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QBE Insurance Group Limited

19 January 2022

Sector: Financials
Sub-sector: Insurance
Country: Australia
Ownership: Public

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Issuer Outline

QBE Insurance Group (QBE, Group) is headquartered in Sydney and is one of the world's largest general insurance and reinsurance companies, with strong market positions across primary operating regions--Australia and New Zealand, North America, Europe, and to a lesser extent, broader Asia Pacific. It is one the largest publically-listed companies on the ASX (ASX: QBE).

QBE is a property and casualty insurer and reinsurer. Through its worldwide businesses, QBE offers personal, commercial, speciality, reinsurance and risk management solutions.

Key Financials (USDm)

Last six months (30 June)	2021
Gross written premium	10,203
Net earned premium	6,571
Net claims expense	(4,023)
Insurance profit	674
NPAT	441
Loss ratio (%)	61.2%
Combined operating ratio (%)	90.2%
PCA multiple (x)	1.73x
CET1 ratio (%)	109%

Source: Company Reports.

Summary Bond Details

ISIN	Issue Amount	Ranking	Coupon	Coupon Frequency	First Call[1]	Maturity Date
AU3FN0055489	AUD500m	Subordinated Unsecured Tier 2	3M BBSW+2.75%	Quarterly	25 August 2026	25 August 2036
XS1423722823	USD524m	Subordinated Unsecured Tier 2	5.875%	Semi-annual	17 June 2026	17 June 2046

[1]*Excludes potential terms that would allow the issuer to redeem prior to the maturity date through a make-whole call*

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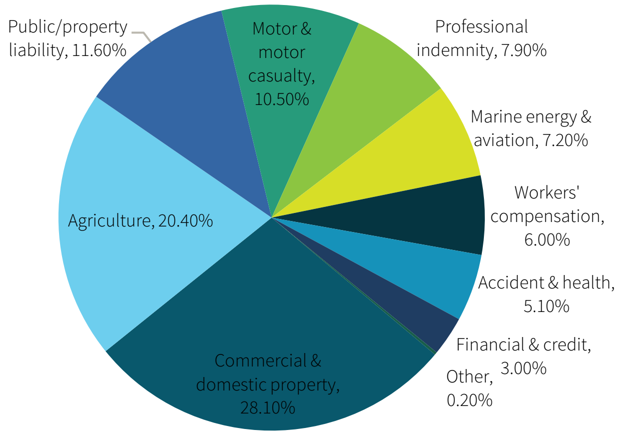
Tier 2 Structure	
Interest Deferral/Cancellation	Interest will be deferred only in the highly unlikely circumstances that the payment would result in QBE becoming insolvent.
Non-Viability Trigger	Yes, standard Basel III compliant non-viability trigger. If APRA deems a non-viability event will occur the notes can be converted to common equity or written off. The notes can also be written off if the issuer is prevented by law or court order from converting the notes within five business days after a trigger event.

Strengths

- Strong competitive position: QBE is one of the top five insurers in Australia with a leading market position in commercial insurance for small and medium-sized enterprises through strong distribution channels. In Europe and the US, where the property and casualty (P&C) insurance sectors are more fragmented and intensely competitive, its market position remains relatively modest overall but continues to improve, and the company is among the market leaders in the federal multi-peril crop insurance sector. Given the renewed focus on its core markets (following the disposal of numerous operations throughout Latin America and Asia Pacific), stronger insurance margins through the European and North American markets should be expected (which continue to lag margins in Australia and New Zealand).
- Diverse operations provide a reasonable mitigant to gross natural peril exposure: QBE's earnings quality and risk profile are aided by a well-diversified range of product lines (see Figure 1), across main geographies of operation. Gross written premiums are also well-diversified by geography, with Australia and New Zealand accounting for 25%, North America (37%), and Europe (38%) (ex-inward reinsurance).

Figure 1: GWP by class of business



- Strong capital position: QBE maintains a strong capital position, recently reporting a Prescribed Capital Amount (PCA) multiple of 1.72x (regulatory minimum of 1.00x) and a Common Equity Tier 1 (CET1) ratio of 109% (minimum of 60%). Although composition of capital has a higher weighting toward Tier 2 compared with peers, the headroom above regulatory minimums is nevertheless sizeable.

  QBE's probability of adequacy (PoA; the level of confidence that the outstanding claims provision will be sufficient to pay claims as and when they fall due) sits at 92.3%, toward the top-end of QBE's targeted PoA range of 87.5%–92.5%, and compares with the regulatory minimum of 75% as set by APRA.

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- Sound balance sheet structure and good quality (low-risk) investment portfolio to provide cover for claims: Property and casualty insurers, such as QBE, accumulate substantial funds due to the time gap between the receipt of premiums and the payment of potential claims. To ensure QBE has sufficient liquid funds available to meet payment obligations to policyholders and creditors, the company maintains a high proportion of high-quality liquid assets.

  QBE maintains a portfolio of high quality investments, with only a small exposure to equities. As at 30 June 2021, QBE's total investment securities (backing policyholder and shareholder funds) equalled ~USD28bn, of which 93% are investment grade fixed income (inc. cash), with the residual comprising private equity, unlisted property and unlisted infrastructure investments. QBE has no exposure to listed equities within its investment portfolio.

  This compares with outstanding claims reserve (a provision for the future liability for claims which have occurred but which have not yet been settled), net of reinsurance and recoveries of AUD17.6bn and unearned premiums (premiums written but not yet earned) of AUD9.6bn (the unearned premium reserve is a balance sheet reserve to cover the unearned portion of a policy in the event a policyholder or the insurer decides to cancel the policy during its tenure).

- Reinsurance arrangements provide capital and earnings protection: Insurers including QBE overlay the risk from catastrophes and other claims expenses with reinsurance, whereby they transfer portions of their risk portfolios to other insurers (reinsurers) to reduce the likelihood of paying a large obligation resulting from an insurance claim.

  QBE has consistently obtained reinsurance from counterparties with very strong credit quality, adjusting protection for catastrophe and large risk events as necessary (e.g., in 2020 they purchased additional catastrophe cover for North America peak peril and crop hail damage). Reinsurance cover has typically increased, in line with an increased frequency in catastrophic claim events.

Risks

- Material exposure to worldwide natural peril (catastrophe) events: QBE, as a provider of property and casualty insurance, has high exposure to natural perils (catastrophe risk), particularly in North America and Australia. A significant environmental change or external event has the potential to disrupt the general insurance business with the potential for large numbers of insurance claims in the instance of such events. For example, the group's North America operations' crop business was adversely impacted by abnormally unfavourable weather condition in 2019, which the Australian operations remain continually exposed to the threats of bushfires, droughts and floods.

  Net claim costs from natural perils have overrun allowances (provisions) in recent years, although capital levels are more than sufficient to absorb the increase in claims.

- Large exposure to long-tail classes of business which could result in adverse prior year development. The notification and settlement of claims relating to liability and other long-tail classes of business (for example, professional indemnity and workers' compensation) may not happen for many years after the event giving rise to the claim. As a consequence, liability and other long-tail classes typically display greater variability between initial estimates and final settlement due to delays in reporting claims and uncertainty in respect of court awards and future claims inflation.

  QBE has a relatively large exposure to long-tail claims' risk, including public/product liability (11.6% of GWP), professional indemnity (7.9%), workers compensation (6.0%), and accident and health (5.1%).

- Interest rate risk within investment portfolio: Like all insurance companies, QBE's interest rate risk arises primarily from fluctuations in the valuation of investments in fixed interest-bearing securities (more than 90% of QBE's investment portfolio is held in fixed income and cash). Movements in interest rates can result in material losses (or gains), albeit, generally unrealised (to the extent losses do not need to be crystalised (realised) to support the company's ability to meet its claims, losses should generally unwind).

  For example, QBE reported an investment income (pre-tax) loss on technical reserves of USD60m in 1H20 (almost entirely as a function of widening credit spreads and market volatility, and compared with positive earnings of USD457m in the prior corresponding period) (technical reserves are investments held to support premium liabilities and outstanding claims reserves). Investment income on technical reserves subsequently returned to profitability in 1H21 (USD32m), unwinding some of the prior-year (unrealised) losses.

Risks relevant to the Subordinated Unsecured Tier 2 instrument

- Subordinated ranking: Regulatory Tier 2 instruments are unsecured and subordinated instruments, ranking ahead only of ordinary shares and regulatory Additional Tier 1 hybrids. Tier 2 instruments rank behind senior creditors, which includes senior unsecured creditors and policyholders.
- Basel III compliant structural features: The subordinated bonds are Basel III complaint and as such do not include a step-up margin if not called and contain a point of non-viability clause. If APRA, the Australian Prudential Regulator, determines that QBE requires capital support to prevent it becoming non-viable (a 'non-viability event'), the QBE may be required to convert some or all of the notes into ordinary shares. The number of shares at time of conversion may be worth significantly less than the face value of the notes and a holder may suffer a loss as a consequence of conversion.

  If the notes required to be converted following a non-viability event are not converted for any reason within 5 business days of the non-viability trigger, then conversion will not occur and the notes will be written off.
- Risks upon conversion: Ordinary shares rank behind the claims of all other securities and debts in a winding-up of QBE. Ordinary Shares trade in a manner that is likely to be more volatile than that of Subordinated Notes and the market price is expected to be more sensitive to changes in the performance and prospects of the business.
- Coupons are deferrable: QBE may elect to defer payment of all or part only of any interest amount payable in respect of the Notes, by giving no less than five business days' notice to noteholders.

  However, any deferred coupon is cumulative and will accrue interest at the applicable Interest Rate until it is paid. In addition to this, QBE is only able to defer a coupon at its own discretion if no distributions have been made on junior ranking instruments or certain equal ranking instruments during the financial year in which such coupon payment date falls, and no dividend on its ordinary shares has been paid in the preceding 12 months.
- Optional call dependent on regulatory approval: The Notes include an early call feature where the face value of the Tier 2 notes may be repaid early in cash. The optional redemption requires regulatory approval, which may not be provided.

  In general, regulators are unlikely to provide approval for a Tier 2 instrument to be called if it results in a reduction in the issuer's capitalisation; regulators are unlikely to provide approval for a redemption or resale unless the issuer has, or is expected to, issue an instrument of similar size to replace the instrument subject to that call. To the extent the optional call was expected not to be exercised, it is likely that the price of the notes will be negatively affected, with this negative price movement being potentially material.

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