because again, by design, as well as growing our equity base, we're also converting goodwill into tangible capital as a part of the plan.

A few other thoughts on the balance sheet before I move on to performance. Firstly on reserving, just stating the obvious, it's obviously vital for us we demonstrate consistent reserve development and reserving as we go forward, and it's worth saying that I'm comfortable with the overall level of the group reserves, although obviously we'll continue to look at some of the portfolios such as the North American program reserve and keep a close eye on that.

And in that regard I'm satisfied with what I regard as a decisive action we've taken on the Argentinean workers' comp book that can put that issue behind us.

I am also very pleased that we've been able to announce today the reinsurance of the Med Mal reserves in Italy and Spain at essentially book value and it's a deal that allows us to help us reduce volatility as of our reserves for a net neutral P&L outcome.

We're obviously be looking for other portfolios that are long dated and have a potential for higher volatility and see if there is any more intelligent reinsurance deals that can be done.

Not a lot of news on goodwill, no real change in carrying values at the half year versus the full year. Just a reminder obviously by definition having taken a $600 million impairment charge at year end that means you start with zero headroom at year end in the North American goodwill calculation.

Since then, by executing on the business plan, we've created a little bit headroom, which inevitably remains tight and sensitive to future performance and business plan assumptions.

Lastly an area that I think has a lot of potential for QBE as we go forward and that's our investment portfolio. I think it's fair to say that while we generate good performance from our current spread of assets, our approach to investments differs really quite greatly from our global peer group. And you can measure that whether you measure that by the type of assets we hold. We hold just over 1% of assets in what we call risk assets to the year end.

So just over 1% is invested in anything other than cash and fixed income, of the fixed income we hold, two-thirds of it is in short dated AAA or AA paper and the average duration of our assets is around six months, which is obviously much shorter compared our other liabilities which were about three year or the average duration of our global peers, which is anything from 3 years to around 4.5 years.

We're saying, we're not going to go crazy overnight on any of the stuff, you should rest easy. We're not going to go to change our position overnight, and we will retain a risk aversion generally as we approach our assets.

That said, I do think that additional capital we're creating today does give us the opportunity to gradually and over time broaden out our approach. And again to give you some sense of that, again over time we looked to potentially move our risk assets up to market conditions allowing 15% of the portfolio, slightly broaden out the type of fixed income we hold, and again at the right time, global yield curve is allowing extend average duration of assets closer to the duration of our liabilities.

I think in summary, a lot of good work's already been done on the underwriting side of the business. And we do have good returns on the assets we invest in, but I do think there's some pretty significant opportunity for incremental returns on capital from our asset portfolio.

Moving back to performance, slide 14 shows you our results by division in our usual format, so what we call our statutory format and that's after the impact of the internal quota shares into Equator, so that leaves the quota shares in the Equator results not in the business units.

The captive clearly serves many useful purposes for us, but I'm not sure one of them is actually the way we present the results, and potentially doesn't most accurately reflect the underlying business trends will necessarily how we think about performance.

So, what we've done on slide 15 show you those same results but with the quota shares put back into the divisions. We'll have a little bit of a think about how we do this more formally in the actual results pack, perhaps at yearend. And just you see what's left in the Equator, therefore, is just the excess of loss treated.

Just a couple of comments on performance by division and starting with Europe, you can see in Europe is the positive impacts of the portfolio cleansing that Richard and the team have been doing, starting to work their way into the results, partly offset by more competitive market conditions, certainly in the reinsurance business there.

Gross written premiums down 13% against year ago, principally again in reinsurance and international markets, reflecting both a disciplined approach to underwriting and the more difficult market conditions.

While the cat experience in Europe was slightly above budget, following the U.K. January and February storms and discount rates had a negative impact. The disciplined approach to underwriting positive prior year development and a little bit of foreign exchange has meant that the claims ratio improved by almost 2% versus the first half of last year.

The combined expense ratio of Europe increased to just over 34%, reflecting both investment in the operational transformation program and a bit of an impact of stronger sterling, given the cost base in sterling and part of their revenues in dollars.

In the Australia business, Australia, obviously delivered another very strong set of results, pretty much across all metrics. Underlying, GWP was up 1%, despite more competitive conditions and the business delivered combined ratio of around 87% some 2.5 points better than past year.

And there were pretty much improvements across all ratios, the claims ratio, the commission ratio and the expense ratio and perhaps even more impressively, virtually all of our lines of business are performing profitable and are making returns in line with our above our target returns.

While market conditions became more competitive as the half developed, we were pleased our policy retention improved towards I think strong 82% and new business growth was strongest in CTP and New Zealand.

And although the claims ratio benefited from a benign level of cap activity, this was offset by higher large risk claims, including surety claim and the reduction in the discount rate. Perhaps most importantly, the attritional loss ratio improved from 51.7% last year to 51% despite that higher proportion of CTP.

In Asia, excluding the impact of last year's large MTR premium, the GWP grew by 21% and we maintained profitability at around 91% combined ratio and growth is pretty broad based across Hong Kong, Singapore and Malaysia.

The Latin American results were obviously dominated by the $169 million of prior year reserve booking, the vast majority of which was in Argentina. Now I am going to come back to the underlying loss ratio in Argentina in a moment. But lastly, I think the Equator results for the excess of loss book behaved broadly as you would expect a reinsurer's results to behave.

Just on North America and I'll come back to a separate slide on that in a minute. You can see firstly the impact of the putting quota share back into North America with the results of 99% versus a stat of 103% and that was because of the renegotiation of the quota shares share with Equator.

Just in terms of the moment from 95.9% to 99%, there's a few different moving parts there. Obviously, the combined impact of risk margins and discount rate's about 2.6%. Prior development broadly offsets the cat impact. So, what you're left with is a slightly higher expense ratio in the North American business.

GWP was down 11%, primarily as a reduction of the Bank of America business in lender-placed, coupled with a reduction of the program GWP following the termination of a number of under-performing portfolios.

In dollar terms, the North American expenses were about $20 million lower than the first half of last year, but obviously, the ratio was impacted by that reduction in top-line. It's probably also worth noting that the expense ratio is actually ahead of our own plans for the first half.

Outside of that, the North American business is performing broadly in line with our expectations both in total and by loan of business.

Lastly from me then, just a few comments on the overall group attritional loss ratios, and as before, we spilt out the noise from crop, which is not really an attritional product, lender-placed and Argentina.

Just on lender-placed, you can see the impact of that lower premium, a couple of hundred million dollars lower premiums in the first half. And Argentina, there's probably a couple of things worth nothing. Given the height and level of claims inflation in Argentina, there is a bit of a new norm there. This is a higher undiscounted loss ratio, so you can see there is the undiscounted current year loss ratio.

The impact of current year discounting reduces that by almost one half, but even notwithstanding that the overall combined ratio of Argentina comes out probably in bit in excess of a 100%, but given both the length of the book and the investment yields in Argentina, this will still result in an ROE in excess of 30%.

At the start, as John noted, you can see the portfolios for the rest of the world, we've seen a continued improvement in the attritional loss ratios on the back of all the underwriting improvements that have taken place across the group. And again, notable improvements in Australia, Europe on the back of the portfolio work that we've been doing and with a small improvement also in North America.

With that, I will hand back to John.

John D. Neal {BIO 20988613 <GO>}

Thanks, Pat. Just a couple of slides to finish for me before we hand over to questions, so just looking at our outlook for 2014, we are now forecasting gross written premium in the range of $16.6 billion to $17.0 billion, which is about $400 million down on where we originally anticipated at the beginning of the year. The net earned premium now $13.9 billion to $14.2 billion. Now obviously that's down between $800 million and $900 million, but important to remember that half of that change is down to the reinsurance treaty in respect to the medical malpractice reserves in Spain and Italy.

And just to remind you again that whilst there is a $400 million reduction on the net earned premium line there is equally a $400 million reduction on the incurred claims line. So they counter each other. Really the remediation activities that we've been running in the past 12 months run through the half year is what seen the reduction in premium. But I think equally as you've seen through the divisional results that Pat took you through, you can see the improvement in the results division by division except in Latin America come through.

There is some further pressure in the second half in North America in terms of the two specialty lines of business, obviously with commodity prices being off in the crop product. You will see some lessen net earned premium come through in crop and we're also anticipating the lender-placed insurer income to fall again slightly in the second half. Otherwise the second half income has stabilized and there's no reason to assume that we can't achieve some nominal growth into 2015. If we look at the combined operating ratio we're assuming that the attritional claims ratio can remain stable. As you can see there are allowances for large individual risk and catastrophe claims for the second half of 13.2% of net earned premium.

That's in fact 12.5% if you reverse back out the $400 million reduction for the reinsurance of the medical malpractice claims. So exactly the allowance that you'd be expecting us to run through the second half is still intact and being assumed for catastrophe claims and large individual risk losses.

You will see the commission and expense ratio slightly up at 33%. Expenses obviously being impacted by the lower net earned premium coming through and again impacted by that further reduction with the reinsurance and you will see a footnote at the bottom of the slide that again if you reverse back the reinsurance, the expense ratio is slightly in excess of 32%. So again, pretty much inline where we thought it would be.

Combined operating ratio for the full year now 95% to 96%, obviously the impact of the reserving decision we made in Latin America flows through to the full year and has a 1.2% impact on the full year combined operating ratio. There is also some further unwind of discount rate in Argentina in the second half that impacts the combined operating ratio but of course correspondingly benefits the investment line.

So when you get down to the insurance profit margin, you are looking at an insurance profit margin forecast of between 8% and 9%, pretty close to the 10% that we were forecasting for the full year. So you can see the double impact of Argentina on the combined operating ratio being offset partially in the investment line and therefore in the insurance profit margin. As I said earlier on dividend policy, on behalf of the board is unchanged at 50% of cash profit with an adjusted dividend weighted 40%, the interim 60% to the final.

So, just a few closing remarks. For us in the second half there is really three priorities. One to demonstrate that our claims reserves are and can be stable; two, to illustrate that in terms of performance we can maintain the level of improvement that we've shown really through the first half; and third, to show you how those proposals around the capital plan actually come through in the metrics as we execute that plan.

So Australia, New Zealand, Europe, Asia Pacific, Equator Re are doing exactly what we would have expected them to do through the first half and indeed the North American transformation is absolutely on-track. Notwithstanding that comment there is a great deal of work to do in the second half of this year and through 2015 as we look to pull North America further into shape to get it exactly into the business that we thinking though it can be.

The Latin American result was incredibly disappointing with the action we took. But as I said earlier on, we do consider the action decisive and our intent in establishing in emerging markets division to insure that we leverage the best practice, particularly in terms of achieving sensible growth on top line or good growth on top line and managing the results that we've seen in Asia Pacific. So we do think that emerging markets division will work well for us.

We would consider the capital plans that we announced today very complete and very comprehensive. And I hope you'll consider them transparent as well and executable as Pat's described.

When we look at our strategy, underwriting excellence absolutely underpins performance for us and we believe will support what we're doing across the market place. So, you won't hear me up here making excuses for market conditions. That's the reality of what we find ourselves in and we believe we can outperform across the market cycle. Equally, I think we've demonstrated an ability to take cost out of the business and we believe we can continue to do so. So if net earned premium falls, we can take cost out of the business, pull better still when the opportunities arise to grow then we have flexibility in the way which we have structured our back office, so we can grow more easily and more quickly.

We do consider the growth opportunities in the emerging markets remain and that is a growth engine for QBE near and medium term. And as Pat alluded, our improved capital base will support some flexibility and a sensible flexibility ensuring that we can get better value out of the investment portfolio and improve our yields.

So in summary, we have seen strong signs through the half of improving performance, despite some more challenging market conditions. The improvement in our capital base will support an ability to emend the investment performance and strategy over time and carefully. And we do believe that QBE is uniquely placed or near uniquely placed with the global franchise and footprint we have to keep us alert to changing market conditions and maximize and realize growth opportunities as and when we think market conditions will permit.

So with that, I was going to handover to questions.

Q&A

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

Thanks, Daniel Toohey from Morgan Stanley. Just a question on the proposed asset sales. Can you give us some comfort around, I guess, the due diligence you've done on the sale prospects and, I guess, the comfort around the $1.5 billion cash number you talked about?

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

The agency sales, we have appointed advisors on both Australia and on North America. I think our view of that – our informed view of that is that I mean the cash flow businesses they're attractive to both trade buyers and I expect a lot of interest from trade buyers pretty broadly, but also to financial buyers as well given the nature of the business and simple kind of cash flow nature of the business.

So we think it's both attractive, both in terms of demand and hopefully speed to execution as well. Another item, I mean I think the – you'll know probably better than I, but the clear market precedent on that is helpful in terms of assessing that.

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

And the European Central and Eastern European assets? I mean they've been on the agenda for a little while.

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

It's quite – I mean the actual asset value held there is quite nominal. We are actually in discussions with two parties to conclude the sale of Central and Eastern Europe. Two of the businesses have gone already, Bulgaria and Romania. So we're just tiding up the other four, so we would expect that to complete in Q3. It makes no difference to the kind of numbers on the capital part.

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

Just on the moving to the high yields, can you confirm – with the move to capture high yields, is that capture within your technical pricing? So as you move up the risk curve do you assume a higher yield in your technical pricing?

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

Well, there's a complex question. I think I'm not sure that's probably all that smart. I mean, there is element of that you probably should capture in terms of the asset liability matching. So I think if you went to technical pricing so we'll probably tell you that actually you should capture yield that is something relatively close to risk free, but with the duration that matches your liabilities, I think in terms of going into a higher proportion to risk assets, I'm not sure that is something you would be factoring into technical pricing, but I've got an underwriter next to me, so I should probably...

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

Yeah, I think we tend to drive the pricing as much of the combined operating ratios, the return on allocated capital, so we're as focused on getting the moving components of the claims line right, nutritional large risk and cat as we are on getting the return on allocated capital. So – and I think measures we're talking about, well I'd say beneficial overall to the insurance profit margin are not really going to step-change i.e. reduce pricing in our view.

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

Okay. Just a final question on the insurance risk charge has increased by some $225 million, yet your net earned premiums come up 5%, so what's driving that?

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

There's been an interesting discussion that we've been having with both regulators and rating agencies, which takes us into the complex world of the assessment of whole portfolio, particularly relevant for us being a global business. So it's a question of how much reinsurance you need to buy at the top of your reinsurance program to recognize particular exposures to the likes of earthquake and hurricane. So those charges have gone up, the end result of which is a corresponding drop in the PCI. That's the major moving factor of the half year.

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

Okay. Thank you.

Q - Kieren Chidgey {BIO 7268946 <GO>}

Thanks. Kieren Chidgey, Deutsche Bank. I have got three questions. First one, just following up on the shift to higher allocation for risk assets over time, I am just hoping you could help – put a couple of numbers around, so you said, you are around 5% at the end of first half and to shift that 15% over some period. Does that 15% apply to the total investment portfolio? You're not just talking shareholder funds.

And secondly, if that is the case, we are talking – the number seem quite material if for example you are picking up say a 5% risk premium on an additional sort of circa $3 billion of assets, talking in addition of $150 million earnings from that shift. Is that what we should be thinking about? And over what timeframe you are looking to execute?

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

Yes. So, I mean the short answer on the first bit is yes. The 15% applies to the whole portfolio. Having said that, I think you do naturally take a different approach to asset allocation for assets backing liabilities and assets in your shareholder portfolio. So incrementally it would be assumed kind of perhaps more to the shareholder portfolio, that's the first think I would say.

In terms of the timeframe, I think obviously it's partly dependent on market condition, I mean we would want to move in that direction, somewhat in that direction by the end of 2015, whether we get all the way to 15% or not, I think we'll see. And then obviously, you get some idea of the asset classes we are going to move into. If you look at our half year report, we started to kind of move a little bit into it – a little bit emerging market debt and into a little bit emerging market equities, a little bit of high yields. So, it starts to give you a flavor and then you can do the math of the amount of our risk free.

Q - Kieren Chidgey {BIO 7268946 <GO>}

Okay. And in addition to that, so you talked about the fixed interest portfolio, broadening that out, you are talking about increasing the allocation to lower grade credit within that?

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

I think – I mean off the three things I mentioned I think that's going to be the least impactful. Because I think, as you extend out duration and you move the risk assets up towards 15%, you need to be very measured in terms of what – and actually quite good, if you like to have a little bit a barbell approach and have a balance of the portfolio that's still risk averse. So, if we broaden, it's going to be at the margins and it will be the least impactful of the three things I mentioned.

Q - Kieren Chidgey {BIO 7268946 <GO>}

Okay. And two other questions, just on the proposed sale of the – partial sale of the Australian agency and full sale of the U.S. agency businesses; can you provide some sort of figures around what those businesses have been contributing in this result?

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

I think we're probably not going to give you specifics on that. I think the way to do the math, if you follow what I said on the incremental kind of capital been about over $1.5 billion, a little less than the third of that coming from the agency sales. And therefore you can do the math as well that would give you proceeds and divide by a reasonable multiple and that probably gives you a place to start on that.

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

I can to give you some of the parts, I mean the – as I said earlier on the value for us is really in the underwriting. I think we've driven the right results out of the underwriting those agency businesses that will keep the loss of income for us on the distribution component is significantly out-weighted by the increased opportunity on the investment line. So I think if you look at it in the round, it really is de minimis.

Q - Kieren Chidgey {BIO 7268946 <GO>}

Okay. And final question just John on the expense program, all the targets have been reaffirmed to the $250 million, but when you initially roll that out the end point that would take us to is the 30.5% expense ratio with the significant reduction in your NEP. Are you still targeting the 30.5%? Or do you think that's now out of the window sort of the $250 million is sort of the number we should be thinking about?

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

No, I mean, I think the short answer is against the current levels gross written premium, net earned premium, yes I think it is. The ratio can't hit 30.5% at current levels. If you get beyond the sort of near term one to two years, we are still targeting our combined acquisition cost ratio of 30% or better. I think you heard me say before that the initiatives we put in place to run through this two to three year period are our first shot. We will go again at expense and cost and in fact we got some initiatives that we are beginning to put underway now. So I'll talk a bit more about those as we go through the next six months.

So, yes, medium term target is still to get that ratio 30% or better; short term I think we can take more cost out than we have indicated.

Q - Kieren Chidgey {BIO 7268946 <GO>}

Thanks.

Q - Nigel Pittaway {BIO 3406058 <GO>}

Nigel Pittaway here from Citi. Maybe just picking up on Kieren's last question. First of all, in the annual report, you said that having sort of set original guidance of 10% for this year, you said you expected 2% improvement over the subsequent two to three years in the combined ratio. Can you just say where you are on that? Please.

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

Yes, I think, Nigel, answering the question now, it's hard to be definitive of 2015, I would like to see how the next six months play out more in terms of market conditions. As I am saying I think we can take cost out, but that's some of that maybe offset if we think market conditions require us to take some further income out of the top line. So dollar value of cost will come out in line with what we've said, but whether that actually comes through absolutely in a 1% improvement in the ratio through 2015 very much depends on where market conditions allow us to push the top line.

Q - Nigel Pittaway {BIO 3406058 <GO>}

And then maybe just secondly on the mid market business that you've decided to keep. I mean obviously one of the criticisms of that business was it was up against some pretty big competitors, and it's very difficult for it to be anything other than a price taker. One can understand why you might want to retain it because it would be big hole in terms of top line in the U.S. business and maybe involve another intangible write-down, but can you give you us sort of more comfort as to why you really think that business is going to make money moving forward? I mean, I know you've given one or two reasons in the pack but, it doesn't really answer the competitive situation that business finds itself in?

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

Yes, I think a bizarre irony or the scrutiny you put yourself under when you contemplate whether you're going to sell or keep a business, probably makes you even more forensic in terms of the analysis you undertake of that business. And I think the conclusion we've drawn on it is that in the SME sector, we think it's less price sensitive and less competitive than the balance of the P&C landscape in North America, and in fact whilst we are talking about comparatively nominal rate increases through the balance of the book, we're still achieving 5% rate increases on that book of business. So our sense is that it's going to give us predictable consistent returns if we take the measures that I referred to earlier on and therefore it's a staple diet business and has value for us.

Second point I would say is that we've worked pretty hard through the six months to improve the relationships with the key distribution partners, particularly agency base there and that all to create ironically an opportunity to grow rather than an opportunity to shrink. So if you add that all together it's for those reasons that we've determined is to a keep it rather than a business to sell.

Q - Nigel Pittaway {BIO 3406058 <GO>}

Okay, and maybe just one further question on the U.S. business, I mean if you look at the guidance you set at the full year compared to what you're setting now, there is a number of areas that have been trimmed by the $100 million reinsurance something crop for examples. Obviously you're trying to reposition this business and sort of grow into new lines moving forward, I mean, when do you think the top line will start showing some benefit from those initiatives that you are taking to reposition?

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

I think, yeah, it's a good question. I think we've got a number of areas to focus on through the second half. And I think in income terms the only area to keep an eye on which we forecast through is to lenders-placed insurer, where we have assumed that income will fall again then. Reinsurance business was simply a function of pricing in the marketplace earlier on, the other lines of business is stable or growing, so we are seeing growth come through specialty lines.

So I would anticipate that what we see in 2014 is in fact the trough of the income levels in North America and that we can see some growth through 2015 and 2016. But as I'm saying earlier on that can be wrong, I think we have got a bit more work to do through 2014 and 2015 to get some further improvement come through both on the claims line and on the cost line in North America.

Q - Nigel Pittaway {BIO 3406058 <GO>}

Thank you.

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

Good morning, Jan van Schalk, CLSA. A few questions, on the medical malpractice reinsurance, is there an upper limit on it, and if there is what is it? And what's the buffer between what you have actually reinsured in that limit?

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

Jan the reinsurance is unlimited. So I think we have been careful in the words that we have chosen. So, I think finality is a big word to use in the modern world, but the reinsurance is unlimited. As far as the buffer is concerned, obviously the – in our view and the way in which we are managing the P&L metrics is that there are corresponding risk margins that are attached to that business and therefore the commutation cost or reinsurance cost better description of those reserves roughly equates to the combined value of the central estimate and the risk margins that attach.

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

All right. Slight follow-up then, the counterparty credit of the reinsurer?

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

So, what we've done is, is a combination of one of the world's AA rated reinsurers and there are only two as you know and the medium reinsurers. So, first layers in with one of the AA reinsurers and then it's the medium and above.

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

Thank you. On the reinsurance, continued reinsurance theme, Pat, you talked about other portfolios that you might be looking for some smart reinsurance solutions. Can you give us some sense of what those might be, and where you see them coming from?

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

I'll try not to be too specific, I think. Yeah, I mean you could probably draw the list of your sales to be honest. If you think about where – I mean the reason we did this one was it's had more volatility to-date, as John's said, is the fact that there is a full unlimited reinsurance tax volatility off our balance sheet, so these portfolios have got a similar nature. And above volatility we remain just more judgmental in how you do the reserving, because, as we get look at the lumpier books of business. So there are one or two maybe smaller number than that, but kind of fairly obviously fit to bill, with that specifically naming that.

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

All right. That's a partial thank you, I guess. John you talked about a $200 million saving on your reinsurance program on a risk adjusted basis and really didn't mention it very much. I guess two things, could you give us an idea what that is? And also don't fully understand what you mean by saving on a risk adjusted basis.

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

It's a combination of two factors. So there is a pure saving in terms of cost, which is roughly half the number and the half of the number is the decisions we've taken on the underwriting account. So, where we've essentially taken a view to reduce exposure both in Europe and North America. If you're looking at exposure to exposure, where we're writing the same account in 2014, we were in 2013; our reinsurance cost would be $200 million lower. The cash amount is about half of that figure because of the exposure we've taken off the books.

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

So would that – so could you characterize that more as dealing with the volatility around your earnings rather than the upper end?

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

A bit of both. There is certainly some volatility, yes. I think it's improving, the underwriting would be half of it and the other half is ready to sharpening up the program.

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

Sorry, I am hogging the mic, but the useful things that Equator Re does?

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

Equator does a number of different things for us. I think from a capital perspective it avoids the duplicate cost of capital when you're operating globally, so it's a smart way of managing capital intelligently for us is one factor, hence the quota shares that you see, Equator being used for.

And the second really is managing the difference between group appetite for risk, i.e bigger business and the division's appetite for risk. So our external excessive loss reinsurance treaties are brought with the group in mind and then Equator really operates subject to appropriate transfer pricing mechanisms, the buy down facilities, so the division's going to operate the retention levels that they would prefer.

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

Last question. When you are underwriting, what is the hurdle rate that you aim to exceed?

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

In terms of return on allocated capital. It varies, is the short answer to that question. I think it's personal view. I think it's a dangerous thing to put a number out there for every portfolio because you just have to accept that some businesses are at different points in the cycle and if you believe in the business for the medium-term then you might be prepared to support a lower return on allocated capital that might otherwise be the case. So we would do it portfolio-by-portfolio and then aggregate it to the margins on the return on equity that you're looking out for the company on an aggregate and overall basis.

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

Thank you.

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

Thanks. Brett Le Mesurier from BBY. A couple of questions. Firstly, you've commented that there is an oversupply of capacity in the European market and the competition is increasing as the year goes on. What does that mean for next year presumably we are looking at being a tough environment to actually grow premiums at all?

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

Yeah. I think I said when I stood up there. I mean, the one thing I don't mind is market conditions to be honest with you. I think what I'm keen to demonstrate to our shareholders is that we can get a business to perform even in more challenging market conditions and we're not talking about reserves.

If you look at the action that we've taken particularly in Europe, we've trimmed or sold portfolios that we just don't think can achieve sensible returns either short or medium-term, but very satisfied with the book that we have retained.

And frankly even talking to the European team notwithstanding current market conditions, we think we can achieve some growth. So, I think - I mean, underwritten personally for 20 years along the market, it's always had over capacity. I think at this point in the cycle we're just seeing a particular influx of capacity in the reinsurance space.

So that will mean, we'll just be quite on some ambition we have to grow reinsurance maybe for two or three years. But otherwise I don't think we feel that top line's under any further pressure in Europe.

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

It would also mean that the 6% insurance margin that you are tracking out for this year will be hard to improve next year?

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

Hard to improve, Europe is the third cap of the rank on our cost transformation program. First to go was Australia, where the exercise is pretty much completed. If you wanted a sort of a rough split, North America is about halfway through and Europe is at the beginning of that journey about a quarter the way through. So I think we can take some expense out of their acquisition cost lines. So we can get some improvement in that margin through 2015 in half year.

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

Would it be fair to say in relation to Australia, New Zealand about half of the insurance profit comes from the LMI business?

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

I can't remember of top of my head if that figure is correct. You might help me Pat.

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

It's certainly a big chunk for – I mean that business as you can see the stat results for last year were very strong for this year that have been at least as strong if not a little bit better. So yeah, it makes a very large proportion of the – I think it's a little less than half, isn't it? Yeah, it's a little less than a half. Less than a half of it.

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

And on the reinsurance for the malpractice, right in thinking that the risk margins are not going to come back to you, they will go to the reinsurer?

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

Correct. The value that the reinsurance is being affected, I mean, from our point of view to relate to one of the other questions, it's a delicate balance of determining whether you want to reinsure reserves or keep them, there's nothing wrong with long tail reserves. I mean, they are a good thing, particularly from an investment perspective.

And clearly, the transactional or any transactional reserves from our point of view has got to have some benefit to the P&L. And that's really the attraction here is that if you allocate the appropriate risk margins to that book of business, add them to the central estimate that is the value of which the reinsurance is being affected, hence it's been P&L neutral.

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

I think actually we've got a question from James from UBS on the telephone. Your line is now open.

Q - James Coghill {BIO 14006200 <GO>}

Good morning, guys. Just a couple of questions. First one LMI. It's not clear to me why you have planned to list this business next year. So if I just reflect back on the submission that you made to the Murray Inquiry that was questioning the viability of LMI as a product in Australia and now you're talking about very ambitious growth ambitions that the business has. And it really isn't one that can grow independently of what the banking clients do. So perhaps you could just go into a little bit more detail why you're intending to list it and what those growth ambitions are in the business?

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

I'll let Pat deal with the listing points and I will pick on the growth.

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

Well I think, we pretty much talked about in the kind of comments already, James, so that's – it's a business performance strongly, has very strong results, we expect that to continue for the foreseeable future, but it's more capital consummative by its nature and certainly more, as John said earlier, more than your kind of typical P&C business. So we think it will – the business will benefit from its own access to third party capital.

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

I think, James, from within the business there are obviously competing pressures for capital and we have been restrictive in the pure capital we've allocated to that business. So in the short term, we have actually purchased reinsurance to support their growth ambition through the two most recent years. So there is quota share reinsurance in place for it. So the growth has been there for the past two years and we think it's certainly sustainable at the levels of their ambitions through the next two years. So that's the growth equation.

Q - James Coghill {BIO 14006200 <GO>}

Thank you and just a quick one on the agencies. The numbers that you've spoken about and broadly indicated Pat, are those net of any potential goodwill write-downs that might be required for those agencies or do you believe that's an indication on sale prices or JV prices that will be crystallized will support goodwill for those agencies on your balance sheet?

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

The number I was talking to you earlier were kind of cash numbers and I think when I was walking through the PCA calculation, obviously that doesn't give any value to goodwill. So all of those numbers will be gross of goodwill, there would for both businesses be goodwill – attached to those business both of the Australian agencies when we originally bought them and similarly for the U.S. I think kind of in very, very broad terms the numbers are going to be approximately equivalent. So in other words, we'll overall going to support the goodwill attached to them.

Q - James Coghill {BIO 14006200 <GO>}

Okay and one quick one, final one on your analysis of the underlying margins. There is that bucket of other which is hopefully footnoted as other with no explanation. So perhaps you could just explain what that is or is it just the too hard to solve bucket?

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

Certainly, yes, thank you for the question. It's two things really there is a little bit of foreign exchange in Europe so the – as you remember of course in the European business there are quite a bit of London market business in dollars, their earning through of the premium comes through in a slightly different rate than the claims and expenses not giving the slight benefits in the quarters, so we just wanted to highlight, so in the half that we wanted to highlight.

Second thing actually that's within that there is a slightly larger amount is due to the higher interest rates and higher amount of reserves in Argentina there will be a higher unwinded discount on that book of business going forward. So we just wanted to know that going forward, you should factor in probably at a group level something like the half a point, probably, a little under half a point of higher unwinded discount going forward. So that's really the other one we wanted to bring out in there.

Q - James Coghill {BIO 14006200 <GO>}

Thank you.

Q - Siddharth Parameswaran {BIO 15037291 <GO>}

Hi, John and Pat. It's Siddharth from JPMorgan. If I could just ask a couple of questions. One is just on the large loss allowance, John, you are very clear that you don't believe that should be touched. But if your expectations pan out for the second half as your budgeting, you would have missed your large loss allowance for the last five years at a time when most of you peers are saying we've had a light catastrophe activity except 2011. Could you just give us comfort whether you are going to look at this at any point in time and why you have comfort of that number?

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

Yeah. It's a good question, Sid. I think on the large losses, I think what's giving me encouragement is the frequency of large loss has actually been dropping through the second half of last year and through the first half of this year. What's been unusual through the first half is just having two particular losses in the large loss category that have been significant and have note.

So the underlying trend for large losses in my view is coming down, I think as you know we do buy an aggregate protection around those large losses as well. So we do have an ultimate lock-in on them.

Q - Siddharth Parameswaran {BIO 15037291 <GO>}

There is no – I mean, you aren't going to review that at any point in time?

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

I think indirectly we've reviewed it through the underwriting decisions that we've made both in North America and Europe. And I think that's why the large loss frequency is actually dropping. I think we made the smarter performance decisions which will show through in my view to reduce cost rather than increased cost of large loss.

Q - Siddharth Parameswaran {BIO 15037291 <GO>}

Okay. Fair enough. Just my second question is just on the claims inflation environment versus what's occurring on premium rates, if you could just give us your thoughts on how the 1% compares with what you are seeing overall across your book on inflation?

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

Yeah. I mean excepting Argentina, if I can, just for a moment which obviously adds a degree of complexity to the answer. There is nothing generally that's giving any sort of signs of superimposed claims inflation, we're seeing some specific instances, for example whether its mesothelioma or deafness claims in the U.K. pretty widely reported are certainly out striping normal rates of inflation. I would say if anything that more generally the claims environment is pretty benign and typically 2% to 3%.

Q - Siddharth Parameswaran {BIO 15037291 <GO>}

So as in regarding basically premiums rates are still not covering inflation?

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

Yeah, if prices maintain at a sort of flat or 1% level then yes, you are at/or just slightly below claims inflation.

Q - Siddharth Parameswaran {BIO 15037291 <GO>}

Okay. Very clear. Just my question is just on Latin America which obviously took a large reserve increase, are you confident that the market will allow you to price this business at levels that will allow you to move back to profitability? You did mention I think that your reserves are well above peers so is the market moving to take a similar view to you?

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

I don't think the market locally will necessarily move to the same level of reserves as us, we have always been more strongly reserved than the marketplace and these are round numbers. We were approximately twice the market in terms of reserves. We are now pretty close to three times the market. I'd like to say that's an opportunity. I don't think it is. I think the market is wrong and we are right. In terms of pricing, we have been the most expensive insurer for workers' comp in Argentina now for just over two years and again our pricing models, on average it varies between about 50% and 75% above the market, so it's risk selections that's driving what business we do right. So pricing in the market, yes it is moving up, but we are certainly the most expensive insurer for workers' comp in Argentina.

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

I mean the only other thing to that is what we talked about, you do have a different shape of result in that businesses than you do in kind of the other businesses in the world, where the average length of that book is probably five years, maybe a bit longer than that, maybe six years. So you've got a very long tail book, which means you keep your assets on your books for long time in an environment where risk free rates are in the mid-20%s, so you've just got a different shape, you have to combine this clearly higher.

So I think we'd all aspect to be posting a combined ratio in north of 100, but you clearly got a much higher amount of investment income, both because of the risk free rate or if you like the local rates and the length of the book. So the net of all of that is still kind of a - as we talked about 30% return on capital, just with a very different shape to it.

Q - Siddharth Parameswaran {BIO 15037291 <GO>}

Okay. Thank you.

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

Okay. I think we might have time for one more question, if there are any. Okay. If not, well, I'll wrap it up there. Thank you very much everyone. Thanks for coming on today.

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

Thank you.