Berkshire Hathaway Inc.

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Special Call

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Call Participants

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Warren E. Buffett
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Presentation

Michael John Wilkins
Former Executive Officer

Good morning, everyone, and thank you for joining us today at such short notice. We really appreciate you doing that. For those of you who aren't able to join us in the room in Sydney, Nick Hawkins, our Chief Financial Officer, has also joined me today for our presentation.

Today, we're delighted to be announcing a landmark strategic partnership between IAG and Berkshire Hathaway. As people know, Berkshire Hathaway is one of the world's largest and most successful companies. We see this partnership as a significant endorsement of IAG's strong franchises, our market positions and our long-term strategy. I will expand on the details in a moment, but the key elements are threefold. Firstly, an exclusive business partnership across our respective Australian and New Zealand operations; a 10-year, 20% whole-of-account quota share agreement; and an immediate $500 million equity placement to Berkshire.

From IAG's perspective, the strategic rationale for this partnership is compelling. It leverages our complementary operating capabilities in Australia and New Zealand. It serves to reduce volatility in our future earnings and it enhances our capital flexibility and diversification. This provides us with significant scope to pursue future growth opportunities and to consider potential capital management.

In terms of the overall financial impact, all of this aligns with our delivery of our target through-the-cycle 15% return on equity. In short, we believe that this is a win-win situation for both partners, but it does significantly strengthen the long-term outlook for IAG and for its shareholders.

Berkshire Hathaway probably needs little in the way of introduction to you being 1 of the 10 largest companies in the world. What's perhaps a little less appreciated is the length of the existing relationship between IAG and Berkshire. IAG has had a reinsurance relationship with Berkshire since the year 2000. That relationship has developed and it's deepened over the years with a growing presence on our catastrophe program, accompanied by assistance at key junctures in IAG's recent past.

We view today's announcement as a step-change in our relationship with Berkshire and a logical next development in that relationship. But I think Berkshire views it very similarly, and let's now hear from Warren Buffett on his perspective of today's announcement.

Warren E. Buffett
Chairman of the Board and Chief Executive Officer

Hi. I'm Warren Buffett, CEO of Berkshire Hathaway. And as many of you know, Berkshire is a large, very diversified company here in the United States. But despite the fact that we're in a great many businesses, our first love, our longtime love, our future love has always been the insurance business. Very shortly after I took over as CEO in 1965, 2 years later, in 1967, we entered the property casualty insurance business with a commitment of about $8 million, and now we have an insurance operation that has a net worth of far in excess of $100 billion, so our Board of Directors, our managers, our shareholders, all love the insurance business.

And in the course of that business, 15 years ago or so, we entered our first commercial transaction with IAG. And as the years have passed and we've gotten to know them better and they've gotten to know us better, we've both found a great deal of admirer in each other's organizations. So very recently, we decided to cast aside a commercial relationship and established a very important and enduring partnership arrangement.

IAG is a terrifically strong company with great strengths in many areas and Berkshire's got some strengths. And we believe by bringing these 2 companies closer together as partners, that each company will benefit in a very substantial way. And even though this contract runs for 10 years, I expect for decades and decades and decades to come that both companies will benefit in many ways that we can't even, perhaps, visualize right now.

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So I'm looking forward to it. Our managers are looking forward to it. Our shareholders are looking forward to this partnership. And I can't tell you how delighted I am to be with it. And I should add one small footnote, in fact, it's sort of a confession, I'm 84 years old, and this is my first investment in an Australian company. I mean, I've been very derelict. But it's been worth waiting for. We've now picked the best and we've entered into an area of the world where we've done some business before, but now we're coming in with an ownership position. And better late than never and better the best than ever. So here we are in Australia, and I'm delighted to be here.

Michael John Wilkins
Former Executive Officer

As you heard from Warren, I think both us believe that this is a win-win partnership for our respective organizations.

Now if we look at the strategic relationship, firstly, how that relationship will apply to our Australia and New Zealand operations. As part of our partnership, Berkshire Hathaway will transfer to IAG any personal and SME exposures and business opportunities in Australia and New Zealand. In return, IAG will transfer its existing large corporate property and liability exposures to Berkshire on renewal. The overall effect is that we'll be able to draw on each other's strengths to better service our customers and to deliver superior business outcomes. This is a long-term arrangement for an initial term of 10 years, but as you heard Warren say, our expectation is that this will be an enduring partnership.

I'll now ask Nick to walk you through the quota share and the capital aspects of our partnership.

Nicholas B. Hawkins
Chief Financial Officer

Thanks, Mike, and good morning to everyone. As we said, we're very excited about this strategic partnership that we've announced today and the impact that's going to have on IAG going forward.

The second leg to the strategic partnership is the quota share, which commences 1 July, 2015, and applies to 20% of all IAG-consolidated business. It's for initial 10-year term and serves to increase our financial flexibility and our capital diversification.

The quota share is expected to result in a reduction of our capital needs of approximately $700 million over the next 4 to 5 years with approximately $400 million of that captured in the 2016 financial year. It also results in significantly lower requirement for catastrophe reinsurance cover and it reduces the group's earnings volatility. This is achieved through the increase commission income component to our earnings and our lower exposure to potentially volatile global reinsurance rates.

The impact on our financials is to reduce our net earned premium by around 20% and it increases our insurance margin by roughly 200 basis points. The quota share and the changes to our earnings mix through the higher commissioning element also increase our confidence in delivering our through-the-cycle 15% ROE target.

Our capital position has also been strengthened through the equity placement to Berkshire. This cements the strategic and long-term nature of the relationship that we have established with them. The placement of $500 million is equivalent to -- is approximately 3.7% of our expanded equity base and is issued at yesterday's closing price of $5.57. As part of the partnership agreement, we also have a 24-month option to place up to an additional 5% of our expanded issued capital to Berkshire. This is equivalent to over 120 million shares and will be priced on a 5-day VWAP prices if we choose to exercise that option subject to a cap at $6.50 per share.

The subscription agreement with Berkshire also includes another -- other elements, including a standstill clause, which limits Berkshire's overall ownership to 14.9% of IAG. The requirement of Berkshire must at least maintain its initial stake in IAG for the duration of the quota share. And Berkshire's commitment to vote in accordance with the recommendations of the IAG board, while retaining freedom to vote as it sees fit on the remuneration report and director appointments. As you can see, all of this has been structured in a way that is aligned to our strategic partnership.

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The combination of the quota share and the equity placement materially increases the group's capital position. The equity placement sees us comfortably above our targeted benchmarks and that effect will be immediate. The impact of the quota share is over a more extended time frame, but as I mentioned earlier, over half of that will be in effect -- half of this will affect the 2016 financial year.

We acknowledge the modest dilutionary effect that the new share issue will have on earnings per share in the short term. Over the longer term, however, we expect our partnership with Berkshire to be earnings accretive for us as we fully realize the capital and the operational benefits that are available.

It remains IAG's intent to manage its capital in a disciplined and efficient manner, and we reconfirm our long-term target ratios of 1.4 to 1.6 of our prescribed capital amount and 0.9 to 1.1 of our common equity Tier 1. Our materially strengthened capital position gives us considerable flexibility to pursue both growth opportunities and consider capital management options at the appropriate time. It is not our intention to be above our capital targets over the medium term.

I'll now hand you back to Mike to address our strategy and the group's outlook.

Michael John Wilkins
Former Executive Officer

Thanks, Nick. IAG's strategy and our strategic priorities are essentially unchanged. It's this strategy that Berkshire Hathaway is supporting as it enters into the strategic partnership with us. Our strong businesses in Australia and New Zealand represent the majority of the group, and we don't see that changing. These markets continue to contain growth opportunities for us, however, we also seek continuing opportunities in our target markets in Asia.

Now for all of you, our ambitions in Asia are nothing new, and we continue to see enormous potential in the region. Some of the opportunities you'll be aware of, such as the dial-up of our interest in India, which we're actively pursuing at the moment and which we expect to be finalized by the end of this calendar year. Also, we recently announced an investment in our sixth target market, Indonesia. This small first step saw us acquire a business with an insurance license, which is a precursor to entering into an agreement with a local distribution partner.

We also see a number of further opportunities now emerging in Asia. These include participation in any potential industry consolidation in Thailand and further opportunities to expand our presence in Malaysia by our highly successful joint venture, AmGeneral. And as a result of recent regulatory changes, we're exploring further opportunities in China and specifically those that give us a Pan-China exposure.

Asia continues to represent an important plank of IAG's strategy given the relatively low penetration of insurance in our target markets. This allied with the rising affluence and consumption of the emerging middle classes presents an opportunity, which we believe all forward-thinking Australian companies should be pursuing.

And now to our outlook. Our guidance for the 2015 financial year is unchanged from that which we presented at the end of April. On that occasion, we lowered our reported insurance margin expectation to a range of 10.5% to 12.5%, following the extreme weather events that we'd experienced earlier in the year. Our underlying assumptions are also unchanged, however, they do remain subject to the finalization of our year-end processes and valuations. Our GWP growth guidance remains at the lower end of our 17% to 20% range as updated in February.

And today, we're also providing a first look at our expectations for the 2016 financial year. For that year, GWP growth is expected to be relatively modest, reflecting the competitive conditions that we're seeing in the main markets in which we operate and the continuing relative absence of claims inflation pressures.

Our reported insurance margin expectations for 2016 are in the range of 14% to 16%. This includes further realization of the benefits from the integration of the former Wesfarmers businesses as well as those arising from the move to our new operating model in Australia. It also captures the reported margin benefit from the quota share arrangement, which is of the order of 200 basis point. Whichever way you look at it, our underlying profitability in 2016 is expected to again be strong.

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So in summarizing today's announcements, we believe the strategic partnership that we've announced today is significant and it's a very exciting development for IAG. It closely aligns us with a long-standing business partner while also providing clear benefits from all perspectives of the customer offering, strategic and capital flexibility and reduced earnings volatility. Today's announcement places IAG in a very strong position, and it allows us to face the future with considerable confidence.
With those comments, Nick and I are now happy to take any questions that you might have. [Operator Instructions]

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Question and Answer

Kieren Chidgey
Deutsche Bank AG, Research Division

Kieren Chidgey, Deutsche Bank. Mike, just interested in the 10-year agreement here. What certainty have you got around pricing through that time period? Is it just sort of set amount they're paying you for that business through that time period? Or does it renegotiate at various points going forward?

Michael John Wilkins
Former Executive Officer

It's a set arrangement. It's a traditional quota share with a slight kicker and that we see 20% of our premiums to Berkshire. They pay 20% of the claims, they pay 20% of our costs. Plus there is an agreed fee over and above that, which is one of the reasons why we're talking about it takes some volatility out of our results because we're replacing uncertain insurance margin income with more certain fee type income.

Nicholas B. Hawkins
Chief Financial Officer

I think unless we -- unless we materially change our business mix, it's unlikely that we would have been negotiating anything different on that transaction over 10 years.

Kieren Chidgey
Deutsche Bank AG, Research Division

And just a second quick question. What's the net impact on GWP? I gather it's pretty small from these portfolio transfers?

Michael John Wilkins
Former Executive Officer

So I think that the portfolio that we will be transferring is probably something a little less than $50 million, and it'll be less than that coming considerably that's coming otherwise. So negligible impact? Nigel.

Nigel Pittaway
Citigroup Inc, Research Division

Nigel Pittaway here from Citi. Just maybe if we can take the insurance margin guidance for '15 that it was pre of the large losses and the midpoint there was, what, 14.5%. And then look at what you're guiding to '16, where the midpoint is 15%, that is a 2% benefit from the quota share. So basically, we've got a drop there from 14.5% to 13% despite obviously there being significant Wesfarmers synergies coming through in that year. So can you just explain sort of the major reasons behind that drop?

Michael John Wilkins
Former Executive Officer

Well, I think one of the key regions, Nigel, is we talked about our reserve releases, and we still stand by this for the 2015 year being of the order of 200 basis point or 2% on the margin. What we're talking about in the '16 year is 1%. So there's most of the movement. Plus we have called out that it's a tougher commercial market environment, so we're not hiding from that. But we still think that it's a very strong outcome when you look at the overall conditions in the market and the ROE profile that we're still delivering.

Nigel Pittaway
Citigroup Inc, Research Division

Okay. And then if we do focus on the 2% benefit, is that pretty much all due to the ceding commission, the 200 basis points?

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Michael John Wilkins
Former Executive Officer

It certainly is a considerable component to it. There's a few other bits and pieces that come with it as well, including our need not to now take reinsurance on the 20% of the book.

Nigel Pittaway
Citigroup Inc, Research Division

All right. Okay. And so the drop in NEP is still 20% even though you're taking lower reinsurance from the -- in the cat cover?

Nicholas B. Hawkins
Chief Financial Officer

That's right, Nigel. But what's happening is for 20% of our book, we're paying the GWP in reinsurance expense on that part of the book of the same number. And so therefore, that affects then the NEP. So overall, the group's NEP will come down, driven by that. So part of the 200 basis points will be the mass [ph] of that as well. So an element is a commission. An element is just a shrinking NEP number due to the way that quota share will reflected through our financials.

Nigel Pittaway
Citigroup Inc, Research Division

Okay. And then can you just comment on how you think this will affect your relationship with the other reinsurers in the market? Is there any impact on that?

Nicholas B. Hawkins
Chief Financial Officer

Yes, I mean, we have existing relationships with Berkshire and many others obviously. And so our expectations is that it won't affect them at all. And that actually, going forward, we'll continue to enjoy obviously, we have a partnership agreement with Berkshire, but we also have key relationships with a number of other major providers, and we would expect those to continue on as they are.

Nigel Pittaway
Citigroup Inc, Research Division

So there's nothing that they've done that stimulated you to do this or...

Nicholas B. Hawkins
Chief Financial Officer

No. No.

Michael John Wilkins
Former Executive Officer

James?

James Coghill
UBS Investment Bank, Research Division

James Coghill of UBS. Nick or Mike, just following on from that question about the 200 basis points, perhaps you can just give us a bit more color how the mechanics worked down through the P&L because on the revised NEP number, it's a benefit of about $170 million. So I'm sure we can't be thinking about the net impact of the exchange commission and operating cost being shared. It looks like there's something larger there that eventually drops down through the P&L. Could you just explain how investment income works, firstly? And then secondly, how that natural peril -- the natural perils allowance of $600 million, how that works as well?

Nicholas B. Hawkins

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Chief Financial Officer

Yes, yes. So everything is sort of proportionately drops by 20% is kind of the theme here. However, what we are doing as part of this -- so for example, the perils allowance sort of drops from what would have been, say, call it, $750 million down to we talked about $600 million being effectively 20% reduction, because it's a gross quota share so everything is being passed to Berkshire gross. So everything in our P&L is proportionately sort of 20% smaller. So claims are going to be 20% lower, the contribution to our admin expenses is 20% by Berkshire. But in addition to that, obviously, what's happening is we're giving Berkshire access to the profit pool of IAG on that 20% of our business. So the real trade here is the negotiation, that exchange commission over and above the proportional elements to -- for IAG to be remunerated for effectively the profit stream that is now being passed over to Berkshire. And that's what we did, we obviously didn't want to provide all of the sort of the commercial sensitivities around that transaction, so what we've done, we thought a better way to do that was in the context of guidance, which is why -- really why we've given guidance today for '16 is then provide how that quota share impacts the overall guidance, insurance margin guidance for 2016. So I think you should be thinking, everything is proportionately lower by 20%, but as a kicker, over and above our -- that proportion, which lifts our margin by that 200 basis points. It was effectively the fee that we are receiving over and above the proportion. And of course, there's the capital relief that is in addition to that.

James Coghill
UBS Investment Bank, Research Division

So that fee, as a percentage of your capital base, that could be significant. It must be quite ROE accretive, this deal.

Nicholas B. Hawkins
Chief Financial Officer

Well, if the fee -- obviously, all of it -- for 20% of our business now we don't have underwriting risk on others. As such, we don't have to have -- it's a fee-based business basically to 20% of the group. So yes, I mean, the metrics are different then, obviously because it's a fee-based arrangement on our 20% of our group versus a capital load that would normally be required.

James Coghill
UBS Investment Bank, Research Division

And on that natural perils allowance, you mentioned the figure of $750 million pre the quota share. Should we be thinking about that relative to $700 million plus the $150 million aggregate in '15? Is that a comparable number? So have you effectively lifted about $50 million?

Nicholas B. Hawkins
Chief Financial Officer

Yes, there's probably -- and there's a little bit of protection that we're getting in -- I think we might have lifted the number slightly more, by the way. But the other element that in the 2016 year is that we have some protection in first half '16, so second half of calendar '15 around the aggregate protection. That's on the calendar-year basis. So probably we're getting some help in our perils allowance by the perils that we've had in the first half of this calendar year, we get some additional protection second half of the year. So that number probably would have been slightly higher. So we're incorporating the elements of that, plus the quota share, we've come up with this sort of net number of $600 million.

Michael John Wilkins
Former Executive Officer

Ross?

Ross Curran
Commonwealth Bank of Australia, Research Division

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It's Ross Curran from CBA. Can you just talk us through how the -- is it a put option works that you have with them? And in what instances would it be favorable for existing shareholders for you to exercise that put option?

Nicholas B. Hawkins
Chief Financial Officer

So the mechanics are, I mean, it's relatively simple. We see it as IAG has the option at our core to issue up to roughly 125% of the expanded capital base, so it's 120-odd million shares. At any time based upon -- at any time over the next 2 years, capped at $6.50 and priced at a 5-day VWAP. And at the 5-day VWAP, we can choose that timing anywhere in that 2-year period. I mean, essentially, it's -- what that does is create some flexibility with how we may need to access funding if that's required. I mean, at this point, we're not thinking that we would be using that. But as part of this sort of partnership arrangement, they -- that will sort of put on the table is one of the other options available to us.

Ross Curran
Commonwealth Bank of Australia, Research Division

But given you are so, so far above your target range in capital, can you say...

Nicholas B. Hawkins
Chief Financial Officer

It doesn't feel like we're about to exercise that option next week. So I suppose that's the -- if that's the question, but what it does do is, I mean, it was part of the package. I think the important part of this transaction is everything is part of the package. There's lots of pieces to it. Every -- I mean, no, there's no sort of one piece that -- and we obviously had a lot of this discussion internally around one piece. Will you just do that in isolation, that one piece? There's actually quite a lot in this. And it sort of us trying to really get the whole-of-account package with Berkshire. This was just another element of it. And what it does, I see, is effectively just give it bit of flexibility. As I said right now, we're not -- the intention is not to exercise. And to your point, we don't have the need for that capital.

Michael John Wilkins
Former Executive Officer

So I think, just adding to what Nick was saying there, this really is a partnership. That put option was actually offered by Berkshire. It wasn't something we asked for. They offered it as a demonstration of their ongoing support for what we were trying to do as an organization and more particularly, the strategy that we're following. So we thought that it was great as part of the overall package and certainly, it gives us some confidence to look to the future. But I also agree with Nick, we're not about to run out and exercise this next week because we don't have the need for the capital.

Ross Curran
Commonwealth Bank of Australia, Research Division

It's a fairly cheap option from their point of view, I guess?

Michael John Wilkins
Former Executive Officer

Yes, but it is there. It's a significant amount of money, should we need to call on it, but we're not anticipating that we'll need to do that.

Ross Curran
Commonwealth Bank of Australia, Research Division

And the quota share, is this Australia and New Zealand? Or is this including all your investments?

Michael John Wilkins
Former Executive Officer

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It covers all the businesses that we consolidate. So Australia and New Zealand, and the majority-owned operations throughout Asia. And if some others come in to be in a majority-owned position, it will cover those as well.

Nicholas B. Hawkins
Chief Financial Officer

We thought that was the -- when we, I mean, there's nothing special about that from Berkshire's point of view. We thought that was just the easiest way to define it. Because it's we have from an accounting point of view, what we consolidate, and that's sort of the way the definition works.

Ross Curran
Commonwealth Bank of Australia, Research Division

And forgive me if I sound flippant, I don't mean to be, but is Berkshire essentially getting 20% of IAG for 3.7% of the capital?

Nicholas B. Hawkins
Chief Financial Officer

I mean, I think that the -- so the answer is no. Because it's -- the key of the transaction actually where loads of the negotiation has been held is what additional fee income or commission income or exchange commission are we negotiating over and above the proportional share of claims and expenses to compensate IAG and IAG shareholders for the access to that profit stream. So that's where the deal is really -- that's been a major part of the negotiation, just that bit. So it's not just 3% of the equity. It's plus a fairly sizable exchange commission, which is really resulting in that 200 basis point increase in margin and the capital relief that comes from that as well.

Michael John Wilkins
Former Executive Officer

Daniel?

Daniel P. Toohey
Morgan Stanley, Research Division

Daniel Toohey from Morgan Stanley. I'm just interested how this relationship influences your aspirations in Asia.

Michael John Wilkins
Former Executive Officer

Well, I don't think it changes our aspirations in Asia. We've been very clear about the fact that we see Asia as a part of a long-term future of IAG, and I called it out during the presentation. We currently were not looking beyond the 6 target markets that we have in Asia and with the small investment that we made in Indonesia. We're now in those 6 markets. But what we are starting to see is more opportunities emerging within those 6. But we're not bereft of opportunities in Australia and New Zealand either. So really no change to the strategy.

Daniel P. Toohey
Morgan Stanley, Research Division

So it doesn't -- you don't see it provides greater optionality to deploy capital in the region? Is there any sort of view on, I guess, the amount of capital that you'd like to -- I think going back pre-Wesfarmers, you talked about a certain percentage of your business coming from Asia by 2017. Obviously, things have changed. Any sort of view on quantifying?

Michael John Wilkins
Former Executive Officer

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Well, we'd still like Asia to be meaningful. We had previously talked about Asia representing about 10% of the group by 2017, but obviously with bringing Wesfarmers in, just a mass of that means that it's now about 7%. We still believe that Asia over the long term is the place to be and it will be a meaningful operation for the organization, but we're not setting any particular targets. And more particularly that capital that we've got is not burning a hole in our pockets, saying we've got to go and do something particularly in Asia. As Nick said, we'll be very disciplined about the management of our capital as we've always been. We'd like to see whether we've got any questions on the phone, and then we'll come back to those who've joined us here in the room in Sydney.

Operator

[Operator Instructions] The first question from the phone comes from Siddharth Parameswaran from JPMorgan.

Siddharth Parameswaran
JP Morgan Chase & Co, Research Division

Mike, Nick, a question that I have is just around the need for this capital rate. This, I suppose -- the rating that you're doing. I mean, you're effectively saying that this deal will reduce your capital requirements by $700 million. That's very significant in the context of the amount of capital requirements that you actually have. I'm just wondering what actually is triggering this. I mean, because you're flagging opportunities in Asia, but nothing has really changed from what you said before in the past. I mean, I think you said India, Indonesia, they're all quite small in the scheme of things. I'm just wondering if you could give us some color as to what this might mean, and so what drove this. It also, just what this might mean for capital management opportunities going forward? What does this mean for your dividend payout ratio? What does it mean for capital management opportunities?

Michael John Wilkins
Former Executive Officer

Well, maybe I'll start and Nick can add to this. It wasn't a capital need that drove this. We'd called it a partnership because it genuinely is a partnership and we see it's a long-term relationship that we're entering into. It wasn't just driven by the capital piece. It was also about the business opportunities that were presented and the fact that we are looking to develop our personal lines and SME business in Australia and New Zealand in conjunction with Berkshire, and likewise, that it's bringing its significant expertise in corporate property and specialty liability business to the benefit of our customers. We think when you look at the package, it's a sensible mix development in the relationship that we have with Berkshire. But also I think that it's something that we'll service our customers and our distribution partners in a better way as well. Maybe I'll let Nick talk about the -- what this means for our capital long term, although we've tried to call out that we're going to be disciplined, and we did say that we wouldn't hold excess capital over the medium to long term.

Nicholas B. Hawkins
Chief Financial Officer

Sid, I mean, just sort of making comment on a few of the points you made. So in relation to dividend policy, we believe the policy of 50% to 70% of our cash earnings has served us well over the last 6 or 7 years. So the idea of returning to shareholders, but continuing to invest back into our business both Australia and New Zealand and Asia, we believe that's the right strategy for our organization. So we're not changing our dividend policy. But we are being clear and we get to a point that we've given you some pro forma as at 31 December showing impact of the quota share and the $500 million placement that, that does give us a fair bit more flexibility around our capital. And what we said is, over the medium term, we're not going to hang on to it. So we don't feel compelled to buy things. And that we also get the ROE dilutive nature of holding surplus capital and investing at a 6% or 7% pretax in our shareholders' funds. And what we are saying is in the medium term, if we're above our targets, we'll conduct some sort of capital management initiatives.

Siddharth Parameswaran
JP Morgan Chase & Co, Research Division

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If I could just follow up with one other question, I mean, effectively, this deal, on my calculation, if I take the effect of the quota share against the -- I mean, the boost to the insurance margin against the effects, I mean, the loss in net earned premium, I get about 3% dilution coming through on earnings in FY '16. And then there's also effectively an increase in your share count of 3.8%. So it seems like a dilutive deal. So to do this, I mean, just for a strategic relationship seems like quite an expensive deal.

Nicholas B. Hawkins
Chief Financial Officer

Sid, so I think the quota share is -- in isolation is marginally EPS accretive. And then, the equity raise, and I flagged it when I was talking to that page, is clearly dilutive because we're raising $500 million and sort of back to the point of investing in our shareholders' funds at sort of pretax 6% or 7%. So I mean, we are -- would say the quota share is not the way you articulated it. The quota share, you know our view on that is that it's marginally accretive to the group, taking volatility. So that's part of the play here as well, obviously. But I think that we would agree that obviously, when we add in the equity rate as well, that makes the whole tray in the short term marginally dilutive, but that's sort of probably stating the obvious to you guys where that's just bolstering our capital reserves.

Siddharth Parameswaran
JP Morgan Chase & Co, Research Division

But sorry, am I missing something? I mean, effectively, you're saying that there's a boost of 2 percentage points on the insurance margin from the quota share, but there's a loss of 20% of the premium. So I mean, the margin, the underlying margin, I mean, the -- surely, that's -- isn't that EPS dilutive?

Nicholas B. Hawkins
Chief Financial Officer

Yes, well, there's a few more moving parts to all that. But our view would be versus the prospects of 2016, will not overlay the quota share. That, that in isolation would be a marginally EPS accretive deal for IAG shareholders. Then when we add the equity bucket in as well, that's the bit we're saying if you add that in, in addition to the quota share, that then brings us down to be modestly dilutive, but only a little bit. I mean, the math is [ph] -- you guys can do that as well. So no, I don't agree with your comment that -- on the quota share. We would see that as marginally accretive. But actually, the real trade here is, in our opinion, that actually, we're trading volatility more certainty and your trading insurance risk for fee-based income. And as part of that, this is opportunity as we articulated to release capital off the book to the tune of $700 million over the next 4 or 5 years.

Operator

The next question comes from Toby Langley from Merrill Lynch.

Toby Langley
BofA Merrill Lynch, Research Division

Just a couple of questions. On the arrangement with Berkshire, is there any kind of noncompete in the lines of business that you do up against one another?

Michael John Wilkins
Former Executive Officer

As I said, Toby, during the presentation, it's an exclusive arrangement. So basically, Berkshire will be transferring to us it's personal lines and SME business and opportunities in Australia and New Zealand, so they won't be competing. And likewise, given the size of it and given the greater skills and the greater appetite that Berkshire has for large corporate property and liability business, we won't be going into that business. So to that extent, yes, we're not competing. We're actually cooperating.

Toby Langley
BofA Merrill Lynch, Research Division

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And on your other reinsurance arrangements, what's the impact of this deal?

Michael John Wilkins
Former Executive Officer

Well, none really. I think it goes to the question that Nick was asked earlier. I don't know whether you want to add any more to that?

Nicholas B. Hawkins
Chief Financial Officer

I mean, we're obviously shrinking. We will be shrinking our reinsurance buying just as sort of a global comment, by 20% on everything because this is gross quota share. So our buying in the market, everything else being equal, is 20% lower. And so when we, as an example, when we go to market, assuming the same program, is that the same program we currently have on the main cat to our -- at the moment, we buy just over $7 billion. That number will shrink by 20% when we go to market. And then -- I mean, that's the one we talked about, a lot of it is across all of our reinsurance, both our liability and long-tail classes as well as our property and sort of catastrophe cover, everything shrinks by 20%.

Toby Langley
BofA Merrill Lynch, Research Division

Okay. Great. And just lastly on -- you've called out, I think, previously on what you expect to inject into India, are those numbers still the same?

Michael John Wilkins
Former Executive Officer

Yes, at this stage. As I said, we're going -- we're looking to go from 26% to 49%. We said that we thought that would be of the order of $150 million. That still stands. We are in negotiation or we're going through the process, actually, because this is an agreed process. And we're confident that we'll have that completed by the end of this calendar year.

Operator

The next question comes from Ingrid Groer from Goldman Sachs.

Ryan Fisher
Goldman Sachs JBWere Pty Ltd, Research Division

Sorry, it's not Ingrid, it's Ryan. Just a quick question or more comment. I'm just running the maths and unless we're missing something really significant, I completely agree with Sid's logic. So I'm just hoping given the significance that -- Nick, you can help us to reconcile here. I mean, just to be really crude about it, if you take the NEP and you reduce it by 20% and you add 2% to your margin, you're going to get 9% -- 8%, 9% less insurance profit in dollar terms. So before adjusting for the extra shares, the extra investment income and the capital, whatever, you're down about 8%, 9% on insurance profit. A bit of a reduction when you allow for shareholders' funds and presumably for the minorities will be reduced as well, but it's very difficult to see how you're saying that, that's accretive in its own right. Could you let us know which line item we're missing?

Nicholas B. Hawkins
Chief Financial Officer

I mean, I'm trying to think of the best way to go at that, but I mean, the way to look at this, and maybe we spend less than a couple of minutes now and we can talk about it more after. It's probably easier rather than holding it all up for everyone. But what happens is obviously everything shrinks by 20%. We get this, however, this big kicker in this fee-based income, essentially over and above the proportional share of our claims and our expenses. So what that's obviously, that's obviously fee-based income that doesn't have any capital behind it. The net impact of that moves our margins, as we articulated, by around 200 basis points. And then when I look at those as a package, what that does is sort of in our view

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compared to where we were heading in '16 around earnings per share is it's modestly accretive. There are some other benefits around just the quantum of reinsurance that we're buying, obviously, it comes down. And there are some other benefits that are available to us as part of the way that, that works. And we're pretty confident on that net effect, as we've articulated, x the equity raise on those transactions being modestly EPS accretive in the short way. But if I had any extra equity, the extra $500 million, that's what brings it back a little bit. But why don't we talk -- I mean, we can talk through that line by line after this call if you want, Ryan.

Operator

At this time, we're showing no further questions over the phone.

Michael John Wilkins
Former Executive Officer

Okay, anymore here in the room? James?

James Coghill
UBS Investment Bank, Research Division

James Coghill of UBS. Mike, just 2 more questions on governance and again, Mike, Ross, I'm not saying it is an issue, I'm just trying to get some concepts clear in my own head. So the first question relates to the 14.9% that Berkshire can effectively get up to effectively become an insider through this transaction and that have more insight than any other shareholder as to how high it is performing. Can you just explain the mechanism other than the put option through which Berkshire can increase their stake further?

Michael John Wilkins
Former Executive Officer

They can buy on market. So I think that your initial statement that they have more information than the rest of the market is actually not accurate. This has been done on the basis of information that's available to all shareholders, and we see it as a strong affirmation from Berkshire about the organization and the strategy that is putting forward. So the 14.9% is a standstill. We have the capacity obviously to put another 5%, but Berkshire also has the capacity to go into the market and buy.

James Coghill
UBS Investment Bank, Research Division

So they're privy to no additional information, that I say would be privy to information [indiscernible] have access to Berkshire also.

Michael John Wilkins
Former Executive Officer

It's probably a question for them. But certainly, the way we've conducted business, in my opinion, that they are not insiders. So that's the way it -- that's the way they've conducted business with us, actually.

James Coghill
UBS Investment Bank, Research Division

And the second issue is more a disclosure going around that exchange commission. Are you in a position to disclose when the results comes out and what that is and how that mechanism works because it's clearly quite significant to the way it drops through the P&L? And to quote your words, Nick, most of this transaction is effectively selling 20% of the business foreign exchange commission. Surely existing shareholders are entitled to understand exactly how that's been structured?

Nicholas B. Hawkins
Chief Financial Officer

Yes. I mean, we've got a balance -- I mean, I agree with your comment there, James, it sort of around the confidentiality of the arrangements that we've put in place. I mean, what we've tried to do and the

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reason we're giving guidance today was to give some insight onto the financial effects of '16. By the way, obviously, at June '15 financials, this will have no effect. It's a go-forward from 1 July. But we'll look at how we can in the constraints of what was agreed is around confidentiality and how we can help investors get more clarity on exactly the mechanics of how that works and we'll look to that in August.

Michael John Wilkins
Former Executive Officer

Nigel's got another question.

Nigel Pittaway
Citigroup Inc, Research Division

Nigel Pittaway from Citi here again. Sorry, just a real quickie. But I think, correct me if I'm wrong, previously you said the reserve releases would run at 2% of NEP for longer than FY '15. So the fact that you're now saying 1% in '16, is that telling us they're not going to run that far or you just might be conservative?

Nicholas B. Hawkins
Chief Financial Officer

Listen, Nigel, I think we can look at the slide that says at least. And then I get -- I mean, I think you're point is that NEP has come down, so are we reducing from 1% down to a smaller number, I think we just left. But we didn't try to be too scientific in that number. We thought about this point and we've just left at least 1%, but there's nothing more to be read in that than that.

Michael John Wilkins
Former Executive Officer

Yes?

Unknown Analyst

Slightly a capping [ph] point, but surely through their reinsurance relationship, Berkshire have more insight than most investors?

Michael John Wilkins
Former Executive Officer

Yes, and that's probably a question for them, isn't it? Around whether or not they believe because of that, that makes them an insider and restricts them from trading our shares. But certainly, it's the way we've conducted business over this negotiation of the strategic partnership. I think that they have essentially dealt with publicly available information. But that's a question for them. Anything else? Anymore on the phones one last time?

Operator

The next phone question comes from Andrew Adams from Credit Suisse.

Andrew Adams
Crédit Suisse AG, Research Division

I just wanted to -- a quick question, I understand how the reinsurance works from 1 July. So you got a 250 attached in point at the moment to your main cat program from 1 July, Berkshire comes in, takes 20%. Is your exposure just for the AD still 250?

Nicholas B. Hawkins
Chief Financial Officer

Yes, yes. So in the first, in the sort of first 6 months of, I mean, we could have gone about restructuring our programs and reduced everything down by 20%. We think we're just going to leave it all as it is for the next 6 months, but then -- and then go about that process one -- I know that, of course, it takes a

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little while to build this up as well. So -- but I mean, and then effectively put that the new program in place 1 January, 2016, fully aware of this. And what we are actually doing on the -- we do even use some of the program 1 July, some were long-tail classes in the way we cover that. So we are -- we were putting those programs in place with quota share aware on the calendar year programs. We're essentially just going to leave them as they are.

Andrew Adams
Crédit Suisse AG, Research Division

And you're not repurchasing the net perils allowance, I take it from those comments?

Michael John Wilkins
Former Executive Officer

We might, we might. You mean, you're talking about what used to be the $150 million excess, $750 million layer [ph]?

Andrew Adams
Crédit Suisse AG, Research Division

Yes.

Michael John Wilkins
Former Executive Officer

Yes, we might.

Andrew Adams
Crédit Suisse AG, Research Division

Well, I guess, for 6 months, it just looks like you've increased volatility because you used to attach at 2.5% of NEP. Now you're attaching at 3% of NEP. So it actually looks like I'm more exposed to weather?

Michael John Wilkins
Former Executive Officer

Probably, the only other -- Andrew, the only other comment we'll make on this, and there's another twist to this, which is the protection we have under the aggregate. Actually, there's an argument that our MER at the moment is roughly $25 million. Because of the fact that we're into our aggregate or on the cusp of it. And so actually when we're probably because the medium-term view is still the 250 [ph] or I think you can probably assume you can proportionately reduce that down at 1 January, 2016. But actually, right now, and hopefully for the remainder of calendar '16, because of the way the aggregate plays into our protection, actually, there's an argument that actually our MER is actually $25 million right now. And assuming we don't have any more terrible events this year, that will be in place for the rest of the calendar year. So that came into our thinking as well. So I think net-net, we haven't dialed up our volatility or risk in the next 6 months. I think being -- it's actually at a practical level, what we're doing makes sense and because of other things playing in, we've got that reduced volatility anyway, and we'll get everything in order with the quota share from 1 January, 2016.

Operator

At this time, we're showing no further questions over the phone.

Michael John Wilkins
Former Executive Officer

Okay. Daniel, probably one last question.

Daniel P. Toohey
Morgan Stanley, Research Division

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I think that Berkshire had an MGA setup with Steadfast to provide personal lines business. Would that in effect be you going forward? Or will that continue to be Berkshire?

Michael John Wilkins
Former Executive Officer

That will be effectively be us. That will be part of the business that we'll transfer over to IAG. And Steadfast obviously is already an important partner of IAG, and we see that, that will just strengthen the partnership even further.

Daniel P. Toohey
Morgan Stanley, Research Division

Okay. So just to be clear then also so Berkshire can't write personal lines and SME business in Australia and New Zealand?

Nicholas B. Hawkins
Chief Financial Officer

And New Zealand.

Michael John Wilkins
Former Executive Officer

So it's an exclusive arrangement both ways.

So with that, I thank everyone for the time. Thank you for coming along today. As I said at the outset, we're really excited by this. We think that it is a great long-term partnership, which we believe will show benefit and a win-win situation to both partners.

We're really pleased that we've been able to talk to you about it today. And as we proceed on and certainly, as we get to August, we'll be able to show more about what the effects of this are going to be on IAG.
So thanks, again, for coming along today. We're excited by it. Hopefully, you've been well-informed by the presentation. Wish you a good rest of the day. Thank you.

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