QBE LENDERS' MORTGAGE INSURANCE LIMITED

(A.C.N. 000 511 071)

FINANCIAL REPORT – 31 DECEMBER 2014

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This financial report includes separate financial statements for QBE Lenders' Mortgage Insurance Limited ("the company") as an individual entity, and for the consolidated entity. The financial report is presented in Australian dollars unless otherwise stated.

QBE Lenders' Mortgage Insurance Limited is a company limited by shares, incorporated and domiciled in Australia. Its registered office and principal place of business is:

Level 27, 8-12 Chifley Square
Sydney NSW 2000
Australia

A description of the nature of the company's operations and its principal activities is included in the directors' report on pages 1 to 5, which is not part of this financial report.

The financial report was authorised for issue by the directors on 20th February 2015. The directors have the power to amend and reissue the financial statements.

QBE LENDERS' MORTGAGE INSURANCE LIMITED

DIRECTORS' REPORT

For the year ended 31 December 2014

Your directors present their report on QBE Lenders' Mortgage Insurance Limited ("the company") and the entities it controlled at the end of or during the year ended 31 December 2014.

Directors

The following directors held office during the year and up to the date of this report:

J A Boddington
S P Burns (appointed on 14 February 2014)
C Fagen
G J Gilbert
The Hon. N F H Greiner
A G McGrath
J D Neal (resigned on 14 February 2014)
D A M Ramsay (resigned on 14 February 2014)
J E Skinner
V J Walter

Principal activity

The principal activity of the consolidated entity during the year continued to be underwriting of residential lenders' mortgage insurance. There were no significant changes to the principal activity during the year.

Results and review of operations

The results of the consolidated entity for the year were as follows:

	2014 $M	2013 $M
Gross written premium	**457.1**	468.4
Gross earned premium	**450.9**	288.9
Net earned premium	**378.7**	244.7
Net claims incurred	**20.3**	(59.3)
Net commission expense	**(3.8)**	(7.8)
Underwriting expenses and other acquisition costs	**(67.3)**	(60.2)
Net underwriting profit	**327.9**	117.4
Net investment income on policyholders' funds	**34.8**	32.8
Insurance profit	**362.7**	150.2
Net investment income on shareholder's funds	**43.7**	41.8
Profit before income tax	**406.4**	192.0
Income tax expense	**119.6**	55.8
Net profit after tax	**286.8**	136.2

After a year of material growth in 2013, gross written premium declined slightly in 2014. Regulatory measures intended to reduce the risk of excessive house price growth (by limiting mortgage lending with higher loan to value ratios) restricted opportunities for portfolio growth. The 2014 result was underpinned by a stable customer base and strong property markets.

During the year, in accordance with accounting standards, the company reassessed the expected pattern of risk emergence over the life of its portfolio. Actuarial analysis relating to unearned premium resulted in an estimate that showed a greater proportion of risk of loss in the early years after policy inception than previously modelled. Consequently, it was appropriate to release a portion of previously deferred income and expenditure to the income statement. The increase in net underwriting profit as a result of this change was $84.0 million, equivalent to an increase of $58.8 million in net profit after tax. Removing the impact of this change results in a normalised gross earned premium of $356.4 million, net earned premium of $286.8 million, net commission expense of $3.4 million and underwriting expenses of $59.8 million. In 2013, the review of the consolidated entity's earning pattern reduced net underwriting profit by $9.6 million ($6.7 million after tax).

Results and review of operations (continued)

The consolidated entity also reviewed the level of risk margin in respect of the provision for outstanding claims. In light of the analysis performed and current economic conditions, it was considered appropriate to reduce the level of risk margin by $47.3 million (an increase of $33.1 million in net profit after tax). Removing the impact of this release results in a normalised claims incurred of $27.0 million. Notwithstanding this release, with a probability of adequacy at 31 December 2014 of 91.3%, the consolidated entity maintains a prudent level of provisions against losses, well in excess of the minimum regulatory requirement required by the Australian regulator, Australian Prudential Regulation Authority ("APRA").

Both 2014 reported net profit after tax of $286.8 million and the normalised net profit after tax (which remove the impacts of the above changes) of $194.9 million were favourable compared with 2013.

Normalised net earned premium continued to build, partially offset by an increase in reinsurance expense, as the company managed its capital requirement by increasing quota share cover. Higher earned premium reflects a combination of the growth in the active earning portfolio in recent years and proactive management of the portfolio to ensure unearned premium is released on policies relating to repaid loans.

Normalised claims incurred declined 54.5% on 2013, while the net loss ratio fell to 9.4% from 24.2%. This favourable result was partly due to enhanced underwriting practices and management of mortgage arrears since the GFC. In addition, a benign combination of economic and housing market factors have boosted house prices and helped to lessen borrower stress.

The commission and expense ratio also reduced since the prior year. Net commissions incurred declined principally as a result of the increased impact of commission income from ceded reinsurance. Net expenses fell marginally, reflecting tight control over the consolidated entity's cost base.

Net investment income increased $3.9 million, or 5.2% compared to 2013. The company continues to hold a conservatively managed portfolio, built around highly rated, liquid securities, with a short duration. Average market rates declined compared with 2013, depressing interest income, but overall returns were improved by increased net fair value gains.

The shareholder has decided to partially list the company via an Initial Public Offering (IPO). The IPO will provide the company with a broader shareholder base and funding flexibility more suitable for a business with ongoing and strong growth ambitions. The IPO is targeted to take place in 2015.

Controlling entities

The entity is a company limited by shares, incorporated and domiciled in Australia. The controlling entity is QBE Holdings (AAP) Pty Limited (QBE AAP), incorporated and domiciled in Australia, and the ultimate parent entity is QBE Insurance Group Limited (QBE Group), incorporated in Australia.

The controlling entity's registered office is at Level 27, 8-12 Chifley Square, Sydney, NSW 2000 Australia.

Employee numbers

At the reporting date, the consolidated entity employed 9 persons (2013: 7).

The company is not an employer, a related entity, QBE Management Services Pty Limited ("QMS"), is the employer of the QBE Group employees resident in Australia. As such, it is responsible for the salary and wage payments and employer superannuation contributions. QMS charges a management fee to the company at cost in order to recover employee costs.

Dividends

The dividends paid during the year totalled $65.0 million (2013: $130.0 million).

The directors declared a final dividend of $66.0 million in December 2014 payable in February 2015, which has been provided in the financial statements. In February 2015 the directors approved the payment of a further dividend of $50.0 million.

Options

There were no options granted by the consolidated entity during the year (2013: nil).

Likely developments

Information on likely developments in the consolidated entity's operations in future financial years and the expected results of those operations has not been included in this report because disclosure of the information would be likely to result in unreasonable prejudice to the consolidated entity.

Significant changes

There were no significant changes to the state of affairs of the consolidated entity during the financial year.

Events subsequent to balance sheet date

The following events have occurred after balance date:

(i) dividends were proposed before the financial statements were authorised as disclosed above,
(ii) the company was given notice by a major customer terminating their contract in 2015. The customer contributed 20.9% of the gross written premium in 2014. This has no impact on the financial results reported in these statements. It may impact future earnings and an estimate of this impact cannot be made at the date of signing this report.

There is, at the date of this report, no other matter or circumstance that has arisen since 31 December 2014 that has significantly affected, or may significantly affect:

(i) the consolidated entity's operations in future financial years;
(ii) the results of those operations in future financial years; or
(iii) the consolidated entity's state of affairs in future financial years.

Environmental regulation

The consolidated entity's operations are not subject to any significant environmental regulation under either Commonwealth or State legislation.

Directors' benefits

No director of the company has received or become entitled to receive a benefit (other than a remuneration benefit) by reason of a contract made or proposed by the company or a related entity with a director or with a firm of which the director is a member or with an entity in which the director has a substantial financial interest.

Indemnification and insurance

During the year, a related company paid insurance premiums in respect of a contract insuring directors and officers of the company. The officers of the company covered by the insurance contract include the directors listed on page 1 and the company secretaries, P Smiles and A R Croy. In accordance with normal commercial practice, disclosure of the total amount of premium payable under, and the nature of liabilities covered by, the insurance contract are prohibited by a confidentiality clause in the contract.

Auditor's independence declaration

A copy of the auditor's independence declaration as required under Section 307C of the *Corporations Act 2001* is set out on page 5.

Rounding of amounts

The consolidated entity is of a kind referred to in the ASIC class order 98/100 date 10 July 1998 (as amended by class order 04/667 dated 15 July 2004) relating to the "rounding off" of amounts in the directors' report. Amounts have been rounded off in the directors' report to the nearest hundred thousand dollars or, in certain cases, the nearest thousand dollars in accordance with that class order.

Auditors

PricewaterhouseCoopers continue in office in accordance with Section 327B of the *Corporations Act 2001*.

This report is made in accordance with a resolution of directors.

Director...

Director...

Sydney
20th February 2015

Auditor's Independence Declaration

As lead auditor for the audit of QBE Lenders' Mortgage Insurance Limited for the year ended 31 December 2014, I declare that to the best of my knowledge and belief, there have been:

a) no contraventions of the auditor independence requirements of the *Corporations Act 2001* in relation to the audit; and

b) no contraventions of any applicable code of professional conduct in relation to the audit.

This declaration is in respect of QBE Lenders' Mortgage Insurance Limited and the entities it controlled during the period.

SJ Hadfield

S J Hadfield
Partner
PricewaterhouseCoopers

Sydney
20 February 2015

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STATEMENTS OF COMPREHENSIVE INCOME
For the year ended 31 December 2014

	NOTE	The Company 2014 $M	The Company 2013 $M	Consolidated 2014 $M	Consolidated 2013 $M
Gross written premium		**441.0**	453.3	**457.1**	468.4
Unearned premium movement		**(7.9)**	(178.8)	**(6.2)**	(179.5)
Gross earned premium revenue	6(A)	**433.1**	274.5	**450.9**	288.9
Outward reinsurance premium		**(152.5)**	(66.2)	**(153.3)**	(67.3)
Deferred reinsurance premium movement		**81.0**	22.6	**81.1**	23.1
Outward reinsurance premium expense	6(B)	**(71.5)**	(43.6)	**(72.2)**	(44.2)
Net earned premium		**361.6**	230.9	**378.7**	244.7
Gross claims incurred	6(B)	**18.3**	(64.0)	**18.2**	(63.4)
Reinsurance and other recoveries revenue	6(A)	**2.0**	4.7	**2.1**	4.1
Net claims incurred	7(A)	**20.3**	(59.3)	**20.3**	(59.3)
Gross commission expense	6(B)	**(13.5)**	(10.6)	**(13.5)**	(10.4)
Reinsurance commission revenue	6(A)	**9.7**	2.6	**9.7**	2.6
Net commission		**(3.8)**	(8.0)	**(3.8)**	(7.8)
Other acquisition costs	6(B)	**(32.7)**	(19.7)	**(33.1)**	(20.5)
Underwriting and other expenses	6(B)	**(31.7)**	(37.4)	**(34.2)**	(39.7)
Underwriting result		**313.7**	106.5	**327.9**	117.4
Investment income - policyholders' funds		**36.2**	34.1	**35.9**	33.8
Investment expenses - policyholders' funds		**(1.0)**	(0.9)	**(1.1)**	(1.0)
Insurance profit		**348.9**	139.7	**362.7**	150.2
Investment income - shareholder's funds		**55.0**	47.0	**45.0**	43.0
Investment expenses - shareholder's funds		**(1.3)**	(1.2)	**(1.3)**	(1.2)
Profit before income tax		**402.6**	185.5	**406.4**	192.0
Income tax expense	8	**(117.2)**	(53.9)	**(119.6)**	(55.8)
Profit after income tax		**285.4**	131.6	**286.8**	136.2
Other comprehensive income					
Items that may be reclassified to profit or loss					
Net movement in foreign currency translation reserve		**(0.2)**	(1.4)	**8.0**	9.4
Other comprehensive income after income tax		**(0.2)**	(1.4)	**8.0**	9.4
Total comprehensive income after income tax		**285.2**	130.2	**294.8**	145.6
Profit after income tax attributable to:					
Ordinary equity holders of the company		**285.4**	131.6	**286.8**	136.2
		285.4	131.6	**286.8**	136.2
Total comprehensive income after income tax attributable to:					
Ordinary equity holders of the company		**285.2**	130.2	**294.8**	145.6
		285.2	130.2	**294.8**	145.6
				Cents	**Cents**
Earnings per share for profit after income tax attributable to ordinary equity holders of the company, basic and diluted	20			**87.5**	41.5

These statements of comprehensive income should be read in conjunction with the accompanying notes.

BALANCE SHEETS
As at 31 December 2014

		The Company		Consolidated		
	NOTE	2014 $M	2013 $M	2014 $M	2013 $M	2012 $M
ASSETS						
Cash and cash equivalents	9	**6.2**	9.2	**8.4**	15.0	33.3
Investments	10	**2,236.2**	2,046.6	**2,359.7**	2,156.0	1,984.5
Trade and other receivables	11	**37.4**	64.4	**38.9**	66.1	74.3
Reinsurance and other recoveries on outstanding claims	16(A)	**4.7**	4.8	**4.7**	4.8	2.8
Deferred insurance costs	12	**202.0**	122.7	**203.7**	124.0	85.5
Deferred tax assets	13	**4.7**	3.1	**4.7**	3.0	3.0
Investments in controlled entities	14	**73.5**	73.5	**-**	-	-
Total assets		**2,564.7**	2,324.3	**2,620.1**	2,368.9	2,183.4
LIABILITIES						
Trade and other payables	15	**205.7**	100.0	**206.2**	100.3	128.0
Current tax liabilities		**0.9**	0.2	**1.5**	1.4	0.1
Outstanding claims	16(A)	**119.4**	179.3	**119.5**	179.3	183.4
Unearned premium	17	**860.5**	852.5	**898.0**	888.5	702.2
Unearned reinsurance commission	18	**50.3**	18.6	**50.3**	18.6	-
Total liabilities		**1,236.8**	1,150.6	**1,275.5**	1,188.1	1,013.7
Net assets		**1,327.9**	1,173.7	**1,344.6**	1,180.8	1,169.7
EQUITY						
Share capital	19(A)	**364.3**	364.3	**364.3**	364.3	364.3
Reserves	19(B)	**0.2**	0.4	**(8.2)**	(16.2)	(25.6)
Retained profits		**963.4**	809.0	**988.5**	832.7	826.5
Non-controlling interests		**-**	-	**-**	-	4.5
Total equity		**1,327.9**	1,173.7	**1,344.6**	1,180.8	1,169.7

These balance sheets should be read in conjunction with the accompanying notes.

STATEMENTS OF CHANGES IN EQUITY
For the year ended 31 December 2014

The Company

2014	SHARE CAPITAL $M	RESERVES $M	RETAINED PROFITS $M	TOTAL EQUITY $M
At 1 January	**364.3**	**0.4**	**809.0**	**1,173.7**
Profit after income tax	-	-	**285.4**	**285.4**
Other comprehensive income	-	**(0.2)**	-	**(0.2)**
Total comprehensive income	-	**(0.2)**	**285.4**	**285.2**
Transactions with owners in their capacity as owners:				
Dividends paid or provided on ordinary shares	-	-	**(131.0)**	**(131.0)**
At 31 December	**364.3**	**0.2**	**963.4**	**1,327.9**

2013	SHARE CAPITAL $M	RESERVES $M	RETAINED PROFITS $M	TOTAL EQUITY $M
At 1 January	364.3	1.8	807.4	1,173.5
Profit after income tax	-		131.6	131.6
Other comprehensive income	-	(1.4)	-	(1.4)
Total comprehensive income	-	(1.4)	131.6	130.2
Transactions with owners in their capacity as owners:				
Dividends paid on ordinary shares	-	-	(130.0)	(130.0)
At 31 December	364.3	0.4	809.0	1,173.7

Consolidated

2014	SHARE CAPITAL $M	RESERVES $M	RETAINED PROFITS $M	NON CONTROLLING INTERESTS	TOTAL EQUITY $M
At 1 January	**364.3**	**(16.2)**	**832.7**	-	**1,180.8**
Profit after income tax	-	-	**286.8**	-	**286.8**
Other comprehensive income	-	**8.0**	-	-	**8.0**
Total comprehensive income	-	**8.0**	**286.8**	-	**294.8**
Transactions with owners in their capacity as owners:					
Dividends paid on or provided ordinary shares	-	-	**(131.0)**	-	**(131.0)**
At 31 December	**364.3**	**(8.2)**	**988.5**	-	**1,344.6**

2013	SHARE CAPITAL $M	RESERVES $M	RETAINED PROFITS $M	NON CONTROLLING INTERESTS	TOTAL EQUITY $M
At 1 January	364.3	(25.6)	826.5	4.5	1,169.7
Profit after income tax	-	-	136.2	-	136.2
Other comprehensive income	-	9.4	-	-	9.4
Total comprehensive income	-	9.4	136.2	-	145.6
Transactions with owners in their capacity as owners:					
Dividends paid on ordinary shares	-	-	(130.0)	(4.5)	(134.5)
At 31 December	364.3	(16.2)	832.7	-	1,180.8

These statements of changes in equity should be read in conjunction with the accompanying notes.

STATEMENTS OF CASH FLOWS
For the year ended 31 December 2014

	NOTE	The Company 2014 $M	The Company 2013 $M	Consolidated 2014 $M	Consolidated 2013 $M
OPERATING ACTIVITIES					
Premium received		**491.3**	495.6	**508.9**	513.4
Non-reinsurance recoveries received		**2.5**	3.2	**2.5**	3.0
Reinsurance commissions received		**41.6**	15.2	**41.6**	21.2
Outward reinsurance paid		**(144.9)**	(67.6)	**(145.8)**	(74.6)
Claims paid		**(42.5)**	(68.9)	**(42.7)**	(69.3)
Insurance costs paid		**(38.5)**	(40.5)	**(39.1)**	(41.0)
Other underwriting costs paid		**(67.2)**	(81.4)	**(69.9)**	(82.7)
Interest received		**67.8**	67.9	**69.2**	68.7
Income taxes paid		**(84.4)**	(69.5)	**(87.8)**	(71.0)
Net cash flows from operating activities		**225.7**	254.0	**236.9**	267.7
INVESTING ACTIVITIES					
Proceeds from sale of fixed interest and equity investments		**3,116.3**	2,485.3	**3,516.6**	2,841.5
Purchase of fixed interest investments		**(3,291.0)**	(2,620.4)	**(3,695.7)**	(2,994.3)
Dividends received and capital returned from controlled entity		**11.0**	6.6	**-**	-
Net cash flows from investing activities	9(A)	**(163.7)**	(128.5)	**(179.1)**	(152.8)
FINANCING ACTIVITIES					
Dividends paid		**(65.0)**	(130.0)	**(65.0)**	(134.6)
Net cash flows from financing activities		**(65.0)**	(130.0)	**(65.0)**	(134.6)
Net movement in cash and cash equivalents		**(3.0)**	(4.5)	**(7.2)**	(19.7)
Cash and cash equivalents at the beginning of the financial year		**9.2**	13.7	**15.0**	33.3
Effect of exchange rate changes		**-**	-	**0.6**	1.4
Cash and cash equivalents at the end of the financial year	9	**6.2**	9.2	**8.4**	15.0

These statements of cash flows should be read in conjunction with the accompanying notes.

NOTES TO THE FINANCIAL STATEMENTS
For the year ended 31 December 2014

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies adopted in the preparation of the financial report are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

(A) Basis of preparation

This general purpose financial report has been prepared in accordance with Australian Accounting Standards, interpretations of the Australian Accounting Standards Board (AASB) and the Corporations Act 2001. The consolidated entity is a for-profit entity for the purpose of preparing the financial statements.

The principal accounting policies adopted in the preparation of the financial report are set out below. These policies are consistent with those of the previous financial year except as set out below.

Prior to its acquisition by QBE Group in 2007 the company prepared consolidated financial statements, Following the acquisition the company was exempt from preparing consolidated financial statements under AASB 127: *Consolidated and Separate Financial Statements* and consequently the company only prepared separate financial statements. As the shareholder has decided to partially list the company via an Initial Public Offering (IPO) this exemption no longer applies.

For the year ended 31 December 2014 the company has prepared consolidated financial statements and has complied with the requirements of AASB1 *First-time Adoption of Australian Accounting Standards* and AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* by including additional comparative information in the consolidated Balance sheet.

(i) New and amended standards adopted by the consolidated entity

The company mandatorily adopted the following accounting policies which became effective for the annual reporting period commencing 1 January 2014. These standards have introduced new disclosures but did not materially affect the amounts recognised in the financial statements.

Title	
AASB 1031	Materiality
AASB 2011-4	Amendments to Australian Accounting Standards to Remove Individual Key Management Personnel Disclosure Requirements
AASB 2012-3	Amendments to Australian Accounting Standards - Offsetting Financial Assets and Financial Liabilities
AASB 2013-4	Amendments to Australian Accounting Standards – Novation of Derivatives and Continuation of Hedge Accounting
AASB 2013-9	Amendments to Australian Accounting Standards – Conceptual framework, materiality and financial instruments: Part B
Interpretation 21	Levies

(ii) Statement of compliance

The financial report complies with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board and Australian Accounting Standards as issued by the AASB.

(iii) Historical cost convention

These financial statements have been prepared under the historical cost convention, as modified by certain exceptions noted in the financial report, with the principal exceptions being the measurement of financial assets at fair value and the measurement of the outstanding claims liability and related reinsurance and other recoveries at present value. Refer to note 4.

(iv) Functional and presentation currency

The presentation currency of the consolidated entity is Australian dollars. The consolidated entity has selected an Australian dollar presentation currency as the majority of its underwriting activity occurs in Australia. The presentation currency of the company is Australian dollars, being the functional and presentation currency of the company.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(v) Critical accounting estimates and judgements

The preparation of the financial statements requires the use of certain critical accounting estimates. It also requires management to exercise judgement in the process of applying the consolidated entity's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions or estimates are significant, are disclosed in note 4.

(B) Principles of consolidation

The consolidated financial statements incorporate the assets and liabilities of all subsidiaries controlled by the company as at 31 December 2014 and the results for the financial year then ended. Control exists when it is exposed, or has rights, to variable returns from its involvement with an entity and has the ability to affect those returns through its power over it. The effects of all transactions between controlled entities are eliminated in full. Non-controlling interests in the results and equity of controlled entities are shown separately in the consolidated statement of comprehensive income and balance sheet.

Where control of an entity commences during a financial year, its results are included in the consolidated statement of comprehensive income from the date on which control is obtained. Where control of an entity ceases during a financial year, its results are included for that part of the year during which the control existed.

A change in the ownership of a subsidiary without the loss of control is accounted for as an equity transaction.

(C) Premium revenue

Premium comprises amounts charged to policyholders, excluding taxes collected on behalf of third parties. The earned portion of premium received and receivable is recognised as revenue. Premium is treated as earned from the date of attachment of risk.

(D) Insurance contracts

All of the insurance products offered or utilised by the consolidated entity meet the definition of insurance contracts under AASB 1023: General Insurance Contracts, and are accounted for and reported in accordance with this standard. These products do not contain embedded derivatives or deposits that are required to be unbundled.

Insurance contracts that meet the definition of financial guarantee products are accounted for as insurance contracts under AASB 1023, rather than as financial instruments under AASB 139: Financial Instruments: Recognition and Measurement.

(E) Unearned premium

Unearned premium is calculated based on the term of the policies written and the likely pattern in which risk will emerge over that term.

At each balance sheet date, the adequacy of the unearned premium liability is assessed on a net of reinsurance basis against the present value of the expected future cash flows relating to potential future claims in respect of the relevant insurance contracts, plus an additional risk margin to reflect the inherent uncertainty of the central estimate. The assessment is carried out at the business segment level, being a portfolio of contracts that are broadly similar and managed together as a single portfolio. If the present value of expected future cash flows relating to future claims plus the additional risk margin exceeds the unearned premium liability less deferred acquisition costs, then the unearned premium liability is deemed to be deficient. The resulting deficiency is recognised immediately through profit or loss.

(F) Outward reinsurance

Premium ceded to reinsurers is recognised as an expense from the attachment date over the period of indemnity of the reinsurance contract in accordance with the expected pattern of incidence of risk. Where applicable, a portion of outward reinsurance premium is treated as a prepayment at the balance sheet date.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(G) Claims

The provision for outstanding claims is measured as the central estimate of the present value of expected future claims payments plus a risk margin. The expected future payments include those in relation to claims reported but not yet paid, claims incurred but not reported ("IBNR"), and estimated claims handling costs. Claims expense represents claim payments adjusted for movements in the outstanding claims liability.

The expected future payments are discounted to present value using a risk-free rate.

A risk margin is applied to the central estimate, net of non-reinsurance recoveries, to reflect the inherent uncertainty in the central estimate.

(H) Reinsurance and other recoveries

Reinsurance and other recoveries receivable on paid claims, reported claims not yet paid and IBNR are recognised as revenue.

Amounts recoverable are assessed in a manner similar to the assessment of outstanding claims. Recoveries are measured as the present value of the expected future receipts, calculated on the same basis as the provision for outstanding claims.

(I) Acquisition costs

Acquisition costs (which includes commission costs) are the costs associated with obtaining and recording insurance contracts. Acquisition costs are capitalised when they relate to the acquisition of new business and are amortised on the same basis as the earning pattern of the premium, in accordance with the premium income earning pattern adjusted for policy terminations. At the reporting date, deferred acquisition costs represent the capitalised costs that relate to the unearned premium. Acquisition costs are deferred in recognition of their future benefit and are measured at the lower of cost and recoverable amount.

(J) Commissions

Profit commission is payable in accordance with the applicable agreements and based on the profitability of the underlying portfolio, including the recognition of revenue and claims experience. An expense is recognised as the risk emerges in the underlying portfolio.

Exchange commission is receivable and payable in accordance with the applicable reinsurance agreements on the basis of reinsurance written. Exchange commission revenue and expense is recognised in accordance with the premium income earning pattern adjusted for policy terminations.

(K) Investment income

Interest income is recognised using the effective interest rate method. Dividends are recognised when the right to receive payment is established. Investment income includes realised and unrealised gains or losses on financial assets which are reported on a combined basis as fair value gains or losses on financial assets.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(L) Taxation

The income tax expense for the period is the tax payable on the current period's taxable income based on the applicable income tax rate for each jurisdiction adjusted for changes in deferred tax assets and liabilities attributable to temporary differences and to unused tax losses.

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the end of the reporting period in the countries where the company's subsidiary and branch operate and generate taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred tax liabilities are not recognised if they arise from the initial recognition of goodwill. Deferred income tax is also not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the end of the reporting period and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred tax assets are recognised for deductible temporary differences and unused tax losses only if it is probable that future taxable amounts will be available to utilise those temporary differences and losses.

Deferred tax assets and liabilities are not recognised for temporary differences between the carrying amount and tax bases of investments in foreign operations where the company is able to control the timing of the reversal of the temporary differences and it is probable that the differences will not reverse in the foreseeable future.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets and liabilities and when the deferred tax balances relate to the same taxation authority. Current tax assets and tax liabilities are offset where the entity has a legally enforceable right to offset and intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

The company has implemented the tax consolidation legislation. All entities in the Australian tax-consolidated group continue to account for their own current and deferred tax amounts. These tax amounts are measured as if each entity continues to be a stand-alone tax payer in its own right. Details of the tax funding agreement are included in note 8(B) to the financial statements.

Current and deferred tax is recognised in profit or loss, except to the extent that it relates to items recognised in other comprehensive income or directly in equity. In this case, the tax is also recognised in other comprehensive income or directly in equity, as appropriate.

(M) Insurance profit

Insurance profit is derived by adding investment income on assets backing policyholders' funds to the underwriting result.

(N) Cash and cash equivalents

Cash and cash equivalents include cash at bank and on hand and deposits at call which are readily convertible to cash on hand and which are used for operational cash requirements.

(O) Investments

Investments comprise interest-bearing assets, equities and derivative financial instruments.Investments are designated as fair value through profit or loss on initial recognition. They are initially recorded at fair value, being the cost of acquisition excluding transaction costs, and are subsequently remeasured to fair value at each reporting date. The policy of management is to designate a group of financial assets or financial liabilities as fair value through profit or loss when that group is both managed and its performance evaluated on a fair value basis for both internal and external reporting in accordance with the consolidated entity's documented investment strategy.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

For securities traded in an active market, the fair value is determined by reference to quoted market prices. Where quoted market prices in active markets are not available, fair value is determined using valuation techniques incorporating inputs that are observable for the asset. In the absence of quoted market prices in active markets and observable market inputs, valuation techniques or models which are based on unobservable inputs may be used.

All purchases and sales of investments that require delivery of the asset within the timeframe established by regulation or market convention ("regular way" transactions) are recognised at trade date, being the date on which the company commits to buy or sell the asset. Investments are derecognised when the right to receive future cash flows from the assets has expired, or has been transferred, and the company has transferred substantially all the risks and rewards of ownership.

(P) Derivative financial instruments

Derivatives are initially recognised at fair value and are subsequently remeasured to fair value at reporting date. Derivatives which are not part of a hedging relationship are measured at fair value through profit or loss.

For derivatives traded in an active market, the fair value of derivatives is determined by reference to quoted market prices. For derivatives that are not traded or which are traded in a market that is not sufficiently active, fair value is determined using generally accepted valuation techniques.

(Q) Trade and other receivables

Trade receivables are recognised at amounts receivable less a provision for impairment. A provision for impairment is established when there is objective evidence that the company will not be able to collect all amounts due according to the original term of the receivable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. Any increase or decrease in the provision for impairment is recognised in the profit or loss within underwriting expenses. When a receivable is uncollectible, it is written off against the provision for impairment account. Subsequent recoveries of amounts previously written off are credited against underwriting expenses in the profit or loss.

(R) Impairment of assets

Assets that have an indefinite useful life are tested annually for impairment or more frequently when changes in circumstances indicate that the carrying amount may not be recoverable. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised as the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and its value in use. For the purposes of assessing impairment, assets are grouped in cash generating units, which are the lowest levels for which there are separately identifiable cash flows.

(S) Trade and other payables

Trade and other payables are measured at cost and are settled under standard terms and conditions. Intercompany payables are measured at amortised cost and are repayable on demand.

(T) Foreign currency

(i) Translation of foreign currency transactions and balances

Items included in the financial statements are measured using the currency of the primary economic environments in which the entity operates (the functional currencies). Foreign currency transactions are translated into functional currencies at the spot rates of exchange applicable at the dates of the transactions. At the balance sheet date, monetary assets and liabilities denominated in foreign currencies are translated at the spot rates of exchange prevailing at that date. Resulting exchange gains and losses are included in profit or loss.

(ii) Translation of foreign operation

The results and balance sheets of all operations that have a functional currency different from the consolidated entity's presentation currency are translated into the presentation currency as follows:

- income and expenses are translated at cumulative average rates of exchange; and
- other balance sheet items are translated at the closing balance date rates of exchange.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

On consolidation, exchange differences arising from the translation of the net investment in foreign operations, and of financial liabilities, are taken to shareholder's equity and recognised in other comprehensive income. When a foreign operation is sold in whole or part, these exchange differences are reversed out of other comprehensive income and recognised in profit or loss as part of the gain or loss on sale.

(iii) Exchange rates

The principal exchange rates used in the preparation of the financial statements were:

	2014		2013	
	PROFIT OR LOSS	BALANCE SHEET	PROFIT OR LOSS	BALANCE SHEET
HK$/A$	**0.143**	**0.157**	0.134	0.144
NZ$/A$	**0.919**	**0.955**	0.850	0.921

(U) Equity

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction from the proceeds, net of tax.

(V) Dividends

Provision is made for dividends which are declared, being appropriately authorised and no longer at the discretion of the company, on or before the end of the financial year but not distributed at the balance sheet date.

(W) Earnings per share

(i) Basic earnings per share

Basic earnings per share is determined by dividing net profit after income tax attributable to members of the company, by the weighted average number of ordinary shares outstanding during the financial year.

(X) Goods and services tax ("GST")

Revenues, expenses and assets are recognised net of the amount of GST, except where the amount of GST incurred is not recoverable from the Australian Taxation Office ("ATO"). In these circumstances, the GST is recognised as part of the cost of acquisition of the asset or as part of an item of expense. Receivables and payables in the balance sheet are shown inclusive of GST.

The net amount of GST recoverable from, or payable to, the Australian Taxation Office is included with other receivables or payables in the balance sheet.

Cash flows are presented on a gross basis. The GST components of cash flows arising from investing or financing activities which are recoverable from, or payable to the taxation authority, are presented as operating cash flow.

The company is part of a GST group headed by QBE Management Services Pty Limited, a related entity.

(Y) Rounding of amounts

The consolidated entity is of a kind referred to in the ASIC class order 98/100 date 10 July 1998 (as amended by class order 04/667 dated 15 July 2004) relating to the "rounding off" of amounts in the financial statements. Amounts have been rounded off in the financial statements to the nearest hundred thousand dollars or, in certain cases, the nearest thousand dollars in accordance with that class order.

(Z) Comparatives

Where appropriate, prior period comparatives have been reclassified in this financial report to ensure comparability in the current reporting period. The reclassification was necessary to provide the readers of the financial report with a greater understanding of the company's financial statements.

(AA) Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision maker. It has been determined that the Chief Executive Officer is the chief operating decision maker, as it is ultimately responsible for allocating resources and assessing performance.

2. NEW ACCOUNTING STANDARDS AND AMENDMENTS ISSUED BUT NOT YET EFFECTIVE

Title		Operative Date
AASB 9	Financial Instruments	1 January 2018
AASB 9 (revised)	Financial Instruments	1 January 2018
2009-11	Amendments to Australian Accounting Standards arising from AASB 9	1 January 2018
2010-7	Amendments to Australian Accounting Standards arising from AASB 9 (December 2010)	1 January 2018
2013-9	Amendments to Australian Accounting Standards - conceptual framework, materiality and financial instruments: Part C	1 January 2015
2014-1	Amendments to Australian Accounting Standards [Part A – Annual Improvements]	1 January 2015
2014-1	Amendments to Australian Accounting Standards [Part E – Financial Instruments]	1 January 2018
2014-4	Amendments to Australian Accounting Standards – Clarification of Acceptable Methods of Depreciation and Amortisation	1 January 2016
IFRS 15	Revenue from Contracts with Customers	1 January 2017
Various	Annual Improvements to IFRSs 2012-2014 cycle	1 January 2016

The Australian Accounting Standards and amendments detailed in the table above are not mandatory for the company until the operative dates stated; however, early adoption is permitted.

The consolidated entity will apply the standards and amendments detailed above for the reporting periods beginning on the operative dates set out above. An initial assessment of the financial impact of the standards and amendments has been undertaken and they are not expected to have a material impact on the company's financial statements or accounting policies.

3. SEGMENT INFORMATION

(A) Operating Segments

The consolidated entity has identified its operating segments based on information used by the Chief Executive Officer for measuring performance and determining the allocation of capital. The operating segments have been identified based on the way that the consolidated entity's underwriting and services are managed within the various markets in which we operate.

The consolidated entity is a monoline lender's mortgage insurer. The business is managed along geographical lines with operations in Australia/New Zealand and Hong Kong. Over 95% of the operations (as measured by gross written premium, profit after tax and total assets) are based within the Australian segment, consequently no segment reporting is required.

(B) Geographical analysis

The operating segments reported to management are defined by reference to the geographical locations and, as such, satisfy the requirements of a geographical analysis as well as an operating segment analysis. As noted above the Australian segment dominates the operations of the consolidated entity.

Gross earned premium revenue – external for Australia, the parent's country of domicile, was $427.9 million (2013 $269.5 million).

(C) Customer analysis

Three customers on an individual basis contributed more than 10% of the consolidated entity's gross written premium. These customers contributed to the Australian segment. Their contributions are respectively 26.3%, 20.9% and 16.3% (2013: four customers; 26.9%, 13.3%, 13.2% and 12.5%).

4. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

The consolidated entity is a lenders' mortgage insurance company underwriting business in Australia, New Zealand and Hong Kong.

The consolidated entity has developed a strong, centralised risk management and policy framework, designed to ensure consistency of approach across a number of operational activities, subject to the specific requirements of the local markets, legislation and regulation. Such operational activities include underwriting, claims management, actuarial assessment of claims provisions and investment management. In addition, assessment of the net outstanding claims provision set at a company and subsidiary level is subject to detailed head office review. The probability of adequacy of the company's insurance liabilities is measured by the company's senior actuaries.

Given the centralised approach to many of its activities, sensitivity analyses in respect of critical accounting estimates and judgements are presented at the consolidated entity level in order to provide information and analysis which is meaningful, relevant, reliable and comparable year on year. Sensitivity disclosure at business segment would not provide a meaningful overview given the dominance of the Australian segment.

The consolidated entity makes estimates and judgements in respect of the reported amounts of certain assets and liabilities. These estimates and judgements are determined by qualified and experienced employees with reference to historical data and reasoned expectations of future events, and are continually updated. The key areas in which critical estimates and judgements are applied are described on the following pages.

(A) Outstanding claims provision

The consolidated entity's net outstanding claims provision comprises:

- the gross central estimate of expected future claims payments;
- amounts recoverable from reinsurers, borrowers and third parties based on the gross central estimate;
- a reduction to reflect the discount to present value using risk-free rates of return to reflect the time value of money; and
- a risk margin that reflects the inherent uncertainty in the net discounted central estimate.

A net discounted central estimate is intended to represent the mean of the distribution of the expected future cash flows. As the company requires a higher probability that estimates will be adequate over time, a risk margin is added to the net discounted central estimate to determine the outstanding claims provision.

(i) Central estimate

The provision for expected future payments includes those in relation to claims reported but not yet paid; claims incurred but not reported (IBNR); and estimated claims handling costs, being the direct and indirect expenses incurred in the settlement of claims.

The estimation of IBNR is generally subject to a greater degree of uncertainty than the estimation of the cost of settling claims already notified to the consolidated entity, where more information about the claims is generally available. The longer the delay between the event giving rise to the claim and final claim settlement, the greater the variability between initial estimates of the loss to be incurred and the final settlement amount, as a result of additional financing and settlement costs incurred by the lender and changes in property valuations.

The consolidated entity's process for establishing the central estimate involves extensive consultation with internal and external actuaries, claims managers, underwriters and other senior management. This process includes regular internal claims review meetings attended by senior management and detailed review by an external actuary at least annually. The risk management procedures related to the actuarial function are explained further in note 5.

4 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (CONTINUED)

The determination of the amounts that the consolidated entity will ultimately pay for claims arising under insurance and reinsurance contracts involves a number of critical assumptions. Some of the uncertainties impacting these assumptions are as follows:

- changes in patterns of claims incidence, reporting and payment;
- volatility in the estimation of future costs during the time that elapses before a definitive determination of the ultimate claims cost can be made;
- changes in the legal environment, including the interpretation of liability laws and the quantum of damages; and
- social and economic trends, for example house price inflation, unemployment and interest rates.

The potential impact of changes in key assumptions used in the determination of the central estimate and the probability of adequacy of the central estimate on the company's profit or loss are summarised in note 4(A)(v).

Central estimates are determined by reference to a variety of estimation techniques, generally based on a statistical analysis of historical experience which assumes an underlying pattern of claims development and payment. The final selected central estimate is based on a judgemental consideration of the results of each method and qualitative information, for example:

- historical trends in the development and incidence of the numbers of defaults reported, numbers of defaults cured, numbers of properties taken into possession, numbers of such properties sold, numbers of claims arising from these sales, and the costs of those claims;
- exposure details, including policy counts, sums insured and various other characteristics of the borrowers and loans; and
- historical and likely future trends of expenses associated with managing claims to finalisation.

Central estimates are calculated gross of any reinsurance and other recoveries. Separate estimates are made of the amounts recoverable from reinsurers, borrowers and third parties based on the gross central estimate.

The net central estimate is discounted at risk-free rates of return to reflect the time value of money. Details of the key assumptions applied in the discounting process are summarised in note 4(A)(iv).

(ii) Assets arising from contracts with reinsurers

Assets arising from reinsurance recoveries under contracts with the consolidated entity's reinsurers are determined using the same methods described above. In addition, the recoverability of these assets is assessed at each balance sheet date to ensure that the balances properly reflect the amounts that will ultimately be received, taking into account counterparty credit risk and the contractual terms of the reinsurance contract. Counterparty credit risk in relation to reinsurance assets is considered in note 5(C)(iii).

(iii) Risk margin

Risk margins are determined by management and are held to mitigate the potential for uncertainty in the central estimate. The determination of the appropriate level of risk margin takes into account similar factors to those used to determine the central estimate, such as:

- prior accident year claims development; and
- the level of uncertainty in the net discounted central estimate due to actuarial estimation, data quality issues, variability of key discount assumptions and legislative uncertainty.

The measurement of variability uses techniques similar to those used in determining the central estimate. These techniques determine a range of possible outcomes of ultimate payments and assign a likelihood to outcomes at different levels. These techniques use standard statistical distributions, and the measure of variability is referred to as the coefficient of variation. The potential impact of changes in the coefficient of variation assumptions on the company's profit or loss is summarised in note 4(A)(v).

4 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (CONTINUED)

The probability of adequacy is a statistical measure of the relative adequacy of the outstanding claims provision and is derived from the comparison of the risk margin with the net discounted central estimate. Using a range of outcomes, it allows a determination of the probability of adequacy represented by a risk margin. For example, a 90% probability of adequacy indicates that the outstanding claims provision is expected to be adequate nine times in ten. The probability of adequacy is not of itself an accounting policy or estimate as defined by AASB 108: Accounting Policies, Changes in Accounting Estimates and Errors. The appropriate level of risk margin is not determined by reference to a fixed probability of adequacy.

During the year the risk margin decreased following actuarial analysis of the uncertainty inherent in the central estimate. The amount released from the risk margin was $47.3m (2013: nil). This analysis is supported by improved economic conditions and the benefits of the ongoing improvements in underwriting controls. As a consequence, the probability of adequacy of the consolidated entity at 31 December 2014 decreased to 91.3% from 98.5% at 31 December 2013. Refer note 16(C).

(iv) Financial assumptions used to determine the outstanding claims provision

Key variables

	The Company		Consolidated	
	2014	**2013**	**2014**	**2013**
	%	**%**	**%**	**%**
Severity	**27.6**	27.1	**27.6**	27.1
Claim rates	**22.7**	26.5	**22.7**	26.5
Coefficient of variation	**36.0**	36.0	**36.0**	36.0

- Severity is a measure of the anticipated claims cost relative to the corresponding risk exposures;
- Claim rate is the percentage of current defaults that are expected to become claims; and
- The percentages adopted in the actuarial model are determined based on an analysis of historical experience combined with actuarial and management judgement of future trends.

Discount rates

AASB 1023: General Insurance Contracts (AASB 1023) requires that the outstanding claims provision shall be discounted for the time value of money using risk-free rates that are based on current observable, objective rates that relate to the nature, structure and terms of the future obligations. The standard also states that government bond rates may be an appropriate starting point in determining a risk-free rate. The consolidated entity generally uses risk-free rates to discount the outstanding claims provision.

The weighted average risk-free rates used to discount the outstanding claims provision are summarised below.

	The Company		Consolidated	
	2014	**2013**	**2014**	**2013**
	%	**%**	**%**	**%**
Discount factor	**2.3**	2.5	**2.3**	2.5

Weighted average term to settlement

The relevant discount rate is applied to the anticipated cash flow profile of the central estimate, including related recoveries, determined by the reference to a combination of historical analysis and current expectations of when claims and recoveries will be settled.

The weighted average term to settlement of the consolidated entity's net outstanding claims provision at the balance sheet date is 1.2 years (2013: 1.1 years).

4 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (CONTINUED)

(v) Impact of changes in key variables on the outstanding claims provision

The impact of changes in key variables used in the calculation of the outstanding claims provision is summarised in the table below. Each change has been calculated in isolation from the other changes and each change shows the after tax impact on profit assuming that there is no change to any of the other variables.

The sensitivities below assume that all changes directly impact profit after tax. In practice, however, it is likely that if the central estimate was to increase by 5%, at least part of the increase may result in a decrease in the appropriate level of risk margins rather than in profit after tax, depending on the nature of the change in central estimate. Likewise, if the coefficient of variation were to increase by 1%, it is possible that the probability of adequacy would reduce from its current level rather than result in a change to net profit after income tax or to equity.

The impact of a change in interest rates on profit after tax due to market value movements on fixed interest securities is shown in note 5(D)(ii).

		PROFIT (LOSS)[1]			
		The Company		Consolidated	
	SENSITIVITY	2014	2013	2014	2013
	%	$M	$M	$M	$M
Severity	+20%	**(12.4)**	**(14.3)**	**(12.7)**	(14.7)
	-20%	**12.4**	**14.3**	**12.7**	14.3
Claim rates	+20%	**(4.4)**	**(6.3)**	**(4.7)**	(6.3)
	-20%	**5.6**	**7.4**	**5.9**	7.4
Discount factors	+5%	**0.1**	**0.1**	**0.1**	0.1
	-5%	**(0.1)**	**(0.1)**	**(0.1)**	(0.1)
Coefficient of variation	+20%	**(5.2)**	**(14.8)**	**(5.2)**	(14.8)
	-20%	**5.4**	**14.1**	**5.4**	14.1

[1] Net of tax at the prima facie rate of 30%.

(B) Liability adequacy test

At each balance sheet date, the adequacy of the unearned premium liability is assessed on a net of reinsurance basis against the present value of the expected future cash flows relating to potential future claims, plus a risk margin to reflect the inherent uncertainty of the central estimate (refer note 17(D)). Future claims are those claims expected to arise from claims events occurring after the balance sheet date. The assessment is carried out using the same methods described in note 4(A).

AASB 1023 requires that this test be carried out at the level of a "portfolio of contracts that are subject to broadly similar risks and are managed together in a single portfolio". AASB 1023 does not explicitly define "broadly similar risks" or "managed together as a single portfolio", as a monoline insurer the company has interpreted these terms to represent the entire portfolio.

(C) Unearned premium and reinsurance commission liabilities and deferred insurance costs

As highlighted in note 1, premium and reinsurance commission is earned and insurance costs recognised based on the term of the policies written and the likely pattern in which risk will emerge over that term. An actuarial analysis of the emergence of risk over the life of a policy is performed annually and is used to derive an earning pattern for each underwriting year. Premium and reinsurance commission is earned and insurance costs recognised in accordance with these patterns, adjusted for policy terminations.

During the year, in accordance with accounting standards, the consolidated entity reassessed the expected pattern of risk emergence over the life of its portfolio. Actuarial analysis indicated that a greater proportion of risk of loss was encountered in the early years after policy inception than had previously been anticipated. Based on this and the benign economic conditions, it was appropriate to release a portion of previously deferred income and expenditure to profit. This decreased the unearned premium liability by $94.5 million (2013: increased $11.2 million), the deferred insurance costs by $11.5 million (2013: increased $1.6 million) and the unearned reinsurance commission by $1.0 million (2013: nil).

5. RISK MANAGEMENT

QBE Group's risk management policy, strategy and framework are embedded in the head office function and in each of the divisional operations, ensuring a consistent approach to managing risk across the organisation. The Board annually approves a comprehensive risk management strategy (RMS), and a reinsurance management strategy (REMS), both of which are lodged with the Australian Prudential Regulation Authority (APRA).

As a member of the QBE Group, the consolidated entity has adopted the risk management policy of QBE Group where applicable. The consolidated entity's risk management objectives are to:

- achieve competitive advantage through better understanding the risk environment in which the consolidated entity operates;
- optimise risk and more effectively allocate capital and resources by assessing the balance of risk and reward; and
- avoid unwelcome surprises by reducing uncertainty and volatility.

It is QBE Group's policy to adopt a rigorous approach to managing risk throughout the QBE Group of entities. Risk management is a continuous process and an integral part of quality business management. QBE Group's approach is to integrate risk management into the broader management processes of the organisation. It is QBE Group's philosophy to ensure that risk management is embedded in the business and that the risk makers or risk takers are themselves the risk managers. Specifically, the management of risk must occur at each point in the business management cycle.

Risk management is a key part of the consolidated entity's governance structure and strategic and business planning. It underpins the setting of limits and authorities and it is embedded in the monitoring and evaluation of performance. This holistic approach to risk management allows all of the QBE Group's risks to be managed in an integrated manner.

QBE Group's global risk management framework sets out the approach to managing key risks and meeting strategic objectives whilst taking into account the creation of value for our shareholders. The framework is made up of complementary elements that are embedded throughout the business management cycle and culture. Key aspects include: governance, risk appetite and tolerance, delegated authorities, risk policies, measurement and modelling, risk and control self assessment, risk treatment, optimisation and ongoing improvement through management action plans and risk and performance monitoring.

A fundamental part of the QBE Group's overall risk management strategy is the effective governance and management of the risks that impact the amount, timing and uncertainty of cash flows from insurance contracts. The operating activities of the company expose it to risks such as market risk, credit risk and liquidity risk. The QBE Group's risk management framework recognises the unpredictability of financial markets and seeks to minimise potential adverse effects on its financial performance. The consolidated entity has established internal controls to manage risk in the key areas of exposure relevant to its business.

The consolidated entity's risk profile is described under the following broad risk categories:

- Strategic risk
- Insurance risk
- Credit risk
- Market risk
- Liquidity risk
- Operational risk
- Group risk

Each of these is described more fully in sections (A) to (G) below.

(A) Strategic risk

Strategic risk refers to the current and prospective impact on earnings and/or capital arising from strategic business decisions, implementation of decisions and responsiveness to external change. This includes risks associated with business strategy and change, investment strategy and corporate governance. Of particular relevance is capital management risk.

5. RISK MANAGEMENT (CONTINUED)

(i) Capital management risk

Australian and overseas controlled entities are subject to extensive prudential and other forms of regulation in the jurisdictions in which they conduct business. Prudential regulation is generally designed to protect policyholders. Regulation covers a number of areas including solvency, change in control and capital movement limitations. The regulatory environment in Australia and overseas continues to evolve in response to economic, political and industry developments. QBE Group works closely with regulators and monitors regulatory developments across its global operations to assess their potential impact on its ability to meet solvency and other requirements.

(B) Insurance risk

Insurance risk is the risk of fluctuations in the timing, frequency and severity of insured events and claims settlements, relative to expectations. This includes underwriting, insurance concentrations and reserving and reinsurance. The risks inherent in any single insurance contract are the possibility of the insured event occurring and the uncertainty of the amount of the resulting claim. By the very nature of an insurance contract, these risks are random and unpredictable for a single contract. In relation to the pricing of individual insurance contracts and the determination of the level of the outstanding claims provision in relation to a portfolio of insurance contracts, the principal risk is that the ultimate claims payments will exceed the carrying amount of the provision established.

Experience shows that the larger the portfolio of similar insurance contracts, the smaller the relative variability around the expected outcome will be. In addition, a more diversified insurance and reinsurance group is less likely to be affected by a change in any one specific portfolio. The company has developed its underwriting strategy to diversify the type of insurance risks accepted and, within each of these categories, to achieve a sufficiently large population of risks to reduce the variability of the expected outcome.

QBE Group has established the following protocols to manage its insurance risk across the underwriting, claims and actuarial disciplines.

(i) Underwriting risks

Selection and pricing of risks

The consolidated entity provides lenders' mortgage insurance ("LMI") in Australia, New Zealand and Hong Kong.

LMI insures the lender should the borrower default on repayment of the loan, and covers the remaining loan balance, plus selling costs and expenses, following the application of the proceeds from the sale of the security property.

Key risk mitigation policies and procedures comprise:

- the pricing model measures return on capital and reflects risks on a long term cyclical performance basis for both standard and new products. Pricing tables are set according to appropriate risk characteristics, such as type of product, loan amounts and loan to valuation ratio;
- standard insurance agreements and documented underwriting policies and procedures are in place with allocation of delegated authority levels to approve applications; and
- quality assurance reviews of underwriting and claims management are conducted on a regular basis.

5. RISK MANAGEMENT (CONTINUED)

Concentration risk
Concentration risk is the risk of exposure due to concentration of activity in certain geographical locations, industries or counterparties. The consolidated entity operates throughout all regions in Australia, New Zealand, and Hong Kong and therefore has limited geographic concentration risk on insurance contracts; exposures are monitored but not limited by region. Limits, such as those placed on maximum aggregate exposures to individual borrowers and per property, are contained in underwriting policies and are embedded in systems and processes.

The consolidated entity is exposed to the possibility of very large losses from economic events such as a significant increase in regional or nationwide unemployment levels, weakening in house prices, or a significant increase in interest rates over a short period of time. As the largest entity within the consolidation, the company calculates its insurance concentration risk charge ("ICRC"), which is the estimated maximum net loss from significant economic events with an approximate return period of 200 years (2013: 200 years). The ICRC must be less than the company's concentration risk tolerance; otherwise, steps such as the purchase of additional reinsurance are taken to limit the exposure. As at 31 December 2014, the ICRC was $786.7 million (2013: $896.3 million) before tax benefit, which was less than the risk tolerance

(ii) Claims management and claims estimation risks
The consolidated entity's approach to determining the outstanding claims provision and the related sensitivities are set out in note 4. The consolidated entity seeks to ensure the adequacy of its outstanding claims provision through the implementation of the following controls:

- experienced claims managers operate within policy and within the levels of authority delegated to them in respect of the settlement of claims;
- processes to ensure that all defaults are captured and updated on a timely basis and with a realistic assessment of the ultimate claims cost;
- initial IBNR estimates are set by experienced internal actuaries in conjunction with the product managers and underwriters for each class of business in each business unit. The valuation of the central estimate is primarily performed by actuaries who are not involved in the pricing function and who therefore provide an independent assessment;
- the determination of the risk margin is performed by senior management and the board with input from senior actuaries;
- the outstanding claims provision is assessed regularly by senior management and is reviewed by the external Appointed Actuary at least annually.

Despite the rigour involved in the establishment and review of the outstanding claims provision, the provision is subject to significant uncertainty for the reasons set out in note 4(A).

(C) Credit risk
Credit risk is the risk of default by transactional counterparties as well as the loss of value of assets due to deterioration in credit quality. Exposure to credit risk results from financial transactions with securities issuers, customers, mortgagees and reinsurers.

The consolidated entity's credit risk arises mainly from investment, insurance and reinsurance protection activities. The following policies and procedures are in place to mitigate the consolidated entity's exposure to credit risk:

- A QBE Group-wide investment credit risk policy is in place which defines what constitutes credit risk for QBE Group and establishes tolerance levels. Compliance with the policy is monitored and exposures and breaches are reported to the QBE Group investment committee.
- Net exposure limits are set for each counterparty or group of counterparties in relation to investments, cash deposits and forward foreign exchange exposures. The policy also sets out minimum credit ratings for investments. The company did not enter into any forward foreign exchange contracts during the year.
- QBE Group has strict guidelines covering the limits and terms of net open derivative positions and the counterparties with which the company may transact. The company does not expect any investment counterparties to fail to meet their obligations given their strong credit ratings and therefore does not require collateral or other security to support derivatives. The company only uses derivatives in highly liquid markets.

5. RISK MANAGEMENT (CONTINUED)

(i) Credit risk arising from insurance contracts

Credit risk arising from insurance contracts principally relates to the risk of default by the underlying borrowers.

As insurer or reinsurer, the consolidated entity does not receive access to the current credit quality of performing insured loans but is provided with data on loans in default by insured lenders. The relevant LMI master policy defines "default" as the borrower's failure to pay when due an amount equal to the scheduled monthly mortgage payment under the terms of the mortgage. Generally, however, the master policies require an insured to notify the insurer of a default within 14 days of the end of the month when the total amount due is unpaid and in arrears by more than ninety days. For reporting and internal tracking purposes, the consolidated entity does not consider a loan to be in default until it has been delinquent for three consecutive monthly payments.

Credit risk on LMI contracts is therefore principally managed up-front through the underwriting process, prior to the acceptance of risk. The company has a centralised credit risk function that incorporates pricing, claims liability modelling, credit policy, portfolio performance reporting and analysis, and underwriting quality assurance.

Acceptance of credit risk is managed primarily using two scorecards, built on credit bureau data and company portfolio history. Credit rules are used to support these two scorecards. The centralised credit risk unit manages and maintains the scorecards and a centralised underwriting policy and procedure.

Lenders usually collect the single premium from a prospective borrower and remit the amount to the company; generally, under a standard LMI policy, premium payment is required before policy cover is incepted, which eliminates credit risk on premiums receivable.

The consolidated entity does not hold any collateral as security against its exposures; however, in the event of a claim by the lender, the lender's rights as mortgagee are assigned to the consolidated entity.

(ii) Investment counterparty credit risk

The following tables provide information regarding the aggregate credit risk exposure at the balance sheet date in respect of the major classes of financial assets. Trade and other receivables are excluded from this analysis on the basis that they comprise of smaller credit risk items which generally cannot be rated and are not individually material. The analysis classifies the assets according to Moody's counterparty credit ratings. Aaa is the highest possible rating. Rated assets falling outside the range of Aaa to Baa are classified as speculative grade.

	The Company CREDIT RATING						
	Aaa $M	Aa $M	A $M	Baa $M	SPECULATIVE GRADE $M	NOT RATED $M	TOTAL $M
At 31 December 2014							
Cash and cash equivalents	**-**	**4.3**	**1.3**	**0.6**	**-**	**-**	**6.2**
Interest-bearing investments	**559.0**	**886.5**	**787.6**	**3.1**	**-**	**-**	**2,236.2**
At 31 December 2013							
Cash and cash equivalents	-	8.0	1.0	0.2	-	-	9.2
Interest-bearing investments	468.4	1,120.9	457.3	-	-	-	2,046.6

5. RISK MANAGEMENT (CONTINUED)

	Consolidated CREDIT RATING						
	Aaa $M	Aa $M	A $M	Baa $M	SPECULATIVE GRADE $M	NOT RATED $M	TOTAL $M
At 31 December 2014							
Cash and cash equivalents	**-**	**5.6**	**2.2**	**0.6**	**-**	**-**	**8.4**
Interest-bearing investments	**559.1**	**1,009.9**	**787.6**	**3.1**	**-**	**-**	**2,359.7**
At 31 December 2013							
Cash and cash equivalents	-	13.8	1.0	0.2	-	-	15.0
Interest-bearing investments	468.4	1,230.3	457.3	-	-	-	2,156.0

The carrying amount of the relevant asset classes in the balance sheet represents the maximum amount of credit exposure.

None of the consolidated entity's financial assets are past due or impaired or have terms that have been renegotiated and would otherwise have been past due or impaired (2013: nil).

(iii) Reinsurance counterparty credit risk

Reinsurance risk management is the process of transferring insurance risk to another insurer for a price. The consolidated entity reinsures a portion of risks underwritten to control exposure to insurance losses, reduce volatility and protect capital.

The consolidated entity's strategy in respect of the selection, approval and monitoring of reinsurance arrangements is addressed by the following protocols:

- reinsurance is placed in accordance with the requirements of the company's REMS and security committee guidelines;
- reinsurance arrangements are regularly reassessed to determine their effectiveness based on current exposures, historical and potential future losses and the company's ICRC and
- exposure to reinsurance counterparties and the credit quality of those counterparties is actively monitored.

The following tables provide information about the quality of the credit risk exposure in respect of reinsurance recoveries on outstanding claims at the balance sheet date. The analysis classifies the assets according to Standard & Poor's counterparty credit ratings. AAA is the highest possible rating. Rated assets falling outside the range of AAA to BBB are classified as speculative grade.

5. RISK MANAGEMENT (CONTINUED)

The Company
CREDIT RATING

	AAA $M	AA $M	A $M	BBB $M	SPECULATIVE GRADE $M	NOT RATED $M	TOTAL $M
At 31 December 2014							
Reinsurance recoveries on outstanding claims[1]	-	**1.1**	-	-	-	-	**1.1**
Reinsurance recoveries on paid claims[1]	-	-	-	-	-	-	-
At 31 December 2013							
Reinsurance recoveries on outstanding claims[1]	-	0.1	-	-	-	-	0.1
Reinsurance recoveries on paid claims[1]	-	-	-	-	-	-	-

Consolidated
CREDIT RATING

	AAA $M	AA $M	A $M	BBB $M	SPECULATIVE GRADE $M	NOT RATED $M	TOTAL $M
At 31 December 2014							
Reinsurance recoveries on outstanding claims[1]	-	**1.1**	-	-	-	-	**1.1**
Reinsurance recoveries on paid claims[1]	-	-	-	-	-	-	-
At 31 December 2013							
Reinsurance recoveries on outstanding claims[1]	-	0.1	-	-	-	-	0.1
Reinsurance recoveries on paid claims[1]	-	-	-	-	-	-	-

None of the consolidated entity's recoveries are past due or impaired or have terms that have been renegotiated and would otherwise have been past due or impaired (2013: nil).

5. RISK MANAGEMENT (CONTINUED)

(D) Market risk

Market risk is the risk of variability in the value of, and returns on, investments and the risk associated with variability of interest rates, credit spreads, foreign exchange rates and economy-wide inflation on both assets and liabilities, excluding insurance liabilities.

Market risk comprises three types of risk: currency risk (due to fluctuations in foreign exchange rates); interest rate risk (due to fluctuations in market interest rates); and price risk (due to fluctuations in market prices). Within each of these categories, risks are evaluated before considering the effect of mitigating controls. The existence and effectiveness of such mitigating controls are then measured to ensure that residual risks are maintained within the consolidated entity's risk appetite.

(i) Currency risk

The consolidated entity's exposure to currency risk generally arises as a result of the translation of foreign currency amounts back to the functional currency or due to the translation of the consolidated entity's investment in foreign operations back to the functional and presentation currency of the parent entity of Australian dollars.

(ii) Interest rate risk

Financial instruments with a floating rate interest rate expose the consolidated entity to cash flow interest rate risk, whereas fixed interest rate instruments expose the consolidated entity to fair value interest rate risk.

QBE Group's risk management approach is to minimise interest rate risk by actively managing investment portfolios to achieve a balance between cash flow interest rate risk and fair value interest rate risk. The consolidated entity predominately invests in high quality, liquid interest-bearing securities and cash and may use derivative financial instruments to manage the interest rate risk of the fixed interest portfolio. The risk management processes over these derivative financial instruments include close senior management scrutiny, including appropriate board and other management reporting. Derivatives are used only for approved purposes and are subject to delegated authority levels provided to management. The level of derivative exposure is reviewed on an ongoing basis. Appropriate segregation of duties exists with respect to derivative use and compliance with policy, limits and other requirements is closely monitored.

The claims provision is discounted to present value by reference to risk-free interest rates. The consolidated entity is therefore exposed to potential underwriting result volatility as a result of interest rate movements. The consolidated entity has a policy of maintaining a relatively short duration for assets backing policyholders' funds in order to minimise any potential volatility affecting insurance profit.

The contractual maturity profile of interest-bearing financial assets, and hence its exposure to interest rate risk, and the effective weighted average interest rate for interest-bearing financial assets is analysed in the table below. The table includes investments at the maturity date of the security, however, many of the longer dated securities have call dates of relatively short duration. At 31 December 2014 the average modified duration of cash and fixed interest securities was 0.4 years (2013: 0.4 years).

	The Company						
	INTEREST BEARING FINANCIAL ASSETS MATURING IN						
	1 YEAR OR LESS	1 TO 2 YEARS	2 TO 3 YEARS	3 TO 4 YEARS	4 TO 5 YEARS	OVER 5 YEARS	TOTAL
At 31 December 2014							
Fixed rate ($M)	**868.3**	**72.1**	**105.5**	**24.0**	**10.3**	**3.0**	**1,083.2**
Weighted average interest rate (%)	**2.83%**	**2.73%**	**2.81%**	**2.25%**	**3.56%**	**4.44%**	**2.82%**
Floating rate ($M)	**239.7**	**446.2**	**240.2**	**117.1**	**83.6**	**32.4**	**1,159.2**
Weighted average interest rate (%)	**2.98%**	**3.12%**	**3.25%**	**3.42%**	**3.52%**	**3.27%**	**3.18%**
At 31 December 2013							
Fixed rate ($M)	503.1	41.2	47.9	122.9	21.5	22.3	758.9
Weighted average interest rate (%)	2.78%	3.21%	3.42%	3.76%	3.77%	3.48%	3.05%
Floating rate ($M)	156.5	246.7	395.5	280.7	180.4	37.1	1,296.9
Weighted average interest rate (%)	2.97%	3.07%	3.16%	3.26%	3.45%	3.55%	3.19%

5. RISK MANAGEMENT (CONTINUED)

	Consolidated						
	INTEREST BEARING FINANCIAL ASSETS MATURING IN						
	1 YEAR OR LESS	1 TO 2 YEARS	2 TO 3 YEARS	3 TO 4 YEARS	4 TO 5 YEARS	OVER 5 YEARS	TOTAL
At 31 December 2014							
Fixed rate ($M)	**973.9**	**72.1**	**123.3**	**24.0**	**10.3**	**3.1**	**1,206.7**
Weighted average interest rate (%)	**2.62%**	**2.73%**	**2.56%**	**2.25%**	**3.56%**	**4.44%**	**2.62%**
Floating rate ($M)	**241.9**	**446.2**	**240.2**	**117.1**	**83.6**	**32.4**	**1,161.4**
Weighted average interest rate (%)	**2.95%**	**3.12%**	**3.25%**	**3.42%**	**3.52%**	**3.27%**	**3.18%**
At 31 December 2013							
Fixed rate ($M)	612.4	41.2	47.9	122.9	21.5	22.2	868.1
Weighted average interest rate (%)	2.34%	3.21%	3.42%	3.76%	3.77%	3.48%	2.71%
Floating rate ($M)	162.4	246.6	395.5	280.7	180.4	37.3	1,302.9
Weighted average interest rate (%)	2.98%	3.07%	3.16%	3.26%	3.45%	3.55%	3.19%

All financial assets are measured at fair value through profit or loss. Movements in interest rates impact the value of interest-bearing financial assets and therefore impact reported profit after tax. The impact of a 0.5% increase or decrease in interest rates on interest-bearing financial assets owned by the consolidated entity at the balance date is shown in the table below.

		PROFIT (LOSS)[1]			
		The Company		Consolidated	
	SENSITIVITY	2014	2013	2014	2013
	%	$M	$M	$M	$M
Interest rate movement -	+0.5	**(3.5)**	(5.5)	**(3.8)**	(3.9)
Interest-bearing financial assets	-0.5	**3.2**	3.3	**3.5**	3.4

[1] Net of tax at the prima facie rate of 30%.

(iii) Price risk

Price risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from interest rate or currency risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded on the market.

The consolidated entity is exposed to price risk on its investment in fixed interest and floating rate securities. All corporate securities are measured at fair value through profit or loss. Movements in credit spreads impact the value of corporate fixed interest and floating rate securities and therefore impact reported profit after tax.

This risk is managed by investing in high quality, liquid interest-bearing corporate securities and by managing the credit spread duration of the corporate securities portfolio.

The impact of a 0.5% increase or decrease in credit spreads on corporate fixed interest and floating rate securities owned by the consolidated entity at the balance sheet date is shown in the table below.

		PROFIT (LOSS)[1]			
		The Company		Consolidated	
	SENSITIVITY	2014	2013	2014	2013
	%	$M	$M	$M	$M
Credit spread movement – corporate	+0.5	**(8.6)**	**(12.2)**	**(8.6)**	(12.2)
interest-bearing financial assets	-0.5	**7.2**	**11.4**	**7.2**	11.4

[1] Net of tax at the prima facie rate of 30%.

5. RISK MANAGEMENT (CONTINUED)

(E) Liquidity risk

Liquidity risk is the risk of insufficient liquid assets to meet liabilities as they fall due to policyholders and other creditors. This includes the risk associated with asset and liability management. The key objective of the consolidated entity's asset and liability management strategy is to ensure sufficient liquidity is maintained at all times to meet the consolidated entity's obligations including its settlement of insurance liabilities and, within these parameters, to optimise investment returns for policyholders and shareholders.

Liquidity must be sufficient to meet both planned and unplanned cash requirements. The nature of the business is that cash is received by way of single premiums at the inception of insurance contracts and is invested to fund future claims. The consolidated entity is exposed to liquidity risk mainly through its obligations to make payments in relation to its insurance activities.

In addition to treasury cash held for working capital requirements, and in accordance with the consolidated entity's liquidity policy, a minimum percentage of investments and cash is held in liquid, short-term money market securities to ensure that there are sufficient liquid funds available to meet insurance and investment obligations. The consolidated entity has a strong liquidity position. The maturity of the consolidated entity's interest-bearing financial assets is included in note 5(D)(ii).

The following tables summarise the contractual maturity profile of certain financial liabilities based on the remaining contractual obligations.

			The Company		
	1 YEAR OR LESS $M	1 TO 3 YEARS $M	3 TO 5 YEARS $M	OVER 5 YEARS $M	TOTAL $M
At 31 December 2014					
Trade and other payables	**198.5**	**8.1**	**-**	**-**	**206.6**
At 31 December 2013					
Trade and other payables	98.7	1.6	-	-	100.3

			Consolidated		
	1 YEAR OR LESS $M	1 TO 3 YEARS $M	3 TO 5 YEARS $M	OVER 5 YEARS $M	TOTAL $M
At 31 December 2014					
Trade and other payables	**198.1**	**8.1**	**-**	**-**	**206.2**
At 31 December 2013					
Trade and other payables	98.7	1.6	-	-	100.3

The consolidated entity has no significant concentration of liquidity risk.

The maturity profile of the consolidated entity's net outstanding claims provision is analysed in note 16(B).

(F) Operational risk

Operational risk is the risk of financial loss resulting from inadequate or failed internal processes, people and systems or from external events (including legal risk). The consolidated entity manages operational risk within the same risk management framework as its other risks. The risk assessment and monitoring framework involves on-going:

- identification and review of the key risks to the consolidated entity;
- definition of the acceptable level of risk appetite and tolerance;
- assessment of those risks throughout the consolidated entity in terms of the acceptable level of risk (risk tolerance) and the residual risk remaining after having considered risk treatment;
- assessment of whether each risk is within the acceptable level of risk, or requires appropriate action be taken to mitigate any excess risk;
- transparent monitoring and reporting of risk management related matters on a timely basis; and
- setting the audit universe and resulting internal audit plan on a risk basis.

5. RISK MANAGEMENT (CONTINUED)

One of the cornerstones of the QBE Group's risk management framework is the recruitment and retention of high quality people who are entrusted with appropriate levels of autonomy within the parameters of disciplined risk management practices.

The consolidated entity operates a system of delegated authorities based on expertise and proven performance, and compliance is closely monitored. Other controls include effective segregation of duties, access controls and authorisation and reconciliation procedures.

(G) Group risk

Group risk is the risk to a division arising specifically from being part of the wider QBE Group, including the financial impact and loss of support from the parent company.

6. INCOME AND EXPENSES

(A) Income summary

	The Company		Consolidated	
	2014 $M	2013 $M	2014 $M	2013 $M
Gross earned premium revenue				
Direct	**390.6**	242.6	**408.4**	256.0
Inward reinsurance	**42.5**	31.9	**42.5**	32.9
	433.1	274.5	**450.9**	288.9
Other revenue				
Reinsurance and other recoveries	**2.0**	4.7	**2.1**	4.1
Reinsurance commission revenue	**9.7**	2.6	**9.7**	2.6
	11.7	7.3	**11.8**	6.7
Other income				
Net fair value gains on financial assets	**14.9**	5.9	**14.4**	5.6
Dividends received from controlled entities	**11.0**	4.8	**-**	-
Interest received or receivable	**65.3**	70.4	**66.5**	71.2
	91.2	81.1	**80.9**	76.8
Income	**536.0**	362.9	**543.6**	372.4

During the year actuarial analysis resulted in a release of previously deferred income and expenditure to profit. Refer note 4(C)

(B) Expenses summary

	The Company		Consolidated	
	2014 $M	2013 $M	2014 $M	2013 $M
Outward reinsurance premium expense	**71.5**	43.6	**72.2**	44.2
Gross claims incurred (note 7)	**(18.3)**	64.0	**(18.2)**	63.4
Gross commission expense	**13.5**	10.6	**13.5**	10.4
Other acquisition costs	**32.7**	19.7	**33.1**	20.5
Underwriting expenses	**31.7**	37.4	**34.2**	39.7
Investment expenses	**2.3**	2.1	**2.4**	2.2
Expenses	**133.4**	177.4	**137.2**	180.4
Profit before income tax	**402.6**	185.5	**406.4**	192.0

7. CLAIMS INCURRED

(A) Claims analysis

	The Company 2014 $M	The Company 2013 $M	Consolidated 2014 $M	Consolidated 2013 $M
Gross claims incurred and related expenses				
Direct	**(17.7)**	59.6	**(17.7)**	59.0
Inward reinsurance	**(0.6)**	4.4	**(0.5)**	4.4
	(18.3)	64.0	**(18.2)**	63.4
Reinsurance and other recoveries				
Direct	**(1.9)**	(4.6)	**(2.0)**	(4.0)
Inward reinsurance	**(0.1)**	(0.1)	**(0.1)**	(0.1)
	(2.0)	(4.7)	**(2.1)**	(4.1)
Net claims incurred	**(20.3)**	59.3	**(20.3)**	59.3

During the year the risk margin decreased by $47.3 million (2013: nil) following actuarial analysis of the uncertainty inherent in the central estimate. Refer to note 4(A)(iii)

(B) Claims development

Current year's claims relate to risks borne in the current reporting year. Prior year claims relate to a reassessment of the risks borne in all the previous reporting periods and include release of risk margins as claims are paid. Refer to note 7(C).

	The Company					
	2014 CURRENT YEAR $M	2014 PRIOR YEARS $M	TOTAL $M	2013 CURRENT YEAR $M	2013 PRIOR YEARS $M	TOTAL $M
Gross claims incurred and related expenses						
Undiscounted	**84.8**	**(103.7)**	**(18.9)**	114.2	(50.3)	63.9
Discount	**(1.4)**	**2.0**	**0.6**	(1.6)	1.7	0.1
	83.4	**(101.7)**	**(18.3)**	112.6	(48.6)	64.0
Reinsurance and other recoveries						
Undiscounted	**(2.7)**	**0.7**	**(2.0)**	(3.1)	(1.7)	(4.8)
Discount	**0.1**	**(0.1)**	**0.0**	0.1	-	0.1
	(2.6)	**0.6**	**(2.0)**	(3.0)	(1.7)	(4.7)
Net claims incurred						
Undiscounted	**82.1**	**(103.0)**	**(20.9)**	111.1	(52.0)	59.1
Discount	**(1.3)**	**1.9**	**0.6**	(1.5)	1.7	0.2
	80.8	**(101.1)**	**(20.3)**	109.6	(50.3)	59.3

7 CLAIMS INCURRED (CONTINUED)

	Consolidated					
	2014			2013		
	CURRENT YEAR $M	PRIOR YEARS $M	TOTAL $M	CURRENT YEAR $M	PRIOR YEARS $M	TOTAL $M
Gross claims incurred and related expenses						
Undiscounted	**84.9**	**(103.7)**	**(18.8)**	114.2	(50.9)	63.3
Discount	**(1.4)**	**2.0**	**0.6**	(1.6)	1.7	0.1
	83.5	**(101.7)**	**(18.2)**	112.6	(49.2)	63.4
Reinsurance and other recoveries						
Undiscounted	**(2.7)**	**0.6**	**(2.1)**	(3.1)	(1.1)	(4.2)
Discount	**0.1**	**(0.1)**	**-**	0.1	-	0.1
	(2.6)	**0.5**	**(2.1)**	(3.0)	(1.1)	(4.1)
Net claims incurred						
Undiscounted	**82.2**	**(103.1)**	**(20.9)**	111.1	(52.0)	59.1
Discount	**(1.3)**	**1.9**	**0.6**	(1.5)	1.7	0.2
	80.9	**(101.2)**	**(20.3)**	109.6	(50.3)	59.3

(C) Reconciliation of net claims incurred to claims development table

The development of the net outstanding claims provision for the four most recent accident years is shown in note 16(E). This note is a reconciliation of the amounts included in the table in note 7(B) and the current financial year movements in the claims development table.

	The Company					
	2014			2013		
	CURRENT YEAR $M	PRIOR YEARS $M	TOTAL $M	CURRENT YEAR $M	PRIOR YEARS $M	TOTAL $M
Net undiscounted claims development – central estimate (note 16(E))	**56.2**	**(30.1)**	**26.1**	61.3	(1.5)	59.8
Movement in claims settlement costs	**1.5**	**(0.1)**	**1.4**	1.6	(0.8)	0.8
Movement in discount	**(1.3)**	**1.8**	**0.5**	(1.5)	1.7	0.2
Movement in risk margin (note 4(A)(iii))	**24.4**	**(72.7)**	**(48.3)**	48.2	(49.3)	(1.1)
Other movements	**0.0**	**0.0**	**0.0**	-	(0.4)	(0.4)
Net claims incurred - discounted	**80.8**	**(101.1)**	**(20.3)**	109.6	(50.3)	59.3

	Consolidated					
	2014			2013		
	CURRENT YEAR $M	PRIOR YEARS $M	TOTAL $M	CURRENT YEAR $M	PRIOR YEARS $M	TOTAL $M
Net undiscounted claims development – central estimate (note 16(E))	**56.4**	**(30.3)**	**26.1**	61.3	(1.5)	59.8
Movement in claims settlement costs	**1.4**	**-**	**1.4**	1.6	(0.8)	0.8
Movement in discount	**(1.3)**	**1.8**	**0.5**	(1.5)	1.7	0.2
Movement in risk margin (note 4(A)(iii))	**24.4**	**(72.7)**	**(48.3)**	48.2	(49.3)	(1.1)
Other movements	**-**	**-**	**-**	-	(0.4)	(0.4)
Net claims incurred - discounted	**80.9**	**(101.2)**	**(20.3)**	109.6	(50.3)	59.3

8. INCOME TAX EXPENSE

(A) Reconciliation of prima facie tax to income tax expense

	The Company		Consolidated	
	2014	2013	2014	2013
	$M	$M	$M	$M
Profit before income tax	**402.6**	185.5	**406.4**	192.0
Prima facie tax payable at 30%	**120.7**	55.6	**121.9**	57.6
Tax effect of non-temporary differences:				
Untaxed dividends	**(3.3)**	(1.4)	-	-
Other, including non allowable expenses and non taxable income	-	0.1	**(0.1)**	0.1
Differences in tax rates	-	-	**(2.0)**	(1.5)
Prima facie tax adjusted for non-temporary differences	**117.4**	54.3	**119.8**	56.2
Overprovision in prior year	**(0.2)**	(0.4)	**(0.2)**	(0.4)
Income tax expense	**117.2**	53.9	**119.6**	55.8
Analysed as follows:				
Current tax	**118.7**	54.3	**121.0**	56.2
Deferred tax	**(1.3)**	-	**(1.2)**	-
Overprovision in prior year	**(0.2)**	(0.4)	**(0.2)**	(0.4)
	117.2	53.9	**119.6**	55.8
Deferred tax (credit) expense comprises:				
Deferred tax assets recognised in profit or loss	**(1.1)**	0.2	**(1.0)**	0.2
Deferred tax liabilities recognised in profit or loss	**(0.2)**	(0.2)	**(0.2)**	(0.2)
	(1.3)	-	**(1.2)**	-

(B) Tax consolidation legislation

The accounting policy in relation to this legislation is set out in note 1(L).

QBE Insurance Group Limited and its wholly-owned Australian controlled entities have implemented the tax consolidation legislation.

On adoption of the tax consolidation legislation, the entities in the tax consolidated group entered into a tax sharing and tax funding agreement under which the wholly-owned entities are required to fully compensate QBE Insurance Group Limited for any current tax payable and are compensated by QBE Insurance Group Limited for any current tax receivable and deferred tax assets relating to unused tax losses or unused tax credits that are transferred to QBE Insurance Group Limited under the tax consolidation legislation.

The head entity, QBE Insurance Group Limited, and the controlled entities in the tax consolidated group allocate compensation based on a notional stand-alone tax calculation done as if each entity in the tax consolidated group was a stand-alone taxpayer in its own right. The assets and liabilities arising under the arrangement are recognised as intercompany assets and liabilities in the balance sheet of each Australian company.

9. CASH AND CASH EQUIVALENTS

	The Company		Consolidated	
	2014	2013	2014	2013
	$M	$M	$M	$M
Cash at bank and on hand	**5.8**	9.0	**8.0**	14.8
Overnight money	**0.4**	0.2	**0.4**	0.2
	6.2	9.2	**8.4**	15.0
Analysed as follows:				
Floating interest rate	**6.2**	9.2	**8.4**	15.0
	6.2	9.2	**8.4**	15.0

Amounts in cash and cash equivalents are the same as those included in the cash flow statement.

Cash and cash equivalents include balances readily convertible to cash. All balances are held to service normal operational requirements.

(A) Reconciliation of cash flows from operating activities to profit after income tax

	The Company		Consolidated	
	2014	2013	2014	2013
	$M	$M	$M	$M
Cash flows from operating activities	**225.7**	254.0	**236.9**	267.7
Net fair value gains on financial assets	**14.9**	5.9	**14.3**	5.6
Dividends received from controlled entity	**11.0**	4.8	**-**	-
Net foreign exchange gains	**-**	-	**(1.3)**	(0.8)
Decrease in net outstanding claims	**59.9**	3.9	**59.8**	4.3
Increase in unearned premiums	**(8.0)**	(180.4)	**(5.8)**	(179.9)
Increase in unearned reinsurance commission	**(31.7)**	(18.6)	**(31.7)**	(18.6)
Increase in deferred insurance costs	**79.3**	37.5	**79.5**	38.0
(Decrease) increase in reinsurance and other recoveries	**(0.1)**	2.4	**(0.1)**	2.0
Decrease in trade and other receivables	**(27.0)**	(6.3)	**(27.8)**	(8.8)
(Increase) decrease in trade and other payables	**(5.6)**	12.5	**(4.8)**	11.7
Increase (decrease) in deferred tax assets	**1.6**	-	**1.6**	0.1
(Increase) decrease in amounts due to parent entity or tax authorities for current tax	**(34.6)**	15.9	**(33.8)**	14.9
Profit after income tax	**285.4**	131.6	**286.8**	136.2

(i) Restatement of 2013 cash flows

Some balances in the 2013 comparatives for the company have been reclassified in accordance with the policy in Note 1(Z). Net cash flows from operations have not changed. The categories impacted are premium received: $41.6 million, claims paid: $1.5 million and other underwriting costs paid: $40.1 million.

10. INVESTMENTS

	The Company 2014 $M	The Company 2013 $M	Consolidated 2014 $M	Consolidated 2013 $M
Fixed interest rate				
Short term money	**782.4**	369.6	**878.2**	422.7
Government bonds	**74.6**	97.1	**102.3**	153.2
Corporate bonds	**226.2**	292.2	**226.2**	292.2
	1,083.2	758.9	**1,206.7**	868.1
Floating interest rate				
Short term money	**1.0**	2.2	**1.0**	2.4
Government bonds	**34.0**	48.5	**34.0**	48.5
Corporate bonds	**1,118.0**	1,237.0	**1,118.0**	1,237.0
	1,153.0	1,287.7	**1,153.0**	1,287.9
Total investments	**2,236.2**	2,046.6	**2,359.7**	2,156.0
Amounts maturing within 12 months	**1,101.8**	650.4	**1,207.4**	759.8
Amounts maturing in greater than 12 months	**1,134.4**	1,396.2	**1,152.3**	1,396.2
Total investments	**2,236.2**	2,046.6	**2,359.7**	2,156.0

(A) Fair value hierarchy

The investments are disclosed in the following tables using a fair value hierarchy which reflects the significance of inputs into the determination of fair value as follows:

Level 1: Valuation is based on quoted prices in active markets for the same instruments.

Level 2: Valuation is based on quoted prices in active markets for similar assets or liabilities or other valuation techniques for which all significant inputs are based on observable market data, for example, consensus price using broker quotes and valuation models with observable inputs.

Level 3: Valuation techniques are applied for which one or more significant inputs are not based on observable market data.

The Company

	2014 LEVEL 1 $M	2014 LEVEL 2 $M	2014 LEVEL 3 $M	2014 TOTAL $M	2013 LEVEL 1 $M	2013 LEVEL 2 $M	2013 LEVEL 3 $M	2013 TOTAL $M
Short term money	**126.0**	**657.4**	-	**783.4**	62.2	309.5	-	371.7
Government bonds	**21.9**	**86.7**	-	**108.6**	22.2	123.4	-	145.6
Corporate bonds	-	**1,344.2**	-	**1,344.2**	-	1,529.3	-	1,529.3
Total investments	**147.9**	**2,088.3**	-	**2,236.2**	84.4	1,962.2	-	2,046.6

Consolidated

	2014 LEVEL 1 $M	2014 LEVEL 2 $M	2014 LEVEL 3 $M	2014 TOTAL $M	2013 LEVEL 1 $M	2013 LEVEL 2 $M	2013 LEVEL 3 $M	2013 TOTAL $M
Short term money	**221.6**	**657.6**	-	**879.2**	115.6	309.5	-	425.1
Government bonds	**49.6**	**86.7**	-	**136.3**	78.3	123.4	-	201.7
Corporate bonds	**0.0**	**1,344.2**	-	**1,344.2**	0.0	1,529.2	-	1,529.2
Total investments	**271.2**	**2,088.5**	-	**2,359.7**	193.9	1,962.1	-	2,156.0

(B) Valuation of investments

The consolidated entity's approach to measuring the fair value of investments is described below:

Short term money

Term deposits are valued as par plus accrued interest and are classified as level 1. Other short term money (bank bills, certificate of deposit, treasury bills and other short-term instruments) are priced using interest rates and yield curves observable at commonly quoted intervals.

10. INVESTMENTS (CONTINUED)

Fixed and floating rate bonds
Bonds which are traded in active markets and have quoted prices from external data providers are classified as level 1. Bonds which are not traded in active markets are priced using broker quotes, using comparable prices for similar instruments or using pricing techniques set by local regulators or exchanges.

QBE Group's Investments' independent control team values each asset, as described above, in accordance with QBE Group's investment valuation policy. The QBE Group's investment valuation policy is reviewed at least annually and any changes are approved by the Group Chief Investment Officer, who reports directly to the Group Chief Financial Officer.

(C) Movements in level 3 investments
There are no investments valued with reference to level 3 inputs (2013: nil).

(D) Restrictions in use
There are no restrictions on use of the consolidated entity's investments.

11. TRADE AND OTHER RECEIVABLES

	The Company		Consolidated	
	2014 $M	2013 $M	2014 $M	2013 $M
Trade debtors				
Reinsurance premiums and related receivables	**6.3**	11.2	**7.8**	20.2
Other recoveries	**1.3**	1.5	**1.3**	1.5
	7.6	12.7	**9.1**	21.7
Investment receivables	**18.3**	14.7	**18.5**	15.0
Other receivables and prepayments	**11.5**	37.0	**11.3**	29.4
Trade and other receivables	**37.4**	64.4	**38.9**	66.1
Amounts maturing within 12 months	**35.7**	58.0	**37.2**	59.7
Amounts maturing in greater than 12 months	**1.7**	6.4	**1.7**	6.4
Trade and other receivables	**37.4**	64.4	**38.9**	66.1

(A) Fair value
Due to the short term nature of these receivables, their carrying value is assumed to approximate their fair value.

(B) Risk
The maximum exposure to credit risk at the reporting date is the fair value of each class of receivables. No receivables have been pledged by the consolidated entity as collateral for liabilities or contingent liabilities. No receivables are past due or impaired (2013: nil).

12. DEFERRED INSURANCE COSTS

	The Company		Consolidated	
	2014	2013	2014	2013
	$M	$M	$M	$M
Deferred reinsurance premium	**128.5**	47.5	**129.3**	48.2
Deferred commission	**11.0**	11.6	**11.0**	11.6
Deferred acquisition costs	**62.5**	63.6	**63.4**	64.2
Deferred insurance costs	**202.0**	122.7	**203.7**	124.0
To be expensed within 12 months	**71.3**	32.5	**72.6**	33.5
To be expensed in greater than 12 months	**130.7**	90.2	**131.1**	90.5
Deferred insurance costs	**202.0**	122.7	**203.7**	124.0

The Company

	DEFERRED REINSURANCE PREMIUM		DEFERRED COMMISSION		DEFERRED ACQUISITION COSTS	
	2014	2013	2014	2013	2014	2013
	$M	$M	$M	$M	$M	$M
At 1 January	**47.5**	24.8	**11.6**	8.5	**63.6**	51.9
Costs deferred in financial year	**97.8**	47.5	**4.1**	6.0	**28.1**	27.6
Amortisation of costs deferred in previous financial years	**(14.2)**	(25.2)	**(6.1)**	(3.0)	**(21.7)**	(17.4)
Additional (release) deferral (note 4(C))	**(2.6)**	0.2	**1.4**	0.1	**(7.5)**	1.3
Foreign exchange	-	0.1	-	-	-	0.2
At 31 December	**128.5**	47.5	**11.0**	11.6	**62.5**	63.6

Consolidated

	DEFERRED REINSURANCE PREMIUM		DEFERRED COMMISSION		DEFERRED ACQUISITION COSTS	
	2014	2013	2014	2013	2014	2013
	$M	$M	$M	$M	$M	$M
At 1 January	**48.2**	25.0	**11.6**	7.9	**64.2**	52.6
Costs deferred in financial year	**98.5**	48.1	**4.1**	6.0	**28.5**	27.9
Amortisation of costs deferred in previous financial years	**(14.8)**	(25.3)	**(3.3)**	(2.4)	**(22.0)**	(17.9)
Additional (release) deferral (note 4(C))	**(2.6)**	0.2	**(1.4)**	0.1	**(7.5)**	1.3
Foreign exchange	--	0.2	**0.0**	0.0	**0.2**	0.3
At 31 December	**129.3**	48.2	**11.0**	11.6	**63.4**	64.2

13. DEFERRED INCOME TAX

	The Company 2014 $M	The Company 2013 $M	Consolidated 2014 $M	Consolidated 2013 $M
Deferred tax assets	**4.7**	3.1	**4.7**	3.0

(A) Deferred tax assets

(i) The balance comprises temporary differences attributable to:

	The Company 2014 $M	The Company 2013 $M	Consolidated 2014 $M	Consolidated 2013 $M
Amounts recognised in profit or loss				
Insurance provisions	**1.0**	0.6	**1.0**	0.6
Other accrued expenses	**3.9**	2.7	**3.9**	2.7
	4.9	3.3	**4.9**	3.3
Set-off deferred tax liabilities	**(0.2)**	(0.2)	**(0.2)**	(0.3)
	4.7	3.1	**4.7**	3.0
Deferred tax assets before set-off analysed as follows:				
Recoverable within 12 months	**2.4**	0.8	**2.4**	0.7
Recoverable in greater than 12 months	**2.5**	2.5	**2.5**	2.6
	4.9	3.3	**4.9**	3.3

(ii) Movements:

	The Company 2014 $M	The Company 2013 $M	Consolidated 2014 $M	Consolidated 2013 $M
At 1 January	**3.3**	3.5	**3.3**	3.5
Amounts recognised in profit or loss	**1.1**	(0.2)	**1.0**	(0.2)
Prior year adjustments	**0.5**	-	**0.6**	0.0
At 31 December	**4.9**	3.3	**4.9**	3.3

(B) Deferred tax liabilities

(i) The balance comprises temporary differences attributable to:

	The Company 2014 $M	The Company 2013 $M	Consolidated 2014 $M	Consolidated 2013 $M
Amounts recognised in profit or loss				
Insurance assets	**0.2**	0.2	**0.2**	0.3
	0.2	0.2	**0.2**	0.3
Set-off deferred tax assets	**(0.2)**	(0.2)	**(0.2)**	(0.3)
	-	-	-	-
Deferred tax liabilities before set-off analysed as follows:				
Payable within 12 months	**0.1**	0.1	**0.1**	0.1
Payable in greater than 12 months	**0.1**	0.1	**0.1**	0.2
	0.2	0.2	**0.2**	0.3

13 DEFERRED INCOME TAX (CONTINUED)

(ii) Movements:

	The Company		Consolidated	
	2014	2013	2014	2013
	$M	$M	$M	$M
At 1 January	**0.2**	0.4	**0.3**	0.5
Amounts recognised in profit or loss	**(0.2)**	(0.2)	**(0.1)**	(0.2)
Prior year adjustments	**0.2**	-	**-**	-
At 31 December	**0.2**	0.2	**0.2**	0.3

14. INVESTMENT IN CONTROLLED ENTITIES

	COUNTRY OF INCORPORATION	EQUITY HOLDING	
		2014	2013
		%	%
Permanent LMI Pty Limited	Australia	**-**	50.1%
QBE Mortgage Insurance (Asia) Limited	Hong Kong	**100.0%**	100.0%

	The Company		Consolidated	
	2014	2013	2014	2013
	$M	$M	$M	$M
Permanent LMI Pty Limited	**-**	-	**-**	-
QBE Mortgage Insurance (Asia) Limited	**73.5**	73.5	**-**	-

Both controlled entities have a 31 December year end.

On 29 October 2013, the value of company's investment in Permanent LMI Pty Limited ("Permanent") was returned and Permanent's shareholding reduced to $2. Permanent was deregistered on 12 November 2014.

15. TRADE AND OTHER PAYABLES

	The Company		Consolidated	
	2014	2013	2014	2013
	$M	$M	$M	$M
Trade payables	**54.3**	49.0	**54.8**	49.2
Other amounts due to related entities	**75.5**	42.7	**75.4**	42.8
Dividends payable	**66.0**	-	**66.0**	-
Other payables	**9.9**	8.3	**10.0**	8.3
Trade and other payables	**205.7**	100.0	**206.2**	100.3
Payable within 12 months	**197.6**	98.4	**198.1**	98.7
Payable in greater than 12 months	**8.1**	1.6	**8.1**	1.6
Trade and other payables	**205.7**	100.0	**206.2**	100.3

16. OUTSTANDING CLAIMS

(A) Net outstanding claims

	The Company		Consolidated	
	2014	2013	2014	2013
	$M	$M	$M	$M
Gross discounted central estimate	**80.5**	92.1	**80.6**	92.1
Risk margin	**38.9**	87.2	**38.9**	87.2
Outstanding claims	**119.4**	179.3	**119.5**	179.3
Reinsurance and other recoveries on outstanding claims	**(4.7)**	(4.8)	**(4.7)**	(4.8)
Net outstanding claims provision	**114.7**	174.5	**114.8**	174.5
Analysed as follows:				
Net undiscounted central estimate	**77.8**	89.8	**77.9**	89.9
Discount to present value	**(2.0)**	(2.5)	**(2.0)**	(2.6)
Net discounted central estimate	**75.8**	87.3	**75.9**	87.3
Risk margin	**38.9**	87.2	**38.9**	87.2
Net outstanding claims provision	**114.7**	174.5	**114.8**	174.5
Gross undiscounted central estimate	**80.8**	92.7	**80.8**	92.7
Claims settlement costs	**1.8**	2.0	**1.9**	2.1
	82.6	94.7	**82.7**	94.8
Discount to present value	**(2.1)**	(2.6)	**(2.1)**	(2.7)
Gross discounted central estimate	**80.5**	92.1	**80.6**	92.1
Payable within 12 months	**44.9**	53.0	**45.0**	53.0
Payable in greater than 12 months	**35.6**	39.1	**35.6**	39.1
Gross discounted central estimate	**80.5**	92.1	**80.6**	92.1
Reinsurance and other recoveries on outstanding claims	**4.8**	4.9	**4.8**	4.9
Discount to present value	**(0.1)**	(0.1)	**(0.1)**	(0.1)
Reinsurance and other recoveries on outstanding claims	**4.7**	4.8	**4.7**	4.8
Payable within 12 months	**2.6**	2.8	**2.6**	2.8
Payable in greater than 12 months	**2.1**	2.0	**2.1**	2.0
Reinsurance and other recoveries on outstanding claims	**4.7**	4.8	**4.7**	4.8

16. OUTSTANDING CLAIMS (CONTINUED)

(B) Maturity profile of net outstanding claims provision

The expected maturity of the discounted net outstanding claims provision is analysed below:

	The Company						
	1 YEAR OR LESS $M	1 TO 2 YEARS $M	2 TO 3 YEARS $M	3 TO 4 YEARS $M	4 TO 5 YEARS $M	OVER 5 YEARS $M	TOTAL $M
At 31 December 2014	**64.0**	**33.4**	**10.7**	**3.7**	**1.5**	**1.4**	**114.7**
At 31 December 2013	100.5	52.3	14.6	4.2	2.9	-	174.5

	Consolidated						
	1 YEAR OR LESS $M	1 TO 2 YEARS $M	2 TO 3 YEARS $M	3 TO 4 YEARS $M	4 TO 5 YEARS $M	OVER 5 YEARS $M	TOTAL $M
At 31 December 2014	**64.1**	**33.3**	**10.8**	**3.7**	**1.5**	**1.4**	**114.8**
At 31 December 2013	100.4	52.4	14.6	4.2	2.9	-	174.5

(C) Risk margins

The process used to determine the risk margin is explained in note 4(A)(iii) and details of the risk-free discount rates adopted are set out in note 4(A)(iv).

The risk margin included in net outstanding claims is 51.3% (2013: 99.9%) of the central estimate. The decrease in the risk margin reflects the results of actuarial analysis of the uncertainty inherent in the central estimate. Refer note 4(A)(iii). As a consequence, the probability of adequacy at 31 December 2014 is 91.3% (2013: 98.5%) which is above APRA's 75% benchmark. Net profit before tax would have decreased by $25.7 million if the probability of adequacy was maintained at 98.5%.

(D) Reconciliation of movement in outstanding claims provision

	The Company					
	2014			2013		
	GROSS $M	RECOVERIES $M	NET $M	GROSS $M	RECOVERIES $M	NET $M
At 1 January	**179.3**	**4.8**	**174.5**	183.2	2.8	180.4
Increase in net claims incurred in current accident year	**83.4**	**2.6**	**80.8**	112.6	3.0	109.6
Movement in prior year claims provision	**(101.7)**	**(0.6)**	**(101.1)**	(48.6)	1.7	(50.3)
Incurred claims recognised in income statement	**(18.3)**	**2.0**	**(20.3)**	64.0	4.7	59.3
Claims (payments) recoveries	**(41.6)**	**(2.1)**	**(39.5)**	(68.1)	(2.7)	(65.4)
Foreign exchange	-	-	-	0.2	-	0.2
At 31 December	**119.4**	**4.7**	**114.7**	179.3	4.8	174.5

16. OUTSTANDING CLAIMS (CONTINUED)

	Consolidated					
	2014			2013		
	GROSS $M	RECOVERIES $M	NET $M	GROSS $M	RECOVERIES $M	NET $M
At 1 January	**179.3**	**4.8**	**174.5**	183.4	2.8	180.6
Increase in net claims incurred in current accident year	**83.5**	**2.6**	**80.9**	112.6	3.0	109.6
Movement in prior year claims provision	**(101.7)**	**(0.5)**	**(101.2)**	(49.2)	1.1	(50.3)
Incurred claims recognised in income statement	**(18.2)**	**2.1**	**(20.3)**	63.4	4.1	59.3
Claims (payments) recoveries	**(41.6)**	**(2.2)**	**(39.4)**	(67.7)	(2.1)	(65.6)
Foreign exchange	**-**	**-**	**-**	0.2	-	0.2
At 31 December	**119.5**	**4.7**	**114.8**	179.3	4.8	174.5

(E) Claims development

	The Company					
	2010 & PRIOR YEARS $M	2011 $M	2012 $M	2013 $M	2014 $M	TOTAL $M
Estimate of net ultimate claims cost:						
At end of accident year		70.4	69.5	61.3	56.2	
One year later		62.4	65.2	48.4		
Two years later		65.6	55.0			
Three years later		61.0				
Current central estimate cost for the four most recent accident years		**61.0**	**55.0**	**48.4**	**56.2**	
Cumulative net claims payments to date		58.5	50.7	30.6	6.0	
Net undiscounted central estimate	**1.2**	**2.5**	**4.3**	**17.8**	**50.2**	**76.0**
Discount to present value						**(2.0)**
Risk margin						**38.9**
Claims settlement costs						**1.8**
Net outstanding claims						**114.7**
Net central estimate development Increase (decrease) in the year	**(2.4)**	**(4.6)**	**(10.2)**	**(12.9)**	**56.2**	**26.1**

16. OUTSTANDING CLAIMS (CONTINUED)

	Consolidated					
	2010 & PRIOR YEARS $M	**2011 $M**	**2012 $M**	**2013 $M**	**2014 $M**	**TOTAL $M**
Estimate of net ultimate claims cost:						
At end of accident year		70.4	69.5	61.3	56.4	
One year later		62.4	65.2	48.4		
Two years later		65.6	55.0			
Three years later		61.0				
Current central estimate cost for the four most recent accident years		**61.0**	**55.0**	**48.4**	**56.4**	
Cumulative net claims payments to date		58.5	50.7	30.6	6.1	
Net undiscounted central estimate	**1.1**	**2.5**	**4.3**	**17.8**	**50.3**	**76.0**
Discount to present value						**(2.0)**
Risk margin						**38.9**
Claims settlement costs						**1.9**
Net outstanding claims						**114.8**
Net central estimate development Increase (decrease) in the year	**(2.6)**	**(4.6)**	**(10.2)**	**(12.9)**	**56.4**	**26.1**

A reconciliation of the net claims development in the table above to net incurred claims in the income statement is included in note 7(C).

Development of claims from prior accident years was significantly better than expected at 31 December 2013, leading to an overall release of the central estimate for prior years of $30.3 million. The majority of this release related to the 2012 to 2013 accident years. Both the volume and the average size of claims were notably lower than anticipated at 31 December 2013.

Uncertainty surrounding claims development is materially resolved within four years.

Conditions and trends that have affected the development of the liabilities in the past may, or may not, occur in the future, and accordingly, conclusions about future results may not necessarily be derived from the information presented in the tables.

17. UNEARNED PREMIUM

(A) Unearned premium

	The Company 2014 $M	The Company 2013 $M	Consolidated 2014 $M	Consolidated 2013 $M
At 1 January	**852.5**	672.1	**888.5**	702.2
Deferral of premium on contracts written in the period	**391.4**	396.0	**406.6**	413.0
Earning of premium on contracts written in previous periods	**(289.0)**	(228.4)	**(305.9)**	(244.7)
Additional (release) deferral (note 4(C))	**(94.5)**	11.2	**(94.5)**	11.2
Foreign exchange	**0.1**	1.6	**3.3**	6.8
At 31 December	**860.5**	852.5	**898.0**	888.5
Amount to be earned within 12 months	**316.7**	243.8	**334.5**	259.6
Amount to be earned in greater than 12 months	**543.8**	608.7	**563.5**	628.9
Unearned premium	**860.5**	852.5	**898.0**	888.5

(B) Net premium liabilities

	Note	The Company 2014 $M	The Company 2013 $M	Consolidated 2014 $M	Consolidated 2013 $M
Unearned premium		**860.5**	852.5	**898.0**	888.5
Unearned reinsurance commission	18	**50.3**	18.6	**50.3**	18.6
Deferred insurance costs	12	**(202.0)**	(122.7)	**(203.7)**	(124.0)
Net premium liabilities		**708.8**	748.4	**744.6**	783.1

(C) Expected present value of future cash flows for future claims including risk margin

	The Company 2014 $M	The Company 2013 $M	Consolidated 2014 $M	Consolidated 2013 $M
Undiscounted central estimate	**411.9**	329.3	**412.2**	330.1
Discount to present value	**(41.4)**	(33.7)	**(41.2)**	(33.7)
	370.5	295.6	**371.0**	296.4
Risk margin	**96.4**	93.3	**96.3**	93.3
Expected present value of net future cash flows for future claims including risk margin	**466.9**	388.9	**467.3**	389.7

(D) Liability adequacy test

The probability of adequacy of the unearned premium liability differs from the probability of adequacy of the outstanding claims provision. The reason for the difference is that the former is a benchmark used only to test the sufficiency of net unearned premium liability whereas the latter is a measure of the adequacy of the outstanding claims provision actually carried by the consolidated entity.

AASB 1023 requires the inclusion of a risk margin in insurance liabilities, but does not prescribe a minimum level of margin. Whilst there is established practice in the calculation of the probability of adequacy of the outstanding claims provision, no such guidance exists in respect of the level of risk margin to be used in determining the adequacy of net unearned premium liabilities. The consolidated entity has adopted a risk margin of 26.0% (2013: 31.5%) for net unearned premium liabilities for the purposes of the liability adequacy test to produce a 75% probability of adequacy in respect of total insurance liabilities. The 75% basis is a recognised industry benchmark in Australia, being the minimum probability of adequacy required for Australian licensed insurers by APRA.

The application of the liability adequacy test in respect of the net unearned premium liabilities identified a surplus at 31 December 2014 and 2013.

17 UNEARNED PREMIUM (CONTINUED)

(E) Risk margins

The process used to determine the risk margins is explained in note 4(A)(iii).

The risk margin in expected net future cash flows for future claims as a percentage of the discounted central estimate of the consolidated entity is 26.0% (2013: 31.5%).

18. UNEARNED REINSURANCE COMMISSION

	The Company		Consolidated	
	2014	2013	2014	2013
	$M	$M	$M	$M
At 1 January	**18.6**	-	**18.6**	-
Deferral of commission on contracts written in the period	**38.3**	18.6	**38.3**	18.6
Earning of commission on contracts written in previous periods	**(5.6)**	-	**(5.6)**	-
Additional release (note 4(C))	**(1.0)**	-	**(1.0)**	-
At 31 December	**50.3**	18.6	**50.3**	18.6
Amount to be earned within 12 months	**17.6**	4.6	**17.6**	4.6
Amount to be earned in greater than 12 months	**32.7**	14.0	**32.7**	14.0
Unearned reinsurance commission	**50.3**	18.6	**50.3**	18.6

19. EQUITY

(A) Share capital

2014	NUMBER OF SHARES MILLIONS	$M
Issued ordinary shares, fully paid at 1 January	**327.8**	**364.3**
Issued ordinary shares, fully paid at 31 December	**327.8**	**364.3**

2013	NUMBER OF SHARES MILLIONS	$M
Issued ordinary shares, fully paid at 1 January	327.8	364.3
Issued ordinary shares, fully paid at 31 December	327.8	364.3

Ordinary shares in the company have no par value and entitle the holder to participate in dividends and the proceeds on winding up of the company in proportion to the number of shares held. Ordinary shareholders rank after all creditors and are entitled to any residual proceeds.

(B) Reserves

	The Company		Consolidated	
	2014	2013	2014	2013
	$M	$M	$M	$M
Foreign currency translation reserve				
At 1 January	**0.4**	1.8	**(16.2)**	(25.6)
Currency translation differences	**(0.2)**	(1.4)	**8.0**	9.4
Total reserves at 31 December	**0.2**	0.4	**(8.2)**	(16.2)

19. EQUITY (CONTINUED)

(C) Capital risk management

As a member of the wholly owned group, the consolidated entity has adopted the risk management policies and framework of the QBE Group. QBE Group's objective when managing capital is to maintain an optimal balance of debt and equity in the capital structure to reduce the cost of capital whilst meeting capital adequacy requirements, providing security for policyholders and continuing to provide sufficient returns to shareholders.

Where appropriate, adjustments are made to capital levels in light of changes in economic conditions and risk characteristics of the consolidated entity's activities. In order to maintain or adjust the capital structure, the consolidated entity has the option to adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares or vary the level of outward reinsurance.

The consolidated entity is subject to, and complies with, various externally imposed regulatory capital requirements. These requirements are designed to ensure a sufficient solvency margin is maintained in order to provide adequate protection for policyholders. In addition, the consolidated entity aims to maintain a strong credit rating and insurer financial strength rating, along with robust capital ratios in order to support its business objectives and maximise shareholder wealth.

Capital across the QBE Group is allocated to business units, divisions and ultimately to underwriting portfolios according to the associated risk. The minimum target risk adjusted return on capital is 15%. The business plans include net asset projections, dividends, issued share projections and solvency projections.

Management monitors the consolidated entity's capital levels on an ongoing basis, with particular focus on the following performance indicators which were updated during 2014:

- The consolidated entity is subject to regulatory requirements that a minimum level of capital is maintained to meet obligations to policyholders. It is the consolidated entity's policy to maintain a capital base appropriate to its size, business mix, complexity and risk profile which fully complies with and meets or exceeds regulatory requirements.
- Insurer financial strength ratings provided by the major rating agencies which demonstrate the consolidated entity's financial strength and claims paying ability.

In addition to the management reporting and planning processes, the consolidated entity has dedicated staff across its business units responsible for understanding the regulatory capital requirements of its operations. The quality of assets (particularly investments) held by the consolidated entity is continuously monitored to ensure any potential issues are identified and remedial action, where necessary, is taken to restore effective capital performance and levels.

(D) Dividends

	The company		Consolidated	
	2014	**2013**	**2014**	**2013**
	$m	**$m**	**$m**	**$m**
Dividends paid or payable	**131.0**	130.0	131.0	130.0
Dividends proposed before the financial statements were authorised but not recognised as a distribution during the period	**50.0**	-	50.0	-

20. EARNINGS PER SHARE

	Consolidated	
	2014	**2013**
	cents	**cents**
Basic earnings per share	**87.5**	41.5
Diluted earnings per share	**87.5**	41.5

21. APRA CAPITAL ADEQUACY

Australian Prudential Regulation Authority (APRA) Prudential Standard GPS 110 Capital Adequacy for General Insurers requires that the consolidated entity maintain a capital base in excess of its prudential capital requirement as defined under the prudential standard.

The following table shows the capital adequacy calculated in accordance with the APRA prudential framework for the company. The 2014 position reflects the December 2014 quarter APRA return (unaudited).[3]

	The company	
	2014	**2013**
	$M	**$M**
Eligible Tier 1 capital as defined by APRA		
Contributed equity	**364.3**	364.3
General reserves	**0.2**	0.4
Retained profits [1,2]	**963.4**	809.0
Insurance liability surplus	**186.4**	301.0
Total equity	**1,514.3**	1,474.7
Less: APRA deductions	**(78.2)**	(76.5)
Total APRA capital base	**1,436.1**	1,398.2
APRA prudential capital requirement	**951.6**	1,042.3
APRA capital adequacy multiple	**1.51**	1.34

1 Retained profits are in accordance with APRA prudential standards

2 Dividends of $65.0 million were paid during the year and dividends of $66.0 million were declared as at 31 December 2014 (2013: $130.0 million)

3 Subsequent to lodging the return the directors approved a further dividend of $50.0 million. This will reduce the total APRA capital base to $1,386.1 million and the APRA capital adequacy multiple to 1.46.

22. KEY MANAGEMENT PERSONNEL

The names of persons who were directors of the company at anytime during the financial year are as stated in the directors' report.

Key management personnel are all the directors of the company and the executives with the greatest authority for the strategic direction and management of the company.

Certain directors of the company are also directors of other subsidiaries of QBE Insurance Group Limited, the ultimate parent company. Their remuneration, which is paid by a related company, has been apportioned to the company on a basis consistent with the level of management effort.

Key management personnel compensation for the years ended 31 December 2014 and 2013 is set out below:

	The Company		Consolidated	
	2014	**2013**	**2014**	**2013**
	$'000	**$'000**	**$'000**	**$'000**
Short-term employment benefits	**1,856**	2,427	**1,856**	2,427
Post-employment benefits	**84**	105	**84**	105
Other long-term employment benefits	**9**	5	**9**	5
Termination benefits	**28**	61	**28**	61
Share-based payments	**152**	188	**152**	188
	2,129	2,786	**2,129**	2,786

23. REMUNERATION OF THE AUDITOR

	The Company		Consolidated	
	2014	2013	2014	2013
	$'000	$'000	$'000	$'000
PricewaterhouseCoopers (PwC) – Australian firm				
Audit of financial reports of the company	**481**	484	**481**	484
Audit of statutory returns and other assurance services	**138**	137	**138**	137
	619	621	**619**	621
Related practices of PricewaterhouseCoopers (including overseas PricewaterhouseCoopers firms)				
Audit of financial reports of controlled entities	-	-	**93**	98
Actuarial peer review	-	15	-	15
	93	15	**93**	113

The board believes some non-audit services are appropriate given the external auditor's knowledge of the QBE Group. The consolidated entity may engage the external auditor for non-audit services other than the excluded services subject to the general principle that fees for non-audit services should not exceed 50% of all fees paid to the external auditor in any one financial year. External tax services are generally provided by an accounting firm other than the external auditor. Consistent with prior periods, PwC cannot provide the excluded services of preparing accounting records or financial reports, asset or liability valuations, acting in a management capacity, acting as a custodian of assets or acting as share registrar.

24. CONTINGENT LIABILITIES

	The Company		Consolidated	
	2014	2013	2014	2013
	$M	$M	$M	$M
The consolidated entity had the following contingent liabilities				
Related party guarantees	**61.2**	56.0	-	-

25. CAPITAL EXPENDITURE COMMITMENTS

The consolidated entity had no capital commitments as at 31 December 2014 (2013: $nil).

26. RELATED PARTIES

(A) Parent entity
The parent entity is QBE Holdings (AAP) Pty Limited ("QBE AAP") and the ultimate parent entity is QBE Insurance Group Limited ("QBE").

(B) Controlled entities
Interests in controlled entities are set out in note 14.

(C) Transactions with related parties
The following material transactions occurred with related parties:

	The Company		Consolidated	
	2014	2013	2014	2013
	$000	$000	$000	$000
Revenue				
Dividends received from controlled entity	**10,970**	4,771	**-**	-
Management fee received from controlled entity	**608**	754	**-**	-
Expenses				
Payments made for management fees and cost allocations to other related parties	**40,494**	43,454	**41,106**	45,573
Outward reinsurance premium (net of no claims bonus) to other related parties	**42,099**	12,073	**42,978**	13,150
Other transactions				
Dividends paid or proposed to parent	**131,000**	130,000	**131,000**	130,000

(D) Outstanding balances arising from transactions with related parties
The following balances are outstanding at the reporting date in relation to transactions with related parties:

	The Company		Consolidated	
	2014	2013	2014	2013
	$000	$000	$000	$000
Current assets				
Reinsurance premiums and related receivables from other related parties	**-**	7,694	**-**	7,694
Trade and other receivables from controlled entity	**139**	-	**-**	-
Deferred reinsurance premium from other related parties	**-**	-	**738**	691
Current liabilities				
Trade and other payables to other related parties	**7,774**	9,027	**7,809**	8,855
Trade and other payables to ultimate parent	**67,748**	33,799	**67,558**	33,799
Dividends payable to parent	**66,000**	-	**66,000**	-
Reinsurance and related payables to other related parties	**-**	-	**-**	50

(E) Terms and conditions
All transactions were made on normal commercial terms and conditions and at market rates.

Outstanding balances are unsecured and repayable in cash.

26. RELATED PARTIES (CONTINUED)

(F) Other related party disclosures

All material information required to be disclosed under AASB 124: Related Party Disclosures has been included in the financial statements as follows:

	Reference
Dividends received from controlled entities	Note 6(A)
Tax sharing agreement	Note 8(B)
Amounts due from controlled and related entities	Note 11
Investment in controlled entities	Note 14
Amounts due to controlled and related entities	Note 15
Remuneration of key management personnel	Note 22
Guarantees in respect of related parties	Note 24

27. EVENTS OCCURRING AFTER REPORTING DATE

The following events have occurred after balance date:

(i) dividends were proposed before the financial statements were authorised as disclosed in Note 19(D),
(ii) the company was given notice by a major customer terminating their contract in 2015. The customer contributed 20.9% of the gross written premium in 2014. This has no impact on the financial results reported in these statements. It may impact future earnings and an estimate of this impact cannot be made at the date of signing these statements.

There is, at the date of this report, no other matter or circumstance that has arisen since 31 December 2014 that has significantly affected, or may significantly affect:

(i) the consolidated entity's operations in future financial years;
(ii) the results of those operations in future financial years; or
(iii) the consolidated entity's state of affairs in future financial years.

DIRECTORS' DECLARATION

For the year ended 31 December 2014

In the directors' opinion:

(a) the financial statements and notes set out on pages 6 to 51 are in accordance with the *Corporations Act 2001*, including:

(i) complying with accounting standards, the *Corporations Regulations 2001* and other mandatory professional reporting requirements; and

(ii) giving a true and fair view of the company and consolidated entity's financial position as at 31 December 2014 and of its performance for the financial year ended on that date; and

(b) there are reasonable grounds to believe that the company will be able to pay its debts as and when they become due and payable.

Note 1(A) confirms that the financial statements also comply with International Financial Reporting Standards as issued by the International Accounting Standards Board.

Signed in Sydney, this 20th day of February 2015 in accordance with a resolution of the directors.

Director

Director

Independent auditor's report to the members of QBE Lenders' Mortgage Insurance Limited

Report on the financial report

We have audited the accompanying financial report of QBE Lenders' Mortgage Insurance Limited (the company), which comprises the balance sheets as at 31 December 2014, the statements of comprehensive income, statements of changes in equity and statements of cash flows for the year ended on that date, a summary of significant accounting policies, other explanatory notes and the directors' declaration for both QBE Lenders' Mortgage Insurance Limited and QBE Lenders' Mortgage Insurance Limited Group (the consolidated entity). The consolidated entity comprises the company and the entities it controlled at year's end or from time to time during the financial year.

Directors' responsibility for the financial report

The directors of the company are responsible for the preparation of the financial report that gives a true and fair view in accordance with Australian Accounting Standards and the *Corporations Act 2001* and for such internal control as the directors determine is necessary to enable the preparation of the financial report that is free from material misstatement, whether due to fraud or error. In Note 1, the directors also state, in accordance with Accounting Standard AASB 101 *Presentation of Financial Statements*, that the financial statements comply with International Financial Reporting Standards.

Auditor's responsibility

Our responsibility is to express an opinion on the financial report based on our audit. We conducted our audit in accordance with Australian Auditing Standards. Those standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the financial report is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Independence

In conducting our audit, we have complied with the independence requirements of the *Corporations Act 2001*.

Auditor's opinion

In our opinion:

(a) the financial report of QBE Lenders' Mortgage Insurance Limited is in accordance with the *Corporations Act 2001,* including:

  (i) giving a true and fair view of the company's and consolidated entity's financial position as at 31 December 2014 and of their performance for the year ended on that date; and

  (ii) complying with Australian Accounting Standards (including the Australian Accounting Interpretations) and the *Corporations Regulations 2001*.

(b) the financial report also complies with International Financial Reporting Standards as disclosed in Note 1.

PricewaterhouseCoopers

PricewaterhouseCoopers

SJHadfield

S J Hadfield
Partner

Sydney
20 February 2015