Y 2019 Earnings Call

Company Participants

- Inder Singh, Chief Financial Officer
- Patrick Regan, Chief Executive Officer

Other Participants

- Analyst
- Andrei Stadnik
- Andrew Buncombe
- Brett Le Mesurier
- Kieran Chidgey
- Matt Dunger
- Nigel Pittaway
- Siddharth Parameswaran

Presentation

Patrick Regan {BIO 15131018 <GO>}

Good morning, everybody. You can see the tenure of our new Chairman has got off to a tough start for me. it's -- I didn't get in a fight, it was a football injury as you could imagine, Good morning, everybody, and thank you for joining us here today. Before I get into the result in detail, I wanted to talk through again the program of work we've been undertaking. It's really built around four main pillars: Simplifying the group, completely rolling our underwriting capability and culture, modernizing the company, and reducing our expense ratio, and embedding a consistent culture across the company, our QBE DNA.

Firstly, we executed on the extensive program to simplify QBE by reducing our geographical footprint and narrowing our product set. We've gone from six divisions in 36 countries to three divisions in only 27 countries. So simplified how we manage the group, helped us reduce central costs, but also allowed us to avoid unprofitable business and significant volatility, the major economic and currency crisis in Argentina, California wildfires, and earthquakes in the Philippines and Puerto Rico.

Secondly, and probably the most significant part of the program has been to redo our underwriting capability and culture, primarily by the Brilliant Basics and Cell review programs. Brilliant Basics isn't just about rate increases or reductions in our attritional loss ratio, it's about shifting the capability and culture of our company. We've been quietly and comprehensively revolutionizing underwriting and pricing at QBE.

This has included the implementation of consistent group-wide underwriting standards, introducing multiple additional detailed underwriting guidelines particularly for underperforming portfolios, the introduction of upgraded underwriting peer reviews, increasing their frequency and their quality, more formalized underwriter training, revised underwriting authorities, reducing standalone authorities for more volatile or higher hazard business. Targeted reductions in line sizes or limits on portfolios where we anticipate increased loss activity, I'll talk you through some examples of that a little bit later. Using new data sources to help in risk, almost like an underwriter's Bloomberg. the introduction of sophisticated portfolio and exposure monitoring tools. Implementation of pricing standards and significant upgrades in our pricing tools and our actuarial resources, everything from more granular data, more frequent updates to leveraging third-party data.

At the same time as all of that, we also introduced cell reviews across the organization to ensure that these changes were resulting in the underwriting strategies and results that we wanted. And together, Cell reviews and Brilliant Basics have contributed to systematic overhaul of the underwriting performance of the business. The Most obvious evidences of this are our rate increases, the reduction in large losses, the step change improvement in the rate adequacy of our portfolios, and the reductions in attrition loss ratios. This work is also helping us reduce volatility and avoiding where we can some of the increased loss trends. And again, I'll talk through some examples of that in a moment.

Our third program has been about modernizing the company, in terms of culture, ways of working, technology, data analytics, automation and efficiency. We've talked to you about some of the outputs of this in terms of expense targets, but the program is about much more than that. We're not looking to do big bang technology projects, but we are systematically working through and modernizing our technology stack, retiring old tools, greater automation, greater use of robotics, greater integration of apps, more use of digital front-end tools.

In terms of expenses, last year we launched a three-year operational efficiency program that targeted $130 million reduction in costs, and a sub 14% expense ratio by next year. You remember, just a few years ago we had an expense ratio of almost 17%. In many years, 2019 should have been the year of foundational activity, and indeed it was as we launched significant automation projects in all three of our divisions. But we also achieved loads of good old-fashion tactical cost saves, everything from headcount reductions, how much we travel, down 20% across the company, lower IT costs, fewer consultants, better procurement and a leaner, more effective head office.

We've saved already over $100 million, with $70 million of that through underlying savings. nearly double our target for 2019, and well on the way to our overall $130 million target. Altogether, all of that program of work has helped meaningfully improve the quality of QBE's earnings. And we now have a lower reliance on positive prior year development or on things like LMI earnings.

And our earnings momentum is underpinned by improvements in attritional loss ratios and the expense ratio. We saw evidence of this again in 2019, 8.3% rate increases across the entire group in the second half and up to 9% in the fourth quarter. The group's attritional loss ratio down by a further 2.7% for the full year and is now down almost 7 points since its peak in the second half of 2017. We achieved very strong results in Australia Pacific and international that compare very well to their local peers.

I'll talk more about North American results shortly, however, I believe that the fundamentals of our North American business were improving and we expect to -- can expect to see positive development in their earnings going forwards.

Well another area we don't perhaps talk as much about is our investment decisions. Certainly closing the longstanding asset liability mismatch, duration mismatch has helped to save hundreds of millions of dollars last year. We a further strengthened the portfolio through diversification and improved performance by a higher exposure to real assets. We exceeded the upper-end of our guidance, delivering a return of 3.6%, and we delivered returns for pretty much each asset class ahead of their relevant benchmarks. We've also added $1.5 billion to our funds under management in 2019.

We've undertaken significant capital management initiatives, including buying back $600 million of senior debt, nearly AUD$800 million of QBE shares or 5% of our issued capital, at an average price of just over $11. I should also highlight the improvements we've been making at QBE haven't just been financial. We're focused on building a sustainable business and a great culture for the long term. We've introduced QBE DNA right across the company, which is transforming our culture. We've increased the percentage of women in our leadership positions from 28% to 34%, with more to come.

We've made commitments to improve the environment through our climate change action plan and our energy policy. And we've committed to growing our impact investment portfolio to $1 billion in 2021. And today, we have announced the doubling of that to $2 billion by 2025. As you remember, this is where we invest 25% of a customer's premiums in projects that have a measurable social impact benefit. As a result of all that, we've now entered the prestigious Bloomberg Diversity Index and significantly improved our overall ranking in the Dow Jones Sustainability Index.

So a couple of things on the results for me. Our combined operating ratio of 97.5% was very slightly higher than was anticipated at the time of our December update. And obviously, this was due to the fact that we had significant bushfire losses in the last two weeks of the year. There's also been significant weather in the early part of this year in Australia, and we can cover off the financial impact of that in Q&A a little later. Cash ROE for the year was 8.9%. Given we stay confident in the trajectory of the business, the Board has declared a full-year dividend of $0.52, an increase of 4% over the prior year.

As I mentioned earlier, we're achieving very strong rate increases right across the group, not for just one division or one product line. With the rate environment in the second half the strongest it's been for at least a decade. We achieved rate growth for the group of 6.3% for the full year, which accelerated to 8.3% in the second half and over 9% in the final quarter.

In North America, that was just under 6% for the full year, and 8% for the second half, or if you exclude workers comp where there's legislative reductions, nearly 9%. Checking rate momentum was particularly strong in North America in specialty and casualty program, just under 20% professional lines in the teens, and accident and health almost double digits.

Our international business achieved average premium rate increases of 6%, increasing to over 9% in the second half and 10% in the fourth quarter. And key contributors in that second half included our UK and international financial lines, both up strongly, international markets liability, international property and overall rates in the London market were particularly strong in the second half. Even Asia achieved rate of 5% in the second half, and while lower than elsewhere, that's the first time in some time that we've seen rates development in Asia.

In AusPac, it was pleasing to see the rate momentum from the last couple of years continue in 2019. And AusPac again achieved an average rate increase of around 7%. Main contributors there were commercial property, strata, engineering and New Zealand. And we've seen that grate momentum across the group continue in the early part of 2020, positioning us well for the year ahead.

Our attritional claims ratio for the year improved again by nearly 3%. Since peaking at 54.3% in the second half of '17, the attritional claims ratio has now improved by almost 7%. And AusPac improved by a further 4.2%, and the ratio has now improved or reduced by 11% since we introduced the Cell review and Brilliant Basics program into AusPac in the second half of 2016. And I think there is still more we can do there. Pleasingly, almost every cell in the AusPac business showed an improvements in 2019. International's attritional ratio improved by further 3%, reflecting strong underwriting actions and targeted rate increases across financial lines, liability and property.

North America's ratio improved only marginally to 49.8% and this was largely due to the heightened level of attritional weather activity in the second half, consistent with the experience of a number of our competitors. Excluding that impact, the attritional ratio for North America would have been closer to 48%. And as we head into 2020, I think we can expect further improvements in each of our divisions given the strength of the rate environment.

On gross written premium, we grew by almost 4% for the year constant currency. North America achieved underlying growth of 3%, including good growth in property programs, specialty programs and accidental and health. International reported growth of 4%, including 20% growth in natural resources and 10% across Europe and international property. And AusPac delivered underlying growth of 4%, starta workers comp and commercial packages all saw good growth, partially offset by a reduction in LMI.

Moving into 2020, we do see increasing opportunities for targeted growth across all of our divisions. Following this launch of our customer commitment program, our approach in new business is more systematic, underpinned by consistent use of sales force for retention and new business, combined with the focus of providing great products and a great claim service to our customers.

Our challenge for 2020 is can we rub our tummy and pat our head at the same time, can we be better as systemic growing our business, while also improving our attritional loss ratios. We are going to look to repeat our play for the last couple of years, being disciplined about risk-selection, focusing on margin expansion, but also seeing that we can grow at least in line with rate increases.

Let me turn back to North America for a moment. Obviously, the headline result of a 106% in North America is not as good as we would want. As we indicated in December, our crop result was significantly impacted by weather events. And this was particularly true in a few states, where we had a higher market share, so North Dakota, Minnesota, Indiana for example, all of which states have been historically large profit contributors.

Notwithstanding 2019, whether we have a good franchise which delivered a 10-year average combined ratio of 90%, and we expect to return to a more normalized level of underwriting profit in 2020. We also strengthened prior year claims reserves in some selected casualty portfolios to make sure we're on top of or ahead of industry-wide inflation trends. That said, the underwriting actions we've taken in North America in recent years have helped us avoid some of the more severe impacts of these trends. For example, exiting standalone commercial auto and repositioning our financial lines book.

Looking forward for North America, we believe that North America's underlying combined ratio is better stated around 98.5%. We have a new leadership team in place in North America under our CEO there, Todd Jones. Ex that weather impact, we saw good improvement in our attritional loss ratio. The rate environment there remains strong, was up 9% in the fourth quarter.

We've a more targeted strategy in place to selectively grow our mid-market corporate business. As I mentioned, we expect crop to return to a more normal level of performance, and our expense ratio reduced by 160 basis points in 2019 with further savings to come. And I'm confident that all of this means, we can expect a significantly improved result in North America in 2020.

I thought it might be useful to give you a few examples a more specific examples of some of the changes we've made on the back of our Brilliant Basics program. The industry worldwide has seen much heightened loss trends on directors and officers insurance. And we believe, we've got ahead of some of those trends by repositioning our books a couple of years ago.

North America on the left-hand side of the chart there, we repositioned the book to focus on private company D&O, as opposed to public company D&O, with public company D&O now just 20% of the book. We reduced our overall limits by 30%, and line sizes to a maximum of $10 million or less on all accounts. In parallel, we increased rates by 30%, and all of that resulted in a profitable portfolio, at the same time others are seeing significant losses.

And there seems a similar story in our London market D&O book, on the right hand side of the slide. We reduced our exposure to segments such as U.S. public company, pharma, Australian side C, while again increasing rate and again delivering a combined ratio in the mid-90s.

A couple of other examples. On our AusPac aviation book, we've taken a range of targeted underwriting actions to both reduce our sums insured and particularly our exposure to single-engine helicopters. At the same time, we are doing right through, the book and all of that resulted in a reduction of large losses by 18%, and improvement in attritional by 5% an improving our premium rate adequacy by 15%. And again, a profitable book of business.

And lastly, our London markets property book D&F, through its Direct and Facultative, which we've significantly re-under written over the past two years, reducing its exposures by roughly 50%. We refocused away from U.S. habitational risks and heavy industry risks, we've also materially reduced our exposures to North Atlantic wind or North American earthquake by more than 50%. A result of all of that, our attritional loss ratio is down by 20% and, again, we've got a profitable book of business.

Lastly, I thought it might be useful to show you a picture of our overall rate adequacy by cell. So, let's take a moment on here. The X axis there is our premium rate increases for the year. And our Y axis shows the rate adequacy by cell. So each bubble is a cell, the size of the bubble is relative to the size of the GWP, and the color coding you can see by division. Technical premium rate adequacy is defined as the premium we need to achieve a 12% return on the allocated capital of the set.

So a few highlights, probably lots of things you can take away from this. First of all, almost all of our GWP, 92% of the GWP is seeing rate increases. And kind of the only areas we aren't, which are the two cells on the bottom there are areas where there's legislative rate decreases, so CTP in New South Wales or workers comp in North America. And obviously, the average rate increases are 8% for the less adequate size in the company overall.

Secondly, worth noting the cells on the far right-hand side, where we are getting a better rate adequacy are ones where we take higher volatility, higher earthquake risk, higher cyclone risk or where we have a market premium level of expertise, so some of our London market industry specialisms.

The third, one -- and one of the most important is the dotted lines there, the average rate adequacy of all the cells taken together. The one on the left hand side is 2018 and then improving to the one on the right hand side in 2019, so a significant improvements in our overall rate adequacy of the portfolios. Actually had we shown you '17, it would have been further to the left again. Finally, and probably most importantly, there's loads more we can still do there, Whether that's the overall rate adequacy or the number of cells we've still got to the left hand side on the chart.

With that, thank you. And I will hand over to Inder.

Inder Singh {BIO 20396872 <GO>}

Thank you, Pat. Good morning, all. I'll take you through some of the details of our full year result, which demonstrates the continued improvement in the underlying quality of our earnings.

I'll start with our overall group's P&L. Gross written premium was up 2% on a constant currency basis. During the year, we completed sale of our operations in Colombia, Indonesia, the Philippines, Puerto Rico, our personal lines business in North America and our travel insurance business in Australia. Adjusted for these divestments, written premium was up around 4%. The combined operating ratio deteriorated by 1.8 points to 97.5%. This was almost entirely due to the severe weather related impacts on our U.S. crop business, which we had called out in our December market update.

Importantly, we delivered strong improvement in both our attritional claims ratio and our expense ratio. The total cost of large risk and cat claims was within our allowance for the year, and we fully absorbed the impact of the change in our group reinsurance structure in 2019. I'll provide some more color on these component movements shortly.

Pleasingly, our net annualized investment return of 3.6% was above the top end of our range of 3% to 3.5%. The significant extension in the duration of our investment assets over the last 18 months helped insulate our P&L from the movements in risk-free rates and also enhanced our returns.

Cash profit after tax was $733 million, adjusted for the Ogden decision, restructuring costs and discontinued operations. This equates to a return on equity of 8.9%, which was up around 90 basis points on the prior year. The effective tax rate of around 15% was slightly higher than 11% in the prior year, albeit still lower than our natural run rate, which is around the low-20s. We've declared a final dividend of AUD0.27 per share, which brings the full year payment to AUD0.52, and represents a 4% increase on the prior year.

Overall, I'm encouraged by the ongoing improvement in both the quality of our earnings and the strength of our balance sheet. During 2019, we bought back nearly $300 million worth of QBE shares. and when combined with our full year dividend, we will have returned close to $1 billion to shareholders for the second consecutive year.

I'll now briefly walk you through the year-on-year movements in our combined ratio. As you can see from the waterfall, our combined ratio deteriorated by 1.8 points from 95.7% in the prior period to 97.5% in 2019. The first block on the chart represents a restructure of our reinsurance program. As we had previously flagged, this impacted our combined ratio by around one point. Pleasingly, we finished the year within our overall allowance for large risk and CAT claims.

Large risk losses were slightly higher than planned, but lower than last year on a like-for-like reinsurance basis. The second block shows that movements in prior year reserves have had close to a net zero impact on our result in 2019, compared to the 1 point benefit we had last year. We strengthened reserves in specific U.S. and European casualty lines, but this was almost entirely offset by a combination of reinsurance recoveries and continued favorable reserve development elsewhere across the group.

The third block on the chart represents a two point impact from the performance of our U.S. Crop business. As you're aware, our crop result was impacted by severe weather and delivered a combined ratio of 107.5%, relative to a 10-year historical average of around 90%. Importantly, we continue to achieve strong, sustainable improvements in our attritional claims ratio, and we're making good progress on our cost out program. Collectively, these initiatives have contributed to around a 2.5 point year-on-year improvement in our combined ratio.

I'll now turn to our divisional performance in more detail. I'll start with our home market of Australia Pacific. Gross written premium of $3.92 billion was up 3% in constant currency terms and up 4% when adjusted for the sale of our travel insurance business and the contraction in lenders' mortgage insurance. The attritional claims ratio improved by an impressive 4.2 points. We continue to carefully track how our pricing and underwriting actions are translating into sustainable improvements in the attritional claims ratio.

To give you some specific portfolio examples, in commercial property, we achieved a rate increase of 17% and a year-on-year improvement in the attritional claims ratio of 9 points. In workers comp, we achieved a rate increase of 7%, and the attritional is down around 9 points. Similarly, in our strata business, we achieved a rate increase of 12% and the attritional is down around 11 points.

Despite elevated CAT activity in 2019, including flood events in Townsville towards the start of the year and the recent catastrophic bushfires, AusPac delivered a strong combined ratio of 90%. As you can see from the middle two bricks on the chart, the 2019 result had a lower benefit from prior year reserve releases, with favorable development largely attributable to the New South Wales CTP scheme and lower than expected average claim sizes in the recently privatized South Australian CTP scheme.

Our lenders' mortgage insurance business delivered a combined ratio of 58.3%, a slight uptick from the 54.8% recorded in 2018, mainly driven by premium contraction. To give you some context, the underwriting earnings contribution from LMI has reduced from around $300 million at its peak in 2014 to around $60 million today. The expense ratio in AusPac was broadly flat with meaningful underlying savings offset by reduction in fee income and higher regulatory and compliance costs.

Moving now to our international business. Gross written premium of $4.9 billion were up around 4% in constant currency terms with 5% growth in European operations, partly offset by a decrease in Asia due to remediation and the country exits I referenced earlier. Overall, our gross international premium rates increased by around 6% with the retention steady at around 80%. The headlined combined ratio of 95.4% was 0.5 point better than the prior period.

A couple of key points to call out here. The attritional claims ratio improved by 3 points to 43.1%, the restructure of our insurance program that I referenced earlier had the most pronounced impact on the international business translating to around a 3 point headwind in 2019. The total cost of large risk and CAT claims was broadly within our allowance for the year, albeit with risk losses moderately higher than planned. The net impact of prior year reserve movements is broadly in line with 2018.

Adverse development in financial lines and to a lesser degree international property and commercial motor was largely offset by reinsurance recoveries and favorable development in UK liability in Marine and in Asia. Total acquisition costs, including commissions and expenses improved by just over one point, with underlying cost savings partly offset by additional VAT associated with Brexit and the establishment of our new entity in Brussels.

Turning to North America. I'll keep my comments here relatively brief, given Pat has covered some aspects of the result. Gross written premium of $4.6 billion increased by around 3%, adjusting for the sale of our underperforming retail personal lines business. As noted earlier, a severely weather affected crop result, combined with adverse prior year claims development drove a headline combined ratio 106.5% compared to 98.7% in 2018.

The attritional claims ratio was broadly flat year-on-year, but when adjusted for the elevated frequency of small weather events, showed an underlying improvement of 1.7 points. The total cost of large risk and CAT claims was in line with our 2019 allowance. As Pat referenced earlier, the strengthening of prior year reserves impacted our result to the tune of a $112 million or 2.8 points.

Simplification of our business in North America is an important component of our overall efficiency program and we've seen a meaningful improvement in the expense ratio from 14.4% to 12.8%, benefiting from portfolio exits, the reset of our operating model and associated headcount reduction and rationalization of legacy technology.

Turning now to operational efficiency, and you'll recall that we're targeting around $200 million of gross cost savings, $130 million of net savings, and an expense ratio of less than 14% by 2021. On a headline basis, and as you can see from the chart, expenses are down by around $100 million from our 2018 starting point of $1.8 billion, and the expense ratio has decreased 60 basis points from 15.2% in 2018 to 14.6%.

Just to call out a couple of moving parts between 2018 and 2019, we've had some benefit from FX movements, but this has been largely offset by the loss of fee income and higher VAT in Europe related to Brexit. Of the $100 million headline improvement, we've achieved run rate savings of closer to $70 million, when adjusting for some one-off benefits such as lower incentive payments.

The savings that we've achieved in 2019 have come from a number of different areas; the simplification of our technology estate including the rationalization of legacy systems, the sale of our inefficient personal lines business in North America, productivity improvements within our shared services operation in the Philippines, simplification of our organizational structure and operating models in each of the divisions including our Group Head Office, and a meaningful reduction in third-party consulting and travel costs. We remain on track to achieve our three-year expense target, including a sub 14% expense ratio by 2021.

Turning now to investment performance. We delivered a net investment return of 4.6% compared to 2.2% in the prior period. If we exclude the impact of the movement in risk-free rates on our liabilities, the investment return was 3.6%, above our target range of 3% to 3.5%. Fixed income assets generated a return of 3.7% compared with 1.8% in the prior period, and growth asset returned 11.8%, up from 6.2%. Importantly, we've outperformed our fixed income and broader market benchmarks.

We've significantly extended our asset duration from 1.6 years in 2017 to 2.6 years at the end of 2019. This has helped close the duration gap between assets and liabilities, which in turn has materially de-risked our balance sheet and supported a higher investment return. Absent of this duration extension, we would have had an earnings hit of over $200 million from the fall in risk-free rates in 2019.

It is also worth highlighting that our funds under management have increased by almost 7% during 2019, and we finished the year with investment assets of around $24.5 billion. This partly reflects the cash flow benefits from restructuring our reinsurance program and moving away from the old, deeply in the money aggregate structure that we had in place between 2015 and 2018.

Going forward, and to align more closely with peer reporting, we are reclassifying high-yield debt and emerging market debt holdings, out of growth assets and into fixed income. We've also started to deploy around a 2% allocation into private credit where the additional liquidity premium offers incremental risk adjusted returns.

With these changes, our pro forma fixed income running yield is was approximately 1.75% and this underpins our 2020 guidance range for investment returns. Collectively, we believe that the actions we've taken over the last 24 months have made our investment portfolio more fit for purpose for a low interest rate environment.

I'll conclude with some remarks on our balance sheet and capital position. Our APRA PCA multiple at year-end is 1.71x, which is around the midpoint of our target range. A couple of points to note around our PCA. Our 2020 reinsurance program has been further enhanced to offer better balance sheet protection, and this has reduced our insurance concentration risk charge. However, this benefit has been more than offset by higher asset risk charges associated with growth in our investment book plus the extension in duration and the net distribution of capital to shareholders through dividends and share buybacks.

Our S&P capital position remains strong with an excess above AA minimum capital levels. Our outstanding debt is down $0.5 billion from 2017 levels. However, the combined impact of our share buyback, the adoption of AASB 9 and a stronger US dollar has meant that our debt to equity ratio remains around 38%. We bought back almost $300 million worth of QBE shares during the year. And since the commencement of the buyback program, we've repurchased around $770 million of shares at an average price of $11.26, resulting in the cancellation of around 5% of our issued capital.

As we move into 2020, we're starting to see some organic growth opportunities in targeted pockets of our business, as well as inorganic opportunities such as small team lifts. As a result, we've decided to pause the current share buyback program. We'll continue to evaluate our broader capital management options including opportunities to reduce gearing and/or create capacity to pursue growth opportunities.

With that, I'll now hand back to Pat to talk through our outlook.

Patrick Regan {BIO 15131018 <GO>}

Thanks, Inder. At the beginning of the presentation, I talked about the program of work over the last few years and how it's delivered sustainable improvements on our underlying combined ratio. Our 2020 priorities represent a continuation of that program of work.

Cell reviews and Brilliant Basics will continue to be at the core of QBE. Brilliant Basics plus, will be more comprehensive, more forward-looking and more data driven. We will increasingly leverage best data science, artificial intelligence where we can and our digital capabilities across pricing, underwriting and claims. We'll continue to invest in our talent and develop our culture. And we will increase our focus on our customer commitment program, building on the strong foundations over the last few years.

We look to develop greater industry expertise, use digital technologies to create seamless end-to-end customer experiences. And we will also continue our work on modernizing the company. Multiple automation projects, digital and robotics projects. And this is a meaningful lever in our expense reduction program. We'll also use QBE Ventures, and other innovation partnerships to help cultivate the skills and capabilities we need for the future.

Finally on guidance, notwithstanding the heightened level of weather activity we've seen in Australia so far this year, we reaffirm our 2020 operating ratio guidance and net investment target ranges as announced in December.

Finally, I'd like to thank our outgoing Chairman, Marty Becker, for his stewardship of QBE over the past six years. As you may recall, Marty took the reins in a particularly difficult time for QBE, and his industry knowledge, his experience and his wise counsel have been invaluable to me, and indeed the rest of the Board. And so, I'd like to publicly thank Marty for his service to QBE's Chairman, and to wish you all the best for the future.

Fortunately, our incoming Chairman is extremely well known to me and to all of you. As we should make for seamless transition and I very much look forward to working with Mike going forwards.

In closing, I'm pleased with the progress we've made in 2019. We are well-positioned heading into 2020, with a supportive rate environment and a clear program of work. Thank you.

Questions And Answers

A - Patrick Regan {BIO 15131018 <GO>}

(Question And Answer)

Q - Andrew Buncombe {BIO 19921333 <GO>}

Thank you. Andrew Buncombe, Macquarie Securities. Congratulations on the results. Just a couple of questions on the reinsurance program to start please. Just on Slide 32, it looks like the per occurrence excess has dropped from $10 million to $5 million. I just wanted to cross check, that, that doesn't change the definition of attritional for next year.

A - Patrick Regan {BIO 15131018 <GO>}

You are right. It does for the use of the aggregate, and no it doesn't change the definition of attritional, we will keep it the same.

Q - Andrew Buncombe {BIO 19921333 <GO>}

Perfect. And then the second question on the reinsurance program, given the number of natural catastrophe losses so far, well, in January this year. Maybe just some comments on how you're going against the excess of the aggregate for 2020 already? Thanks.

A - Inder Singh {BIO 20396872 <GO>}

Yes, look thank you, Andrew, for the question. If you look -- if you take our cat allowance for the full-year, the first quarter is roughly one quarter that fully year's allowance. And Australia-Pacific is roughly one half of that quarter. If

tThat makes sense. I'll give you a moment to follow the maths.

Then we're a bit over that, so far. So in Australia-Pacific, we've used a bit more than our first quarter allowance so far, mid-February. That doesn't mean, we're particularly close to the Group's aggregate at the moment. Because obviously, that's the -- our full year cat allowances are roughly equivalent to that attachment point. Obviously, there's still much of the rest of the year to go. Hopefully that was clear.

Q - Andrew Buncombe {BIO 19921333 <GO>}

Now, that makes sense. And then the last one was just on customer retention in the US. it's obviously, stepped down a little bit in FY '19, just some thoughts there, please?

A - Patrick Regan {BIO 15131018 <GO>}

Okay. It was very much a couple of targeted portfolio. So our corporate mid-market business and particularly, the excess and surplus lines business. So the latter of those two excess and surplus lines, we did a lot of work on in '18 and in '19 repositioning the book of business. And that's one book of business that had been in 2017, writing more of the stuff that has attracted more of what people call social inflation. So we repositioned that book of business significantly in '18 and '19. I would expect therefore, retention to be higher in the US in 2020.

Q - Siddharth Parameswaran {BIO 15037291 <GO>}

Hi. It's Siddharth Parameswaran from J.P. Morgan. Couple of questions if I can. Firstly, just premium rate increases versus claims inflation, very strong numbers 8.3% on the premium rate side, but usually there's a reason for that in the market. I was just wondering if you could comment on what you're seeing in terms of claims inflation?

A - Inder Singh {BIO 20396872 <GO>}

Yes. I mean less than 8.3% would be the first thing, I'd say. A bit higher in the aggregate I mean obviously we're operating all around the world. Things like workers' comp in most places of the world you continue to see relatively low inflation, wage inflation still low, and workers' comp hasn't really attracted social inflation. Plenty of lawyers are more going after liability, directors and officers that kind of stuff.

So workers' comp will still be low. You are seeing a bit higher in things like Auto, and obviously higher in things like liability kind of claims. So probably in the -- I think most folks in the world -- around the world, are calling something in the four maybe a bit higher, four to five kind of range, which is probably one point or so higher than we would have seen. Right now though, the premium inflation is running in excess of that.

Q - Siddharth Parameswaran {BIO 15037291 <GO>}

And just the reserve increases that we have seen in both the international business and also in North America, just can you give us any comfort that this won't continue for a while, we've certainly seen regulators in the UK for instance flag that they see to as an issue, that flag concerns around superimposed inflation. Can you give us --

A - Patrick Regan {BIO 15131018 <GO>}

Sure. And what we've been through it in both books. I mean, UK was very much financial lines, and the US it was things that are kind of casualty driven, so a bit on the E&S book a bit in this assumes were either reinsurance book and a bit in the mid-market corporate book. In the U.S. And in the UK for that matter, it all relates to activity generally speaking, the vast majority to activity pre our re-underwriting over the last couple of years.

So, that's helped us avoid larger amounts and gives us comfort that the underwriting we're doing now is better positioned. I'll give you a couple of examples of D&O, where we moved it away from business that's attracting kind of heightened loss activity. And secondly, we think we've been through the books of business and picked out where we needed to top a bit up. There were no prizes for leaving 2019 heroically. We wanted to make sure that we dealth with reserving where we needed to.

Q - Siddharth Parameswaran {BIO 15037291 <GO>}

Just the final question. Just on the growth outlook. I mean, we have a couple of years, where we've seen portfolio remediation, the numbers, the folks 4% growth that you're seeing ex -- the portfolio exits that's still below the 8.3%. How should we think about next year? Particularly bear in mind that you have canceled the rest of the buyback?

A - Inder Singh {BIO 20396872 <GO>}

Look, I'd like to think we can grow more in line with rate, but we haven't done it so far. We do think that we are kind of through we don't need to reposition our portfolios. We've sort of done that now over the last couple of years in all divisions including North America.

We want to grow selectively and gradually but grow our mid-market business, we think here, we've been growing things like commercial packages, gently, we can grow the business overall, not dramatically, and maybe it's only just in line with rate. But I'd like to see if we can do a little bit better on that in 2020 than we've done in 2019.

Q - Matt Dunger {BIO 20863237 <GO>}

Thanks. Matt Dunger from Bank of America Securities. If I could first to ask about the cost savings, what benefit have you got factored into FY '20 guidance? And also, and you talked to FX thing beneficial for achieving cost savings, does this mean given if right stay where they are FX rates that we should expect higher than what you originally planned in terms of cost out?

A - Inder Singh {BIO 20396872 <GO>}

Yes, sure. In terms of the outlook. So as I said, I think we feel we're well on track to continue to see a reduction in our expense ratio going forward. So we'll see that comes through both in 2020 and then obviously to less than 14% by 2021. In terms of the areas and the impact of FX. I mean it's, as I said, we had some headwinds as well as in higher fee incomes and that taxes, we had to cover so, in the round FX is not really creating a major concern.

A - Patrick Regan {BIO 15131018 <GO>}

I think we're pleased with how we've gone. We're probably done a bit more than we thought we were doing a new one and there's more to come but I think that's -- this deliver 2020 before we do anything more.

Q - Matt Dunger {BIO 20863237 <GO>}

Thanks. And if you could just take impose the investment return target of 2.5% to 3% traditionally. You've given guidance around the growth versus defensive versus changes in the tactical asset allocation and duration, if you able to --

A - Patrick Regan {BIO 15131018 <GO>}

Sure. Indar, can answer this question?

A - Inder Singh {BIO 20396872 <GO>}

Yes. Sure. Look, I think very simplistically, so we're saying growth assets of 12.5%. The fixed income book at 87.5% in terms of total allocation. As I said, we slightly tweaked the definition of that to move some of the fixed income assets in line with peers into the fixed income portfolio. So, I'd say take the 1.75% as our running yield on the 87.5%, and then we assume around 7.5% on growth assets on the 12.5% and to that we add some tactical asset outperformance of kind of call it 20 basis points to 30 basis points, so that kind of gets you to the mid-point of our range.

Q - Matt Dunger {BIO 20863237 <GO>}

Great. Thank you very much. And if I could just ask a final question on, are there any acquisition opportunities underway? You've called out potential for lift out anything you are considering so you can give us a bit of color around what you could do here?

A - Inder Singh {BIO 20396872 <GO>}

No, not really. The --I mean, we as I say, we'd like to grow a little bit more organically and there were a few team opportunities is more what we're attracting a team of people across in various parts of the world, but not really at what we'd traditionally call, M&A.

Q - Matt Dunger {BIO 20863237 <GO>}

Thank you.

Q - Andrei Stadnik {BIO 18854292 <GO>}

Good morning. Andrei Stadnik from Morgan Stanley. Just wanted to ask about your guidance. It appears that, in some ways quite conservative, dropping from 94.5%, 96.5% now dropping 93.5%, 95.5% and yet you have, rate increases well ahead of inflation. You have normalizing improving LMI performance in Australia and you also have cost savings coming through. So what is holding you back from having better guidance for 2020 or are you preferring to build a safety margin around that instead?

A - Inder Singh {BIO 20396872 <GO>}

Look, I mean, we just posted 97.5% for last year and the country has been on fire for the entire month of January. So I think look, let's just as we talked about a bit earlier with Sid's question, there's more to navigate this year, it's not -- you don't just post your 8.3% and deduct four points of claims inflation whatever it is, there's stuff. We've got to be skillful in terms of where we position our books? Where we grow? Where we don't grow? If we want to grow? We are going to do that skillfully or, not skillfully. So, what's the risk? rate and that makes our life certainly a little bit easier. There's still plenty of things to do to make sure that actually you get to deliver your kind of loss ratios as expected avoid undue large losses. So, I think we just want to post a year in line with or -- if we can do slightly better than we're targeting.

Q - Andrei Stadnik {BIO 18854292 <GO>}

Thank you. And second question. Just thinking about the LMI business in Australia, the outlook of the business has changed dramatically in the back through rate cuts and house price increases going annualized from negative 15%, 20%, now to annualized positive in that region, -- pretty amazing turnaround. I mean, -- just thinking why does this business need to be part of QBE? And given the nature of cat risk and LMI is so different, and a catastrophe in LMI is a recession in three years' worth of drag on capital impact on the group. Is now a good time to rethink whether LMI should be part of QBE?

A - Patrick Regan {BIO 15131018 <GO>}

I'll dodge answering that question specifically I think. I think, look, I mean your points a good one. I think, first and foremost, we wanted to reduce the kind of capital we were deploying to that business, and the earnings dependency we had on the business I mean to quote our couple of months numbers, we were $300 million before, we're kind of $60 million now. And that feels better the rest of the P&C business. I mean if we were to continue that trend over time by hook or by crook, that will probably be a good thing as well.

Q - Andrei Stadnik {BIO 18854292 <GO>}

Thanking if I can ask kind of a third bonus question. Just thinking about the extra wrap insurance kind of we have this year from $600 million to $500 million. How useful will that be to QBE, and then what kind of circumstances will that help QBE out? And also then how much did you have to pay out to get that extra coverage?

A - Patrick Regan {BIO 15131018 <GO>}

So the reinsurance program overall, you sort of need to look at overall and overall, our cost was broadly in line we -- as you remember, we renewed 50% of it, so it was broadly in line. Costs are really only going up for parts of not really on property rates, parts of casualty rates. Our loss activity, large loss activities has been trending in the right direction. So it meant overall, we didn't really see increases.

On the program overall, we talked about the per occurrence deductible has fallen for the cat, aggregate program that helps us a little bit. We have got increased cyber coverage which helps us a little bit and we got increased crash coverage which helps us a little bit on the occurrences where you get kind of more than one large loss happening. So they were kind of tweaks, if you like, the rest of the program really does look in probability very similar for 2020 to, what it did in 2019 at roughly the same cost.

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

Brett Le Mesurier from Shaw and Partners. The net cost of the change in the reinsurance arrangements this year was 1% of net earned premium, The increase in catastrophe and large costs allowance was 2.5%, which implies the benefit to the attritional claims ratio was 1.5%, being slightly over half the reduction in attritional claims ratio during the year. Is that how you're seeing?

A - Patrick Regan {BIO 15131018 <GO>}

Yes. So, of the two points increase in larger and risks that's offset by about a point lower any -- sorry, benefit to NEP from lower insurance cost. Part of which helps the attritional loss ratio just in the numerator denominator. I think, the math is about 80 basis points, brett, is the number there, if that helps it.

Any of the questions, we have waiting on the phone. We do have some on the phone, Kieran?

Q - Kieran Chidgey

Hi, Pat, hi Indar. A Couple of questions. Just circling back on some earlier topics. Firstly around the loss ratio improvement, with some very good attritional loss ratio improvement, but the large risk claims seem to be higher than you expected. So just how confident are you that the improvements around Brilliant Basics and underwriting generally having a desired effect around some of those claims? Is it just a poor period of experience or do you think there's something a bit more systemic across a number of portfolios you need to be mindful of?

A - Patrick Regan {BIO 15131018 <GO>}

Look, I mean, we are seeing -- a good question. We are seeing a reduction in large losses across the Group for '19 versus '18 and '18 versus '17, and actually versus '16 as well. So there is a gradual reduction. We are planning for a further reduction not seismic amounts but a further reduction in '20 versus '19.

So, yes, we can see evidence of that, it's probably most obvious here in the AusPac business, where we've been at the program of work for longest and we can see the most clear trends. You can also see that benefit coming through the North American business. But equally, your points are right. You got to be real smart. There are a lot of pockets of increased loss activity in the industry that we've kind of touched upon on casualty liability kind of claims that you need to be smart to make sure that notwithstanding Brilliant Basics et cetera, we are being smart. Generally speaking, we feel okay about that. We're not perfect. But generally speaking, we are seeing improving trends.

Q - Kieran Chidgey

Okay. And secondly, related to that when we look forward to the 2020, combined ratio guidance. Can you just give us some broad feeling for what your expectation is around that cat and large risk allowance for next year? And secondly, around reserve releases or obviously [ph] risk something fairly neutral on reserves?

A - Patrick Regan {BIO 15131018 <GO>}

So, cat and large we're calling it the same number. Obviously, we'd were roughly on that number almost precisely for 2019. We anticipate the shape of that being slightly less large and we've allowed for slightly more cat at the margin. And I will take my traditional response to the reserve releases of not giving you a specific answer on that.

I think, look we did want to make sure that we look at areas where there could be larger loss activities, we left 2019. We've seen positive lost development in AusPac for some time albeit as Inder's noted and I think others have noted that, overtime , we will see lower positive prior year coming from New South Wales CTP.

Q - Kieran Chidgey

Okay. And just a final question on the reserve commentary. I noted earlier, you said that, most of the top up had been in prior years -- prior to 2017, ahead of the introduction of a lot of your underwriting improvements but the statutory declarations and simply your claims development triangle in the annual report today, so just most of the top up seems to be sitting in the 2018 years. So, can you just reconcile those points?

A - Inder Singh {BIO 20396872 <GO>}

Yes, Kieran, octons in 2018, and actually the whilst the top-ups were primarily in '17, '16, '15. So were some of the surpluses we got off workers' comp and CTP et cetera. So that's what sort of nets to the relatively small numbers in those years.

Q - Kieran Chidgey

Perfect. Thank you.

A - Inder Singh {BIO 20396872 <GO>}

We will not there Ancially, Nigel actually might be.

Q - Nigel Pittaway {BIO 3406058 <GO>}

Thanks. Guys, I have first question then just on the reserve top-ups. I mean, obviously when you did the downgrade in early December you're saying, you're not particularly concerned about those trends that are sort of appearing in the North American casualty lines. It does seem to be one of the reasons why the combined was just a little bit worse than you were guiding to in early December. So what changed, I guess since early December to sort of having to -- sort of do those top-ups now?

A - Patrick Regan {BIO 15131018 <GO>}

Look, Nigel, I would say that the predominant thing that changed from early December to now was the bushfires in Australia, that's what we booked. And obviously the losses in from this mid-December to the end of December were pretty significant for us and for others. So that was the biggest single factor. We might have booked up a tiny bit more in North America loss reserves as we went through that period, but really at the margins.

Q - Nigel Pittaway {BIO 3406058 <GO>}

All right. Okay. So I mean you are still very comfortable that those trends that are -- I mean, I'm sort of pivoting to earlier questions to degree, but you are still very comfortable that those trends in the US are not going to sort of offset, materially offset the premium rate rises moving the benefit of the premium rate rises moving forward?

A - Patrick Regan {BIO 15131018 <GO>}

Look, we think so, and I say that partly because we have positioned those portfolios kind of differently now. When then, you will have seen from some of the competitor commentary the public company D&O there is that was really difficult. But we've really pulled back on that. And we're just doing for small ticket stuff there. Commercial auto is getting a lot of loss activity. We only do that, as we don't do any standalone commercial auto and only do that as part of packages. So, A, we're getting good rate, and B, we think we've moved the portfolios away from some of the really heightened loss activities. So yes, I think so.

Q - Nigel Pittaway {BIO 3406058 <GO>}

Okay. And then maybe just also following-up on this sort of you hope to get the top-line more in line with rate prices moving forward. I mean, obviously you've got 9.2% fourth quarter ex CTP. So that's still quite a gap between what you've been achieving I mean are there any other sort of impediments that sort of mean that there will remain a significant difference between those two numbers? I mean, I know you flagged I think ,a small amount of GWP of $150 million but is there anything else that we should be thinking about in terms of sort of trying to work at how much of those rate rises to actually flow through to the top-line?

A - Patrick Regan {BIO 15131018 <GO>}

Look, not mathematically, Nigel, no. But it's different things between me saying it and us doing it isn't it? So and it's been a while, since we grew organically at QBE. So I think that's a not a new skill, but sort of a relearned skill, and we do need to pat our tummy and rub our head at the same time or the other way around. So look not mathematically, no. But I should only really talk about it when we've actually done it.

Q - Nigel Pittaway {BIO 3406058 <GO>}

Okay. Thank you.

A - Patrick Regan {BIO 15131018 <GO>}

Thank you, and then I think Ancially.

Q - Analyst

Good morning, guys. I just had a first question on the commission expense line, quite a big degree of improvement there year-over-year on the commission ratio, just into '20. Should we be thinking that the full-year result in the mid-15%, since is sort of a fair guide into '20 or it looks something closer to where the second half of '19 was?

A - Patrick Regan {BIO 15131018 <GO>}

Yes, I mean I think kind of broadly the full-year '20 in line with full-year '19 is a good proxy.

Q - Analyst

Okay. That's useful. Thank you and just picking up on the comments around like cat and large risk allowance into next year. Can we assume that you are also budgeting for maybe around $900 million of large risk and about $600 million of cat?

A - Inder Singh {BIO 20396872 <GO>}

I mean they are ballpark proximate, yes. Large is slightly lower and cat is slightly higher ballpark.

Q - Analyst

Okay. Great. Thank you.

A - Patrick Regan {BIO 15131018 <GO>}

Thank you. I think, we have got no more questions on the line, and no more in the room. So, thank you everybody, and we look forward to seeing you all soon.