QBE Insurance (Australia) Limited ABN 78 003 191 035
Level 5, 2 Park Street, SYDNEY NSW 2000 Australia
GPO Box 82, Sydney NSW 2001
Telephone +61 2 9375 4802
www.qbe.com

*10064186371*

QBE

18 April 2017

The Companies Office
Northern Business Centre
Private Bag 92061
Victoria Street West
Auckland 1142

Dear Sir/Madam

**QBE Lenders' Mortgage Insurance Limited (*593159*)**

We enclose for lodgement under section 461H of the Financial Markets Conduct Act 2013 the following:

- QBE Lenders' Mortgage Insurance Limited (**QBE LMI**) financial statements for 31 December 2016 together with auditors report.
- QBE LMI's New Zealand branch financial statements for 31 December 2016 together with auditor's report;
- QBE Insurance Group Limited's annual report;
- Section 78 letter as at 31 December 2016;
- QBE LMI's financial condition report; and
- QBE LMI's insurance liabilities valuation report.

We are relying on the Financial Markets Conduct (QBE Group) Exemption Notice 2016 in respect of the accounting period to which the statements relate.

Please contact me if you have any queries on (02) 8275 9098 or at andrea.croy@qbe.com.

Yours faithfully

**Andrea Croy**
**Company Secretary & Governance**
**QBE Australia**

**QBE LENDERS' MORTGAGE INSURANCE LIMITED**

**ANNUAL REPORT – 31 DECEMBER 2016**

(A.C.N. 000 511 071)

**CONTENTS**



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

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 4, which is not part of the financial report.

The financial report was authorised for issue by the directors on 17th February 2017. The directors have the power to amend and reissue the financial report.

QBE LENDERS' MORTGAGE INSURANCE LIMITED

**DIRECTORS' REPORT**
For the year ended 31 December 2016

Your directors present their report on QBE Lenders' Mortgage Insurance Limited ("the company") as at 31 December 2016 and for the year then ended.

**Directors**

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

K A Bailey-Lord
G J Gilbert
The Hon. N F H Greiner (Resigned on 19 February 2016)
M Joiner
A G McGrath
T P Plant (Resigned 17 August 2016)
P C Regan (Appointed on 17 August 2016)
V J Walter
P J White

**Principal activity**

The principal activity of the company 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 company for the year were as follows:

| | 2016 $M | 2015 $M |
|---|---|---|
| Gross written premium | **236.0** | 306.5 |
| Gross earned premium | **348.9** | 406.3 |
| Outward reinsurance premium expense | **(251.6)** | (88.5) |
| Net earned premium | **97.3** | 317.8 |
| Gross claims incurred | **(70.6)** | (26.3) |
| Reinsurance and other recoveries revenue | **81.7** | 2.6 |
| Net claims recoveries (expense) | **11.1** | (23.7) |
| Gross commission expense | **(8.2)** | (12.0) |
| Reinsurance commission revenue | **55.9** | 22.3 |
| Net commission revenue (expense) | **47.7** | 10.3 |
| Other acquisition costs | **(30.5)** | (29.2) |
| Underwriting and other expenses | **(24.7)** | (29.8) |
| Net underwriting profit | **100.9** | 245.4 |
| Net investment income on policyholders' funds | **17.8** | 22.7 |
| Insurance profit | **118.7** | 268.1 |
| Net investment income on shareholder's funds | **45.4** | 33.5 |
| Profit before income tax | **164.1** | 301.6 |
| Income tax expense | **(45.6)** | (90.5) |
| Profit after income tax | **118.5** | 211.1 |

Gross written premium (GWP) declined by $70.5 million in 2016. This was principally a reflection of the full year impact of factors first experienced in 2015 - directives from APRA to the company's ADI partners to reduce the volume of higher loan to value ratio home loans and limit the growth of lending to residential investors, as well as the loss of a major customer mid-way during 2015.

During the year, as required by accounting standards, the company reviewed the expected pattern of risk emergence over the life of its portfolio to reflect updated claims experience. For 2016, this review did not lead to any additional release or deferral of previously deferred income or expenditure. In contrast, in 2015, the equivalent review led to an additional release of previously deferred income and expenditure to the income statement. If the 2014 earning pattern was adopted throughout 2015, 2015 gross and net earned premium would have been $387.3 million and $301.3 million respectively; overall, the review increased 2015 net underwriting profit by $15.8 million.

The additional decline in gross earned premium is principally due to lower earnings from policies written in prior underwriting years. As a result of the company's earning pattern for premium income, the decline in written premiums had a negative, but limited effect on 2016 earned premium. The 2013 and 2014 underwriting years that featured very high levels of GWP were at their earnings peak in 2015 and 2016, and will contribute less to earned premium in 2017 and subsequent years.

The reduction in net earned premium is a reflection of both lower gross earned premium, and the changes to the company's reinsurance arrangements that were highlighted in the 2015 Financial Report, in particular the 45% quota share reinsurance agreement on all policies written prior to 2016 with a related party that contributed $189.2m to 2016 reinsurance expense. Excluding the financial impact of the new quota share agreement, 2016 net earned premium was $286.5m. Restructuring of the company's stop loss / excess of loss reinsurance cover in 2016 led to saving of $24.9m in reinsurance expense compared to the 2015 excess of loss agreement.

The new quota share agreement had a significant and favourable impact on net claims expense. Excluding its financial impacts, 2016 net claims expense of $64.8m represents a net loss ratio of 22.6% compared to a 2015 ratio of 7.5%. This increase was a reflection of increased incidence of loan arrears and approved financial hardships compared to 2015, although net claims paid were consistent with the prior year. Recoveries under the company's other reinsurance agreements increased slightly due to increased claims emergence in respect of those underwriting years.

Overall, claims experience continues to be favourable when compared to historic norms. The company adopted a prudent stance to allow for adverse development of claims, holding a risk margin to provide a probability of adequacy for the outstanding claims provision of 90%. This probability of adequacy was in excess of APRA's benchmark of 75%, and consistent with 31 December 2015.

In 2016, the company experienced an increased volume of claims and arrears from regional Queensland and Western Australia, in those communities more impacted by the downturn in mining activity. Management continue to closely monitor the portfolio exposed to these factors and work closely with its ADI partners to minimise the impacts on future financial performance. As claim levels will be subject to regional and national economic cycles, the company continually seeks to mitigate the risk of future losses prior to policy inception through careful risk selection, both in policy and practice, and working with our Financial Institution Partners to maintain robust lending standards. The company's underwriting decisions reflect a combination of factors, in particular the location of the security property and the borrower's capacity to service the loan.

2016 net commission revenue included $32.4m commission revenue on the new quota share agreement. Excluding this, net commission income increased 48.5% on the prior year, due to reductions in both volume- and performance-based commission expense; other commission revenue was stable compared to 2015.

The 4% increase in acquisition costs is principally due to the impact on 2015 cost levels of one-off adjustments arising from the cancellation of a major customer agreement. Underwriting and other expenses declined 17%, as the company continued to benefit from operational efficiencies as part of the QBE Group, effective management of company direct expenses, and lower volume-based expenses.

The company's investment portfolio decreased by $0.8bn during the year, a result of one-off dividend payments and reinsurance premiums. Despite the decrease in the investment portfolio, investment income increased by $7.0 million compared with 2015 driven by net fair value gains and an increased dividend from the company's Hong Kong subsidiary. The company's investment strategy has remained consistent with the prior year, built around highly rated, liquid securities with a relatively short duration.

### 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.

QBE LENDERS' MORTGAGE INSURANCE LIMITED

**DIRECTORS' REPORT**
For the year ended 31 December 2016

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 company employed nil persons (2015: nil).

A related entity, QBE Management Services Pty Limited ("QMS"), is the employer of most 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.

Another related entity, QBE Insurance (International) Limited ("QII"), performs a similar role in respect of all persons engaged in the activities of the company in New Zealand.

**Dividends**

The dividends paid during the year totalled $576.5 million (2015: $226.0 million).

The directors did not declare a final dividend payable prior to the end of the year for the financial year ended 31 December 2016 (2015: nil).

In February 2017 the directors approved the payment of a further dividend of $42.0 million (2015: $100.0 million).

**Options**

There were no options granted by the company during the year (2015: nil).

**Likely developments**

Information on likely developments in the company'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 company.

**Significant changes**

The company revised its reinsurance strategy and entered into new reinsurance contracts effective 1 January 2016. Under the revised program, claims paid after 2015 on all policies written prior to 2016 will be reinsured to a level of 45% with a related party. Further, a stop loss reinsurance contract has been entered with external parties in relation to claims on policies written in 2016 and 2017.

**Events subsequent to balance sheet date**

The following events have occurred after balance date:

(i) dividends of $42.0m were proposed before the financial statements were authorised as disclosed in note 5.3.

There is, at the date of this report, no other matter or circumstance that has arisen since 31 December 2016 that has significantly affected, or may significantly affect:

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

**Environmental regulation**

The company is not currently required to report under any significant environmental regulations under either Commonwealth, State or Territory legislation.

**QBE LENDERS' MORTGAGE INSURANCE LIMITED**

**DIRECTORS' REPORT**
For the year ended 31 December 2016

**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 company is of a kind referred to in the *ASIC Corporations (Rounding in Financial/Directors' Reports) Instrument 2016/191*. Amounts have been rounded off in the Directors' Report to the nearest hundred thousand dollars or, in certain cases, to the nearest thousand dollars in accordance with that Instrument.

**Auditor**

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

Signed in SYDNEY this 17th day of February 2017 in accordance with a resolution of directors.

Director..........................................

Director..........................................

pwc

## *Auditor's Independence Declaration*

As lead auditor for the audit of QBE Lenders' Mortgage Insurance Limited for the year ended 31 December 2016, 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.

S J Hadfield
Partner
PricewaterhouseCoopers

Sydney
17 February 2017

*PricewaterhouseCoopers, ABN 52 780 433 757*
*Darling Park Tower 2, 201 Sussex Street, GPO BOX 2650, SYDNEY NSW 1171*
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QBE LENDERS' MORTGAGE INSURANCE LIMITED

## FINANCIAL REPORT CONTENTS

**Financial statements**



**Notes to the financial statements**

QBE LENDERS' MORTGAGE INSURANCE LIMITED

## STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2016

| | NOTE | 2016 $M | 2015 $M |
|---|---|---|---|
| Gross written premium | | **236.0** | 306.5 |
| Unearned premium movement | | **112.9** | 99.8 |
| Gross earned premium revenue | 2.1 | **348.9** | 406.3 |
| Outward reinsurance premium | | **(431.4)** | (105.0) |
| Deferred reinsurance premium movement | | **179.8** | 16.5 |
| Outward reinsurance premium expense | | **(251.6)** | (88.5) |
| Net earned premium (a) | | **97.3** | 317.8 |
| Gross claims expense | 2.2 | **(70.6)** | (26.3) |
| Reinsurance and other recoveries revenue | 2.2 | **81.7** | 2.6 |
| Net claims expense (b) | | **11.1** | (23.7) |
| Gross commission expense | | **(8.2)** | (12.0) |
| Reinsurance commission revenue | 2.1 | **55.9** | 22.3 |
| Net *commission* revenue (c) | | **47.7** | 10.3 |
| Other acquisition costs (d) | | **(30.5)** | (29.2) |
| Underwriting and other expenses (e) | | **(24.7)** | (29.8) |
| **Underwriting result (a)+(b)+(c)+(d)+(e)** | | **100.9** | 245.4 |
| Investment income - policyholders' funds | | **18.3** | 23.5 |
| Investment expenses - policyholders' funds | | **(0.5)** | (0.8) |
| **Insurance profit** | | **118.7** | 268.1 |
| Investment income - shareholder's funds | | **46.4** | 34.8 |
| Investment expenses - shareholder's funds | | **(1.0)** | (1.3) |
| Profit before income tax | | **164.1** | 301.6 |
| Income tax expense | 6.1 | **(45.6)** | (90.5) |
| Profit after income tax | | **118.5** | 211.1 |
| **Other comprehensive income** | | | |
| *Items that may be reclassified to profit or loss* | | | |
| Net movement in foreign currency translation reserve | | **0.1** | 0.2 |
| Other comprehensive income after income tax | | **0.1** | 0.2 |
| Total comprehensive income after income tax | | **118.6** | 211.3 |
| | | | |
| **Profit after income tax attributable to:** | | | |
| Ordinary equity holders of the company | | **118.6** | 211.3 |
| | | **118.6** | 211.3 |
| | | | |
| Total comprehensive income after income tax attributable to: | | | |
| Ordinary equity holders of the company | | **118.6** | 211.3 |
| | | **118.6** | 211.3 |

The statement of comprehensive income should be read in conjunction with the accompanying notes.

**QBE LENDERS' MORTGAGE INSURANCE LIMITED**

**BALANCE SHEET**
As at 31 December 2016

| | NOTE | 2016 $M | 2015 $M |
|---|---|---|---|
| **Assets** | | | |
| Cash and cash equivalents | 5.1 | **4.4** | 3.3 |
| Investments | 3.2 | **1,247.6** | 2,045.4 |
| Trade and other receivables | 2.6 | **105.2** | 62.3 |
| Reinsurance and other recoveries on outstanding claims | 2.3 | **67.5** | 5.4 |
| Deferred insurance costs | 2.5 | **402.8** | 218.6 |
| Deferred tax assets | 6.2 | **3.9** | 5.1 |
| Investments in controlled entities | 7.1 | **73.5** | 73.5 |
| Total assets | | **1,904.9** | 2,413.6 |
| **Liabilities** | | | |
| Trade and other payables | 2.7 | **116.2** | 110.6 |
| Outstanding claims | 2.3 | **137.2** | 106.4 |
| Unearned premium | 2.5 | **647.7** | 760.6 |
| Unearned reinsurance commission | 2.5 | **82.5** | 56.8 |
| Total liabilities | | **983.6** | 1,034.4 |
| **Net assets** | | **921.3** | 1,379.2 |
| **Equity** | | | |
| Share capital | 5.2.1 | **364.3** | 364.3 |
| Reserves | 5.2.2 | **0.5** | 0.4 |
| Retained profits | | **556.5** | 1,014.5 |
| Total equity | | **921.3** | 1,379.2 |

The balance sheet should be read in conjunction with the accompanying notes.

QBE LENDERS' MORTGAGE INSURANCE LIMITED

## STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2016

| 2016 | SHARE CAPITAL $M | RESERVES $M | RETAINED PROFITS $M | TOTAL EQUITY $M |
|---|---|---|---|---|
| At 1 January | 364.3 | 0.4 | 1,014.5 | 1,379.2 |
| Profit after income tax | - | - | 118.5 | 118.5 |
| Other comprehensive income | - | 0.1 | - | 0.1 |
| Total comprehensive income | - | 0.1 | 118.5 | 118.6 |
| **Transactions with owners in their capacity as owners:** | | | | |
| Dividends paid on ordinary shares | - | - | (576.5) | (576.5) |
| At 31 December | 364.3 | 0.5 | 556.5 | 921.3 |

| 2015 | SHARE CAPITAL $M | RESERVES $M | RETAINED PROFITS $M | TOTAL EQUITY $M |
|---|---|---|---|---|
| At 1 January | 364.3 | 0.2 | 963.4 | 1,327.9 |
| Profit after income tax | - | - | 211.1 | 211.1 |
| Other comprehensive income | - | 0.2 | - | 0.2 |
| Total comprehensive income | - | 0.2 | 211.1 | 211.3 |
| **Transactions with owners in their capacity as owners:** | | | | |
| Dividends paid on ordinary shares | - | - | (160.0) | (160.0) |
| At 31 December | 364.3 | 0.4 | 1,014.5 | 1,379.2 |

The statement of changes in equity should be read in conjunction with the accompanying notes.

QBE LENDERS' MORTGAGE INSURANCE LIMITED

## STATEMENT OF CASH FLOWS

For the year ended 31 December 2016

| | NOTE | 2016 $M | 2015 $M |
|---|---|---|---|
| **Operating activities** | | | |
| Premiums received | | **255.3** | 335.6 |
| Reinsurance and other recoveries received | | **20.3** | 2.1 |
| Reinsurance commissions received | | **61.7** | 29.1 |
| Outward reinsurance paid | | **(389.9)** | (112.6) |
| Claims paid | | **(40.7)** | (39.9) |
| Insurance costs paid | | **(41.0)** | (46.9) |
| Other underwriting costs paid | | **(63.0)** | (63.6) |
| Interest and dividends received | | **49.6** | 69.0 |
| Income taxes paid | | **(106.6)** | (133.1) |
| Net cash flows from operating activities | 8.3 | **(234.3)** | 39.7 |
| **Investing activities** | | | |
| Proceeds from sale of fixed interest and equity investments | | **2,116.7** | 2,573.3 |
| Purchase of fixed interest investments | | **(1,313.0)** | (2,389.9) |
| Payments to related entities | | **(4.1)** | - |
| Dividends received and capital returned from controlled entity | | **12.3** | - |
| Net cash flows from investing activities | | **811.9** | 183.4 |
| **Financing activities** | | | |
| Dividends paid | | **(576.5)** | (226.0) |
| Net cash flows from financing activities | | **(576.5)** | (226.0) |
| Net movement in cash and cash equivalents | | **1.1** | (2.9) |
| Cash and cash equivalents at the beginning of the financial year | | **3.3** | 6.2 |
| Cash and cash equivalents at the end of the financial year | 5.1 | **4.4** | 3.3 |

The statement of cash flows should be read in conjunction with the accompanying notes.

# 1. OVERVIEW

## 1.1 About the company

**About QBE Lenders' Mortgage Insurance Limited**

QBE Lenders' Mortgage Insurance Limited ("the company") is a lenders' mortgage insurance company underwriting business in Australia and New Zealand.

**About insurance**

In simple terms, insurance and reinsurance companies help their customers (consumers, businesses and other insurance companies) to manage risk. More broadly put, insurance companies create value by pooling and redistributing risk. This is done by collecting premium from those that it insures, (i.e. policyholders) and then paying the claims of the few that call upon their insurance protection. The company may also choose to reduce some of its own accumulated risk through the use of outward reinsurance, which is insurance for insurance companies. As not all policyholders will actually experience a claims event, the effective pooling and redistribution of risk lowers the total cost of risk management, thereby making insurance protection more cost effective for all.

The operating model of insurance companies relies on profits being generated:

- by appropriately pricing risk and charging adequate premium to cover the expected payouts that will be incurred over the life of the insurance policy (both claims and operating expenses); and
- by earning a return on the collected premium and funds withheld to pay future claims through the adoption of an appropriate investment strategy.

Insurance therefore serves a critical function of providing customers with the confidence to achieve their business and personal goals through cost effective risk management. This is achieved within a highly regulated environment, designed to ensure that insurance companies maintain adequate capital to protect the interests of policyholders.

## 1.2 About this report

This Financial Report includes the financial statements for the company. The parent entity is QBE Holdings (AAP) Pty Limited (QBE AAP), incorporated in Australia, and the ultimate parent entity is QBE Insurance Group Limited (QBE Group), incorporated in Australia.

The Financial Report includes the four primary statements, namely the statement of comprehensive income (which comprises profit or loss and other comprehensive income), balance sheet, statement of changes in equity and statement of cash flows, and associated notes as required by Australian Accounting Standards. The notes have been restructured this year to improve clarity of the financial statements. Disclosures have been grouped into the following categories in order to assist users in their understanding of our financial statements:

1. **Overview** contains information that impacts the Financial Report as a whole.
2. **Underwriting activities** brings together all results and balance sheet disclosures relevant to the company's insurance activities.
3. **Investments** includes all results and balance sheet disclosures relevant to our investment activities.
4. **Risk management** provides commentary on the company's exposure to various financial and capital risks, explaining the potential impact on the results and balance sheet and how the company manages these risks.
5. **Capital structure** provides information about the equity components of the company's capital.
6. **Tax** includes all required disclosures in relation to the company's tax balances.
7. **Company structure** provides a summary of the company's controlled entities and includes disclosures in relation to transactions impacting the company structure.
8. **Other** includes disclosures required in order to comply with Australian Accounting Standards.

Where applicable within each note, disclosures are further analysed as follows:

- **Overview** provides some context to assist users in understanding the disclosures.
- **Disclosures** (both numbers and commentary) provides analysis of balances as required by Australian Accounting Standards.
- **How we account for the numbers** summarises the accounting policies relevant to an understanding of the numbers.
- **Critical accounting judgements and estimates** explains the key estimates and judgements applied by management in determining the numbers.

The notes include information which the directors believe is required to understand the financial statements and is material and relevant to the operations, balance sheet and results of the company. Information is considered material and relevant if, for example:

- the amount in question is significant because of its size or nature;
- it is important to assist in understanding the results of the company;
- it helps to explain the impact of significant changes in the company's business – for example, significant acquisitions or disposals; or,
- it relates to an aspect of the company's operations that is important to its future performance.

### 1.2.1 Basis of preparation

This Financial Report is a general purpose financial report which:

- has been prepared in accordance with Australian Accounting Standards and Interpretations as issued by the Australian Accounting Standards Board (AASB), International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board, and the *Corporations Act 2001*;
- has been prepared on a historical cost basis as modified by certain exceptions, the most significant of which are the measurement of investments and derivatives at fair value and the measurement of the net outstanding claims liability at present value;
- is presented in Australian dollars; and
- is presented with values rounded to the nearest one hundred thousand dollars or, in certain cases, the nearest thousand dollars in accordance with *ASIC Corporations (Rounding in Financial/Directors' Reports) Instrument 2016/191*.

The company is a for-profit entity for the purpose of preparing the financial statements.

New and amended Accounting Standards and Interpretations issued by the AASB that are now effective are detailed in note 8.1.

The company has not adopted any Accounting Standards and Interpretations that have been issued or amended but are not yet effective.

These financial statements are separate financial statements and the company is exempted from preparing consolidated financial statements under AASB10 *Consolidated Financial Statements*. The ultimate parent company, QBE Group (incorporated in Australia) produces consolidated financial statements in accordance with IFRS for public use, which can be obtained at www.qbe.com or Level 27, 8-12 Chifley Square, Sydney, NSW 2000 Australia.

### 1.2.2 Critical accounting judgements and estimates

The preparation of the company's financial statements requires management to make judgements and estimates that affect amounts reported in the profit or loss and balance sheet.

The company has developed a centralised risk management and policy framework, designed to ensure consistency of approach across a number of operational activities, subject to the specific requirements of local markets, legislation and regulation. Such operational activities include underwriting, claims management, actuarial assessment of the claims provision and investment management.

Given the centralised approach to many of its activities, sensitivity analyses in respect of critical accounting estimates and judgements are presented in order to provide information and analysis which is meaningful, relevant, reliable and comparable year on year.

The key areas in which critical estimates and judgements are applied are as follows:

- net outstanding claims liability (note 2.3);
- unearned premium and deferred insurance costs (note 2.5);
- liability adequacy test (note 2.5.1); and
- deferred income tax (note 6.2).

### 1.2.3 Foreign currency

**Translation of foreign currency transactions and balances**

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

**Translation of foreign operations**

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

- income, expenses and other current period movements in comprehensive income are translated at average rates of exchange; and
- balance sheet items are translated at the closing balance date rates of exchange.

**Derivatives**

Derivatives and borrowings which meet the specified criteria in AASB 139 *Financial Instruments: Recognition and Measurement* are accounted for using fair value hedge accounting, cash flow hedge accounting or hedging of a net investment in a foreign operation.

**Exchange rates**

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

| | 2016 | | 2015 | |
|---|---|---|---|---|
| | PROFIT OR LOSS | BALANCE SHEET | PROFIT OR LOSS | BALANCE SHEET |
| US$/A$ | **1.345** | **1.387** | 1.333 | 1.372 |
| NZ$/A$ | **0.937** | **0.962** | 0.932 | 0.939 |

## 2. UNDERWRITING ACTIVITIES

**Overview**

This section provides analysis and commentary on the company's underwriting activities. Underwriting, in simple terms, is the agreement by the insurer to assume insurance risk in return for a premium paid by the insured. The underwriter assesses the quality of the risk and prices it accordingly.

## 2.1 Revenue

### Overview

Revenue mainly comprises premiums charged for providing insurance coverage. Premiums are classified as either:

- direct, being those paid by the policyholder to the insurer; or
- inward reinsurance premiums, being coverage provided to an insurer or reinsurer in relation to a specified grouping of policies or risks.

Other sources of revenue include amounts recovered from reinsurers under the terms of reinsurance contracts and commission income from reinsurers.

| | NOTE | 2016 $M | 2015 $M |
|---|---|---|---|
| **Gross earned premium revenue** | | | |
| Direct | | 320.6 | 370.5 |
| Inward reinsurance | | 28.3 | 35.8 |
| | | 348.9 | 406.3 |
| **Other revenue** | | | |
| Reinsurance and other recoveries revenue | 2.2 | 81.7 | 2.6 |
| Reinsurance commission revenue | | 55.9 | 22.3 |
| | | 137.6 | 24.9 |
| Total revenue | | 486.5 | 431.2 |

Other revenue increased significantly in 2016 as a result of commission revenue and reinsurance recoveries on the new quota share agreement. Under the revised program, claims paid after 2015 on all policies written prior to 2016 will be reinsured to a level of 45% with a related party.

### How we account for the numbers

**Premium revenue**
Premium written comprises amounts charged to policyholders, excluding taxes collected on behalf of third parties. Premium is recognised as revenue in profit or loss based on the incidence of the pattern of risk. Premium is treated as earned from the date of attachment of risk.

**Reinsurance and other recoveries**
Reinsurance and other recoveries on paid claims, reported claims not yet paid, and claims incurred but not reported (IBNR) are recognised as revenue. Recoveries are measured as the present value of the expected future receipts, calculated on the same basis as the provision for outstanding claims.

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

## 2.2 Net claims expense

### Overview

A major expense for an insurance company is net claims expense, which is the difference between the net outstanding claims liability (as described in note 2.3 below) at the beginning and the end of the financial year plus any claims incurred and settled during the financial year. Claims expense may be reported on a gross basis (i.e. before reinsurance and other recoveries) or on a net basis (i.e. after reinsurance and other recoveries).

| | NOTE | 2016 $M | 2015 $M |
|---|---|---|---|
| **Gross claims incurred and related expenses** | | | |
| Direct | | **66.7** | 24.2 |
| Inward reinsurance | | **3.9** | 2.1 |
| | | **70.6** | 26.3 |
| **Reinsurance and other recoveries** | | | |
| Direct | | **(81.3)** | (2.4) |
| Inward reinsurance | | **(0.4)** | (0.2) |
| | 2.1 | **(81.7)** | (2.6) |
| Net claims expense | | **(11.1)** | 23.7 |
| **Analysed as follows:** | | | |
| Movement in net discounted central estimate | 2.4.1 | **(20.3)** | 28.4 |
| Movement in risk margin | 2.3.3 | **9.2** | (4.7) |
| Net claims expense | | **(11.1)** | 23.7 |

## 2.3 Net outstanding claims liability

### Overview

The net outstanding claims liability comprises the elements described below.

- The gross central estimate (note 2.3.1). This is the provision for expected future claims payments and includes claims incurred but which have not yet been reported (IBNR) and estimated claims handling costs.
- Less amounts recoverable from reinsurers (note 2.3.2). Insurance companies may elect to purchase reinsurance cover to manage their exposure to any one claim or series of claims. When an insurance company incurs a claim as a result of an insured loss, it may be able to recover some of that claim from reinsurance.
- Less an amount to reflect the discount to present value using risk-free rates of return. The net central estimate is discounted to present value recognising that the claim and/or recovery may not be settled for some time. The weighted average risk-free rate used to discount the outstanding claims liability is summarised in note 2.3.4.
- Plus a risk margin (note 2.3.3). A risk margin is added to reflect the inherent uncertainty in the net discounted central estimate of outstanding claims.

| | NOTE | 2016 $M | 2015 $M |
|---|---|---|---|
| Gross discounted central estimate | 2.3.1 | **93.8** | 72.2 |
| Gross risk margin | 2.3.3 | **43.4** | 34.2 |
| Gross outstanding claims liability | | **137.2** | 106.4 |
| Reinsurance and other recoveries on outstanding claims and risk margin | 2.3.2 | **(67.5)** | (5.4) |
| Net outstanding claims liability | | **69.7** | 101.0 |

The table below analyses the movement in the outstanding claims liability:

| | 2016 | | | 2015 | | |
|---|---|---|---|---|---|---|
| | GROSS $M | REINSURANCE $M | NET $M | GROSS $M | REINSURANCE $M | NET $M |
| At 1 January | 106.4 | (5.4) | 101.0 | 119.4 | (4.7) | 114.7 |
| Movement in prior year accident claims provision | (14.4) | (46.0) | (60.4) | (50.7) | 1.4 | (49.3) |
| Net claims expense in current accident year | 85.0 | (35.7) | 49.3 | 77.0 | (4.0) | 73.0 |
| Incurred claims recognised in profit or loss (note 2.2) | 70.6 | (81.7) | (11.1) | 26.3 | (2.6) | 23.7 |
| Claims payments | (39.8) | 19.6 | (20.2) | (39.3) | 1.9 | (37.4) |
| At 31 December | 137.2 | (67.5) | 69.7 | 106.4 | (5.4) | 101.0 |

### 2.3.1 Gross discounted central estimate

| | NOTE | 2016 $M | 2015 $M |
|---|---|---|---|
| Gross undiscounted central estimate excluding claims settlement costs | | 94.0 | 72.5 |
| Claims settlement costs | | 2.2 | 1.6 |
| Gross undiscounted central estimate | | 96.2 | 74.1 |
| Discount to present value | | (2.4) | (1.9) |
| Gross discounted central estimate | 2.3 | 93.8 | 72.2 |
| Payable within 12 months | | 46.0 | 38.5 |
| Payable in greater than 12 months | | 47.8 | 33.7 |
| Gross discounted central estimate | 2.3 | 93.8 | 72.2 |

**Critical accounting judgements and estimates**

The gross and net discounted central estimate is determined by the Appointed Actuary, supported by a team of actuaries. The valuation process is performed quarterly and includes extensive consultation with claims and underwriting staff as well as senior management. The central estimate of outstanding claims is subject to a comprehensive independent review at least annually. The risk management procedures related to the actuarial function are explained further in note 4.2.

The determination of the amounts that the company 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 due to 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
- changing social, political and economic trends (e.g. house price inflation, unemployment and interest rates).

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 company, for which some 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 incurred and the final settlement amount, as a result of additional financing and settlement costs incurred by the lender and changes in property valuations.

Central estimates are determined using a variety of estimation techniques, generally based on an 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.

The gross central estimate is discounted to present value using the appropriate risk-free rate.

Central estimates are calculated gross of any reinsurance and other recoveries. A separate estimate is made of the amounts recoverable from reinsurers, borrowers and third parties based on the gross central estimate (note 2.3.2).

### 2.3.2 Reinsurance and other recoveries on outstanding claims

| | NOTE | 2016 $M | 2015 $M |
|---|---|---|---|
| Reinsurance and other recoveries on outstanding claims - undiscounted | | **68.7** | 5.5 |
| Discount to present value | | **(1.2)** | (0.1) |
| Reinsurance and other recoveries on outstanding claims | 2.3 | **67.5** | 5.4 |
| Receivable within 12 months | | **33.1** | 2.9 |
| Receivable in greater than 12 months | | **34.4** | 2.5 |
| Reinsurance and other recoveries on outstanding claims | 2.3 | **67.5** | 5.4 |

**How we account for the numbers**

The recoverability of amounts due from reinsurers and others is assessed at each balance 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 or policy document. Counterparty credit risk in relation to reinsurance assets is considered in note 4.3. Recoveries are discounted to present value using the appropriate risk-free rate.

### 2.3.3 Risk Margin

**Overview**

A risk margin is determined by the company Board to reflect the inherent uncertainty in the central estimate.

The risk margin and the net discounted central estimate are key inputs in the determination of the probability of adequacy, which is a statistical measure of the relative adequacy of the outstanding claims liability to ultimately be able to pay claims. For example, a 90% probability of adequacy indicates that the net discounted central estimate is expected to be adequate nine years in 10.

| | 2016 $M | 2015 $M |
|---|---|---|
| Gross risk margin | **43.4** | 34.2 |
| Less: Reinsurance on risk margin | **(19.9)** | - |
| Net risk margin | **23.5** | 34.2 |
| Risk margin as a percentage of the net discounted central estimate | **50.9%** | 51.2% |
| Probability of adequacy | **90.0%** | 90.0% |

The decrease in the net risk margin reflects the results of actuarial analysis of the uncertainty inherent in the central estimate. As a consequence, the probability of adequacy at 31 December 2016 and 2015 is 90% which is above APRA's 75% benchmark.

**How we account for the numbers**

AASB 1023 *General Insurance Contracts* requires an entity to adopt an appropriate risk margin. The resulting probability of adequacy is not of itself an accounting policy as defined by AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*. The appropriate level of the company's risk margin is not determined by reference to a fixed probability of adequacy.

The Board reviews a number of factors when determining the appropriate risk margin, including any changes in the level of uncertainty in the net central estimate, the resulting probability of adequacy and the risk margin as a percentage of the net discounted central estimate.

**Critical accounting judgements and estimates**

Risk margins are determined by the Board 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 estimation error, data quality, variability of key discount assumptions and possible economic and legislative changes.

The probability of adequacy for the company is determined by analysing the variability of each class of business and the correlation between classes of business and divisions. Correlations are determined for aggregations of classes of business, where appropriate, at the divisional level. The correlations adopted by the company are generally derived from industry analysis, the company's historical experience and the judgement of experienced and qualified actuaries.

### 2.3.4 Discount rate used to determine the outstanding claims liability

**Overview**

Claims typically may not settle for some time. As such, provisions are discounted to reflect the time value of money. The table below summarises the weighted average discount rate used to discount the outstanding claims liability.

| | 2016 % | 2015 % |
|---|---|---|
| Australia and New Zealand | 1.8 | 2.0 |

**How we account for the numbers**

AASB 1023 *General Insurance Contracts* requires that the net central estimate is discounted to reflect 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.

### 2.3.5 Weighted average term to settlement

**Overview**

The weighted average term to settlement refers to the period from the balance date to the expected date of claims settlement. All other factors being equal, a longer weighted average term to settlement generally results in a larger benefit from discount and a resulting lower discounted central estimate.

| | 2016 YEARS | 2015 YEARS |
|---|---|---|
| Australia and New Zealand | 1.4 | 1.3 |

### 2.3.6 Net discounted central estimate maturity profile

**Overview**

The maturity profile is the company's expectation of the period over which the net central estimate will be settled. The company uses this information to ensure that it has adequate liquidity to pay claims as they are due to be settled and to inform the company's investment strategy. The expected maturity profile of the company's net discounted central estimate is analysed below.

| | | 1 YEAR OR LESS | 1 TO 2 YEARS | 2 TO 3 YEARS | 3 TO 4 YEARS | 4 TO 5 YEARS | OVER 5 YEARS | TOTAL |
|---|---|---|---|---|---|---|---|---|
| **2016** | **$M** | **12.9** | **8.0** | **3.1** | **1.1** | **0.5** | **0.7** | **26.3** |
| 2015 | $M | 35.6 | 19.4 | 6.9 | 2.4 | 1.1 | 1.4 | 66.8 |

### 2.3.7 Impact of changes in key variables on the net outstanding claims liability

**Overview**

The impact of changes in key variables used in the calculation of the outstanding claims liability is summarised in the table below. Each change has been calculated in isolation from the other changes and 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, if the central estimate was to increase, at least part of the increase may result in a change in the level of risk margins rather than in a change to profit after tax, depending on the nature of the change in the central estimate. Likewise, if the coefficient of variation were to increase, 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.

| | SENSITIVITY % | PROFIT (LOSS)[1,2] 2016 $M | PROFIT (LOSS)[1,2] 2015 $M |
|---|---|---|---|
| Severity | +20 | **(7.8)** | (11.4) |
| | -20 | **7.8** | 11.4 |
| Claim rates | +20 | **(3.4)** | (4.2) |
| | -20 | **4.2** | 5.3 |
| Discount rate | +5 | **-** | 0.1 |
| | -5 | **-** | (0.1) |
| Coefficient of variation | +20 | **(3.0)** | (4.2) |
| | -20 | **3.2** | 4.7 |

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

[2] The impact of a change in interest rates on net profit after income tax due to market value movements on fixed interest securities is shown in note 4.4.

### 2.4 Claims development - net undiscounted central estimate

**Overview**

The claims development table demonstrates the extent to which the original estimated ultimate claims cost in any one accident year (item (a) in the table below) has subsequently developed positively (i.e. claims cost estimates have reduced) or negatively (i.e. further claims expense has been recognised in subsequent years). This table therefore illustrates the variability and inherent uncertainty in estimating the central estimate each year. The ultimate claims cost for any particular accident year is not known until all claims payments have been made which, could be some time into the future. Minimal variability in the central estimate demonstrates disciplined claims management and robust estimation techniques.

The revised ultimate claims cost at the end of each subsequent accident year demonstrates how the original estimate has been revised over time (b).

Cumulative actual net claims payments (d) are deducted from the expected ultimate claims payments in each accident year (c) at the current balance date, resulting in the net undiscounted central estimate (e), which is reconciled to the discounted central estimate (f).

The accident year movement (e) reflects the ultimate undiscounted net claims estimate at the end of the current financial year less the equivalent at the end of the previous financial year (b). This is further summarised in note 2.4.1.

The claims development table is presented net of reinsurance. With reinsurance arrangements and with the company's risk tolerance managed on a net basis, it is not considered meaningful or practicable to provide this information other than on a net accident year basis.

| | 2012 & PRIOR YEARS $M | 2013 $M | 2014 $M | 2015 $M | 2016 $M | TOTAL $M |
|---|---|---|---|---|---|---|
| Net ultimate claims payments: | | | | | | |
| (a) Original estimate of net ultimate claims payments | | 61.0 | 56.2 | 51.4 | 33.0 | |
| (b) One year later | | 48.4 | 41.3 | 28.6 | | |
| Two years later | | 42.0 | 31.6 | | | |
| Three years later | | 39.7 | | | | |
| (c) Current estimate of net ultimate claims payments | | 39.7 | 31.6 | 28.6 | 33.0 | 132.9 |
| (d) Cumulative net payments to date | | 39.0 | 28.0 | 17.2 | 8.1 | 92.3 |
| (e) Net undiscounted central estimate at 31 Dec 2016 | 0.2 | 0.7 | 3.6 | 11.4 | 29.3 | 45.2 |
| Discount to present value | | | | | | (1.2) |
| Claims settlement costs | | | | | | 2.2 |
| Net risk margin | | | | | | 23.5 |
| (f) Net outstanding claims liability at 31 Dec 2016 (note 2.3) | | | | | | 69.7 |
| (g) Net (increase) decrease in estimated ultimate claims payments in current financial year (2.4.1) | (1.5) | (2.2) | (9.7) | (22.8) | 33.0 | (3.2) |

Uncertainty surrounding claims development is materially resolved within four years.

**How we account for the numbers**

The company writes business in Australian dollars and in the case of the New Zealand branch, New Zealand dollars. The translation of central estimates denominated in foreign currencies gives rise to foreign exchange movements which have no direct bearing on the development of the underlying claims. To eliminate this distortion, central estimates have been translated to the functional currencies of our controlled entities at constant rates of exchange. All central estimates and cumulative claims payments for the 4 most recent accident years reported in functional currencies other than Australian dollars have been translated to Australian dollars using the 2016 average rate of exchange.

### 2.4.1 Reconciliation of claims development table to profit or loss

**Overview**

The table below reconciles the net increase or decrease in estimated ultimate claims payments in the current financial year from the claims development table in note 2.4 to the analysis of current and prior accident year central estimate development recognised in profit or loss (note 2.4.2).

| | 2016 | | | 2015 | | |
|---|---|---|---|---|---|---|
| | CURRENT YEAR $M | PRIOR YEARS $M | TOTAL $M | CURRENT YEAR $M | PRIOR YEARS $M | TOTAL $M |
| Net undiscounted central estimate movement (note 2.4) | 33.0 | (36.2) | (3.2) | 51.4 | (24.7) | 26.7 |
| Movement in claims settlement costs | 1.8 | 0.4 | 2.2 | 1.5 | - | 1.5 |
| Movement in discount | (0.8) | 1.4 | 0.6 | (1.2) | 1.4 | 0.2 |
| Movement in recoveries arising from new reinsurance arrangement | - | (19.9) | (19.9) | - | - | - |
| Movement in net discounted central estimate (note 2.4.2) | 34.0 | (54.3) | (20.3) | 51.7 | (23.3) | 28.4 |

Development of claims from prior accident years was significantly better than expected at 31 December 2016. The take-up of 45% quota share reinsurance arrangement led to a $27.4m release of the net central estimate for prior years, with the remaining $8.8m a result of better than expected claims experience since the December 2015 valuation.

### 2.4.2 Net central estimate development

**Overview**

The table further analyses the current and prior accident year movement in the net discounted central estimate, separately identifying the gross and reinsurence components. Prior accident year claims are those claims that occurred in a previous year but for which a reassessment of the claims cost has impacted the result in the current period.

| | 2016 | | | 2015 | | |
|---|---|---|---|---|---|---|
| | CURRENT YEAR $M | PRIOR YEARS $M | TOTAL $M | CURRENT YEAR $M | PRIOR YEARS $M | TOTAL $M |
| **Gross central estimate development** | | | | | | |
| Undiscounted | 71.4 | (9.5) | 61.9 | 57.1 | (26.3) | 30.8 |
| Discount | (1.7) | 1.2 | (0.5) | (1.3) | 1.5 | 0.2 |
| | 69.7 | (8.3) | 61.4 | 55.8 | (24.8) | 31.0 |
| **Reinsurance and other recoveries** | | | | | | |
| Undiscounted | (36.6) | (46.2) | (82.8) | (4.2) | 1.6 | (2.6) |
| Discount | 0.9 | 0.2 | 1.1 | 0.1 | (0.1) | - |
| | (35.7) | (46.0) | (81.7) | (4.1) | 1.5 | (2.6) |
| **Net central estimate development** | | | | | | |
| Undiscounted | 34.8 | (55.7) | (20.9) | 52.9 | (24.7) | 28.2 |
| Discount | (0.8) | 1.4 | 0.6 | (1.2) | 1.4 | 0.2 |
| Net discounted central estimate development (note 2.4.1) | 34.0 | (54.3) | (20.3) | 51.7 | (23.3) | 28.4 |

## 2.5 Unearned premium and deferred insurance costs

**Overview**

Gross written premium is recognised or earned in profit or loss in accordance with the pattern of incidence of risk. The unearned premium liability is that portion of premium that the company has not yet recognised as it has not been earned at the balance date.

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Acquisition costs are the costs associated with obtaining and recording insurance contracts. These are similarly capitalised and amortised, consistent with the recognition of the relevant premium income.

| | 2016 $M | 2015 $M |
|---|---|---|
| Unearned premium (a) | 647.7 | 760.6 |
| To be earned within 12 months | 238.2 | 285.7 |
| To be earned in greater than 12 months | 409.5 | 474.9 |
| Unearned premium | 647.7 | 760.6 |
| Unearned commission income (b) | 82.5 | 56.8 |
| To be earned within 12 months | 31.0 | 20.8 |
| To be earned in greater than 12 months | 51.5 | 36.0 |
| Unearned commission income | 82.5 | 56.8 |
| Deferred reinsurance premium | 324.9 | 145.0 |
| Deferred commission expense | 9.4 | 8.8 |
| Deferred acquisition costs | 68.5 | 64.8 |
| Deferred insurance costs (c) | 402.8 | 218.6 |
| To be expensed within 12 months | 147.3 | 80.5 |
| To be expensed in greater than 12 months | 255.5 | 138.1 |
| Deferred insurance costs | 402.8 | 218.6 |
| Net premium liabilities (a)+(b)-(c) | 327.4 | 598.8 |

**Unearned premium movements**

| | 2016 $M | 2015 $M |
|---|---|---|
| At 1 January | 760.6 | 860.5 |
| Deferral of premium on contracts written in the financial year | 207.8 | 269.5 |
| Earning of premium written in previous financial years | (320.7) | (350.3) |
| Release of deferral | - | (19.0) |
| Foreign exchange | - | (0.1) |
| At 31 December | 647.7 | 760.6 |

**Unearned commission income movements**

| | 2016 $M | 2015 $M |
|---|---|---|
| At 1 January | 56.8 | 50.3 |
| Deferral of commission on contracts written in the financial year | 81.5 | 26.4 |
| Earning of commission written in previous financial years | (55.8) | (18.9) |
| Release of deferral | - | (1.0) |
| At 31 December | 82.5 | 56.8 |

**Deferred insurance costs movements**

| | DEFERRED REINSURANCE PREMIUM | | DEFERRED COMMISSION | | DEFERRED ACQUISITION COSTS | |
|---|---|---|---|---|---|---|
| | 2016 $M | 2015 $M | 2016 $M | 2015 $M | 2016 $M | 2015 $M |
| At 1 January | 145.0 | 128.5 | 8.8 | 11.0 | 64.8 | 62.5 |
| Costs deferred in financial year | 383.6 | 67.4 | 4.1 | 2.2 | 31.1 | 31.1 |
| Amortisation of costs deferred in previous financial years | (203.7) | (48.4) | (3.5) | (4.2) | (27.4) | (27.4) |
| Release of deferral | - | (2.5) | - | (0.2) | - | (1.4) |
| At 31 December | 324.9 | 145.0 | 9.4 | 8.8 | 68.5 | 64.8 |

**How we account for the numbers**

**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.

**Unearned commission income**
Exchange commission income is recognised in accordance with the premium income earning pattern adjusted for policy terminations.

**Deferred insurance costs**
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. 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.

## 2.5.1 Liability adequacy test

**Overview**

At each balance date, the company is required to assess net premium liabilities (being unearned premium less, related intangible assets and deferred insurance costs) to determine whether the amount provided is sufficient to pay future claims.

If the present value of expected future claims plus the additional risk margin exceeds the net premium liabilities, the net premium liability is deemed deficient. This deficiency is immediately recognised in profit or loss. In recognising the deficiency, an insurer must first write down any related intangible assets and then deferred acquisition costs before recognising an unexpired risk liability.

**Expected present value of future cash flows for future claims including risk margin**

| | 2016 $M | 2015 $M |
|---|---|---|
| Undiscounted central estimate | **254.3** | 351.2 |
| Discount to present value | **(24.6)** | (33.6) |
| | **229.7** | 317.6 |
| Risk margin | **59.8** | 82.7 |
| Expected present value of net future cash flows for future claims including risk margin | **289.5** | 400.3 |

The application of the liability adequacy test did not identify a deficiency at either 31 December 2016 or 2015.

**How we account for the numbers**

At each balance date, the adequacy of the unearned premium liability is assessed on a net of reinsurance basis against the present value of the expected future claims cash flows, plus an additional risk margin to reflect the inherent uncertainty of the central estimate.

**Critical accounting judgements and estimates**

In assessing the adequacy of net premium liabilities, AASB 1023 *General Insurance Contracts* requires the inclusion of a risk margin 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 liability, no such guidance exists in respect of the level of risk margin to be used in determining the adequacy of net premium liabilities.

The company has adopted a risk margin of 26.0% (2015: 26.0%) for the purpose 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.

## 2.6 Trade and other receivables

### Overview

Trade and other receivables are principally amounts owed to the company by policyholders, reinsurance counterparties and third parties.

| | 2016 $M | 2015 $M |
|---|---|---|
| **Trade receivables** | | |
| Reinsurance premiums and related receivables | **21.2** | 3.7 |
| Other recoveries | **1.2** | 1.2 |
| | **22.4** | 4.9 |
| Investment receivables | **5.7** | 9.0 |
| Amounts due from parent entities | **39.4** | - |
| Other receivables and prepayments | **37.7** | 48.4 |
| Trade and other receivables | **105.2** | 62.3 |
| Receivable within 12 months | **85.3** | 35.6 |
| Receivable in greater than 12 months | **19.9** | 26.7 |
| Trade and other receivables | **105.2** | 62.3 |

Due to the predominantly short term nature of these receivables, their carrying value is assumed to approximate their fair value.

The maximum exposure to credit risk at the reporting date is the fair value of each class of receivables. No receivables are pledged by the company as collateral for liabilities or contingent liabilities. Information on the ageing and credit rating of these balances is included in note 4.3.

### How we account for the numbers

Receivables are recognised at fair value and are subsequently measured at amortised cost less any 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. Any increase or decrease in the provision for impairment is recognised in 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 profit or loss.

**Goods and services tax (GST)**
Revenues, expenses and assets (except receivables) 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 ATO 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.

### 2.7 Trade and other payables

**Overview**

Trade payables primarily comprise amounts owed to reinsurance counterparties and cedants. Treasury and investment payables are amounts due to investment counterparties for settlement of transactions.

| | 2016 $M | 2015 $M |
|---|---|---|
| Trade payables | **96.5** | 72.9 |
| Other amounts due to related entities | **4.6** | 31.6 |
| Other payables | **15.1** | 6.1 |
| Trade and other payables | **116.2** | 110.6 |
| Payable within 12 months | **96.1** | 81.9 |
| Payable in greater than 12 months | **20.1** | 28.7 |
| Trade and other payables | **116.2** | 110.6 |

**How we account for the numbers**

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.

## 3. INVESTMENTS

**Overview**

Premiums collected from policyholders are invested to meet the company's cash flow needs to pay claims and other expenses, as well as generating a return that contributes to the company's profitability. A sound investment strategy is therefore integral to the success of an insurer's operations.

The company invests its portfolio across a diversified range of instruments to achieve an appropriate balance between risk and return. The decision where to invest is dependent on expected returns, cash flow requirements of the company, liquidity of the instrument, credit quality of the instrument and the overall risk appetite of the company. Further details on the management of risk associated with investment assets can be found in note 4.

### 3.1 Net investment income and expenses

| | 2016 $M | 2015 $M |
|---|---|---|
| Income on fixed interest securities, short-term money and cash | **64.7** | 58.3 |
| Gross investment income[1] | **64.7** | 58.3 |
| Investment expenses | **(1.5)** | (2.1) |
| Net investment income | **63.2** | 56.2 |
| Net investment income | **63.2** | 56.2 |
| Investment and other income – policyholders' funds | **18.3** | 23.5 |
| Investment expenses – policyholders' funds | **(0.5)** | (0.8) |
| Investment and other income – shareholders' funds | **46.4** | 34.8 |
| Investment expenses – shareholders' funds | **(1.0)** | (1.3) |
| Net investment income | **63.2** | 56.2 |

[1] Includes net fair value gain of $5.9 million (2015: loss $7.5 million) and dividend income of $12.3m (2015: $nil).

**How we account for the numbers**

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.

### 3.2 Investment assets

| | 2016 $M | 2015 $M |
|---|---|---|
| **Fixed income** | | |
| Short-term money | **162.9** | 142.9 |
| Government bonds | **281.4** | 266.7 |
| Corporate bonds | **803.3** | 1,635.8 |
| Total investments | **1,247.6** | 2,045.4 |
| Amounts maturing within 12 months | **242.8** | 441.7 |
| Amounts maturing in greater than 12 months | **1,004.8** | 1,603.7 |
| Total investments | **1,247.6** | 2,045.4 |

**How we account for the numbers**

Investment assets are designated as either assets that back insurance liabilities (policyholders' funds) or assets that back shareholders' funds.

Investments are designated as fair value through profit or loss on initial recognition, being the cost of acquisition excluding transaction costs, and are subsequently remeasured to fair value at each reporting date. The fair value hierarchy and the company's approach to measuring the fair value of each investment instrument is disclosed in note 3.2.1.

All purchases and sales of investments that require delivery of the asset within the time frame established by regulation or market convention 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 asset has expired or has been transferred and the company has transferred substantially all the risks and rewards of ownership.

#### 3.2.1 Fair value hierarchy

**Overview**

The QBE Group Investments Valuation Committee is responsible for the governance and oversight of the investment valuation process and ensures that the determination of fair value is in accordance with the QBE Group's investment valuation policy which has been adopted by the company.

The investments of the company are disclosed in the table below 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 inactive markets for the same instruments or in active markets for similar instruments or other valuation techniques for which all significant inputs are based on observable market data, for example, consensus pricing using broker quotes or valuation models with observable inputs.

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

| | 2016 | | | | 2015 | | | |
|---|---|---|---|---|---|---|---|---|
| | LEVEL 1 $M | LEVEL 2 $M | LEVEL 3 $M | TOTAL $M | LEVEL 1 $M | LEVEL 2 $M | LEVEL 3 $M | TOTAL $M |
| Short term money | **1.6** | **161.3** | **-** | **162.9** | 2.1 | 140.8 | - | 142.9 |
| Government bonds | **178.5** | **102.9** | **-** | **281.4** | 122.0 | 144.7 | - | 266.7 |
| Corporate bonds | **-** | **803.3** | **-** | **803.3** | - | 1,635.8 | - | 1,635.8 |
| Total investments | **180.1** | **1,067.5** | **-** | **1,247.6** | 124.1 | 1,921.3 | - | 2,045.4 |

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

**Short-term money**

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

**Government bonds and corporate 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.

**Movements in level 3 investments**

There are no investments valued with reference to level 3 inputs (2015: nil).

### 3.2.2 Derivatives over investment assets

**Overview**

In accordance with our investment management policies and procedures, derivatives are used in the investment portfolio as both a hedging tool and to alter the risk profile of the portfolio. All long positions must be cash backed, all short positions must be covered by an underlying physical asset and no net short exposure to an asset class is permitted. Risk management policies over the use of derivatives are set out note 4.

**How we account for the numbers**

Derivatives over investment assets are initially recognised at fair value and are subsequently remeasured to 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. The mark to market value of futures positions are cash settled on a daily basis resulting in a fair value of nil at the balance date.

## 4. RISK MANAGEMENT

**Overview**

QBE Group is in the business of managing risk. The company's ability to satisfy customers' risk management needs is central to the business model. QBE Group aims to generate wealth and maximise returns for its shareholders by pursuing opportunities that involve risk. Our people are responsible for ensuring that QBE Group's risks are managed and controlled on a day-to-day basis. QBE Group aims to use its ability to properly manage risk to provide more certainty and improved outcomes for all stakeholders. As a member of the QBE Group, the company has adopted the risk management policy of QBE Group where applicable.

QBE Group applies a consistent and integrated approach to enterprise risk management (ERM); we refer to this as ONE ERM. 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. QBE Group's risk management framework is articulated in the Risk Management Strategy (RMS) and Reinsurance Management Strategy (REMS), both of which are accepted by the company and, with minor change made for statutory and regulatory purposes, are approved annually by the company Board and lodged with APRA.

The framework consists of complementary elements that are embedded throughout the business management cycle and culture of the organisation. Key aspects include: risk appetite, governance, reporting, risk assessments, modelling, management, and monitoring and risk culture.

Risk management is a continuous process and an integral part of robust business management. The company's approach, as adopted from QBE Group, is to integrate risk management into the broader management processes of the organisation. It is the company's philosophy to ensure that risk management remains 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.

As a member of the QBE Group, the company has adopted the risk management policy of QBE Group were applicable. These policies are adopted by the company as follows:

The company's strategy for managing risk is to:

- achieve competitive advantage by better understanding the risk environments in which the company operates;
- operate within the stated risk appetite and more effectively allocate capital and resources by assessing the balance of risk and reward; and
- avoid unwelcome surprises to the achievement of business objectives by reducing uncertainty and volatility through the identification and management of risks.

The global framework is supported by a suite of risk policies that detail QBE Group's approach to the seven categories used by QBE Group to classify risk. These policies are adopted by the company as follows:

- Strategic risk (note 4.1)
- Insurance risk (note 4.2)
- Credit risk (note 4.3)
- Market risk (note 4.4)
- Liquidity risk (note 4.5)
- Operational risk (note 4.6)
- Group risk (note 4.7)

## 4.1 Strategic risk

### Overview

Strategic risk is the potential impact on earnings and/or capital as a result of strategic business decisions or lack of responsiveness to external change. QBE Group classifies strategic risk into five subcategories, that have been adopted by the company, as follows:

- business, product and market distribution;
- capital structure and management;
- acquisition, decision and negotiation;
- tax risk management; and
- investment strategy.

As a member of the QBE Group, the company's approach to managing strategic risk is underpinned by the company strategic risk appetite statement as set by the company Board and is summarised below.

**Business, product and market distribution**

**Business:** The company is a lenders' mortgage insurance company underwriting business in Australia and New Zealand. The company Board meets at least quarterly to review performance against business plans. Actual results are monitored and analysed regularly at various levels in the company to identify adverse trends so that remedial action can be taken at an early stage. One of the key tools used to ensure achievement of business plans is to identify our 'manage to' likely scenarios impacting the plan year. We assess how these scenarios would impact return on equity (ROE) forecasts and develop and implement bridging actions to drive plan achievability.

**Products:** The company reviews the structuring of its insurance products on an ongoing basis in line with developments in the market, legislation (including tax legislation) and claims performance.

**Market distribution approach:** The company makes use of banks and other financial institutions to market its insurance products.

**Capital structure and management**

The company'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 company's activities. In order to maintain or adjust the capital structure, the company may adjust the amount of dividends paid to shareholders, issue new shares or adopt more conservative investment or reinsurance strategies.

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

The company uses an economic capital model (ECM) that is used across the QBE Group to assess the level of capital required for the underwriting, claims estimation, credit, market, liquidity, operational risks to which it is exposed. Economic capital is determined as the level of capital that the company needs to ensure that it can, with a pre-specified probability, satisfy its ultimate policyholder obligations in relation to all insurance contracts issued on or before the end of the business plan year. The ECM is used by management to help in the determination of strategic capital allocation, business planning, underwriting performance, pricing, reinsurance arrangements and aggregate management. Capital is allocated to business units, divisions and ultimately to underwriting portfolios according to the associated risk. The business plans include net asset, dividend, issued share capital and solvency projections as well as the impact of potential acquisitions. In the event of a significant change in the company's risk profile, the ECM will be recalculated and the results reported to the company's board.

The company reviews its capital structure on an ongoing basis to optimise the allocation of capital whilst minimising the cost of capital. Active management of the business and its capital has enabled the company to maintain its insurer financial strength and credit rating, and has supported QBE Group's good access to capital markets when needed.

Management has a particular focus on the following performance indicators.

- The company actively manages the components of capital in order to maintain a level of eligible regulatory capital that exceeds APRA requirements. Having determined that the current risk appetite of the company remains appropriate, the Board set the target level of regulatory capital for 2016 at 1.32–1.44 times (2015: 1.32–1.44 times) the Prescribed Capital Amount (PCA).
- The company is subject to regulatory requirements that a minimum level of capital is maintained to meet obligations to policyholders. It is the company'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 local regulatory requirements.
- Insurer financial strength ratings provided by the major rating agencies demonstrate the company's financial strength and claims paying ability.

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

**Tax risk management**

The company's approach to managing taxation risk is underpinned by the QBE Group Tax Risk Management Framework, which is approved by the Group Board and aligns with QBE Group's business strategy.

**Investment strategy**

The company's approach to investment risk is underpinned by QBE Group's investment strategy, which is designed to achieve absolute return targets within pre-defined risk and capital constraints whilst meeting regulatory requirements in every jurisdiction. The strategy requires the company to invest in a range of asset classes with portfolios consisting mainly of investment grade fixed income securities.

## 4.2 Insurance risk

**Overview**

Insurance risk is the risk of fluctuations in the timing, frequency and severity of insured events and claims settlements, relative to expectations. Key drivers of insurance risk include natural or man-made catastrophic events, pricing of individual insurance contracts, reserving and insurance claims.

QBE Group classifies insurance risk into four subcategories which are adopted by the company, as follows:

- underwriting;
- insurance concentrations;
- reserving; and
- reinsurance.

The company's approach to managing insurance risk is underpinned by the company insurance risk appetite statement as set by the company Board and is summarised below.

**Underwriting risk**

The company manages underwriting risk by appropriately setting and adjusting underwriting strategy, risk selection and pricing practices throughout the underwriting cycle.

The company is a monoline insurer providing lenders' mortgage insurance ("LMI") in Australia and New Zealand.

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.

The company's underwriting strategy aims to diversify and limit the type of insurance risks accepted and reduce the variability of the expected outcome. The underwriting strategy is implemented through the company's annual business planning process, supported by underwriting authorities. The authorities are delegated to underwriters based on a detailed retrospective and prospective analysis of each class of business. These authorities reflect the level of risk that the company is prepared to take with respect to each permitted insurance class.

Pricing of risks is controlled by the use of in-house pricing models relevant to specific portfolios and the markets in which the company operates. Underwriters and actuaries maintain pricing and claims analysis for each portfolio, combined with a knowledge of current developments in the respective markets and classes of business.

**Concentration risk**

Concentration risk is the risk of exposure due to concentration of activity in certain geographical locations, industries or counterparties. The company operates throughout all regions in Australia and New Zealand 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 company 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. 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 (2015: 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 2016, the ICRC was $460.7 million (2015: $759.9 million) before tax benefit, which was less than the risk tolerance.

**Reserving risk**

Reserving risk is managed through the quarterly actuarial valuation of insurance liabilities. The valuation of the net central estimate is performed by qualified and experienced actuaries, with reference to historical data and reasoned expectations of future events. The central estimate of outstanding claims is subject to a comprehensive independent review at least annually.

**Reinsurance risk**

The company limits its exposure to an accumulation of claims by reinsuring a portion of risks underwritten. This allows the company to control exposure to insurance losses, reduce volatility of reported results and protect capital.

## 4.3 Credit risk

**Overview**

Credit risk is the risk of not recovering money owed to the company by third parties as well as the loss of value of assets due to deterioration in credit quality. The company's exposure to credit risk arises from financial transactions with securities issuers and/or a reduction or delay in repayments or interest payments from the default of counterparties such as debtors, brokers, policyholders, reinsurers and guarantors. QBE Group categorises credit risk into three sub-categories, as follows:

- reinsurance counterparty credit;
- investment counterparty credit; and
- premium and other counterparty credit.

The company's approach to managing credit risk is underpinned by the company credit risk appetite as set by the company Board and summarised below.

**Reinsurance counterparty credit risk**

The company's objective is to maximise placement of reinsurance with highly rated counterparties. Concentration of risk with reinsurance counterparties is monitored strictly and regularly by the company's security committee and is controlled by reference to the following protocols:

- treaty or facultative 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 claims and potential future losses based on the company's insurance concentrations; and
- exposure to reinsurance counterparties and the credit quality of those counterparties is actively monitored.

Credit risk exposures are calculated regularly and compared with authorised credit limits. In certain cases, the company requires letters of credit or other collateral arrangements to be provided to guarantee the recoverability of the amount involved. The company holds $150.0 million (2015: $139.7 million) in collateral to support reinsurance recoveries on outstanding claims. The credit rating analysis on the following page includes the impact of such security arrangements. In some cases, further security has been obtained in the form of trust arrangements, reinsurer default protection and other potential offsets. This additional security has not been included in the credit rating analysis set out below.

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

| | CREDIT RATING | | | | | | |
|---|---|---|---|---|---|---|---|
| | AAA $M | AA $M | A $M | BBB $M | SPECULATIVE GRADE $M | NOT RATED $M | TOTAL $M |
| **As at 31 December 2016** | | | | | | | |
| Reinsurance recoveries on outstanding claims | - | - | 63.8 | - | - | - | 63.8 |
| **As at 31 December 2015** | | | | | | | |
| Reinsurance recoveries on outstanding claims | - | 2.4 | - | - | - | - | 2.4 |

None of the company's recoveries are past due or impaired or have terms that have been renegotiated and would otherwise have been past due or impaired (2015: nil).

**Investment counterparty credit risk**

The company only transacts with investment counterparties within the limits outlined in the delegated authorities policy. Investment counterparty exposure limits are applied to individual counterparty exposures and to multiple exposures within the one group of related companies (as set out in the delegated authorities policy) in relation to investments, cash deposits and forward foreign exchange exposures. Counterparty exposure limit compliance is monitored daily.

The following table provides information regarding the company's aggregate credit risk exposure at the balance 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 smaller credit risk items which generally cannot be rated and are not individually material. The analysis classifies the assets according to S&P counterparty credit ratings. AAA is the highest possible rating. Rated assets falling outside the range of AAA to BBB are classified as speculative grade.

| | CREDIT RATING | | | | | | |
|---|---|---|---|---|---|---|---|
| | AAA $M | AA $M | A $M | BBB $M | SPECULATIVE GRADE $M | NOT RATED $M | TOTAL $M |
| **As at 31 December 2016** | | | | | | | |
| Cash and cash equivalents | - | - | 4.4 | - | - | - | 4.4 |
| Interest-bearing investments | 364.6 | 273.9 | 456.8 | 152.3 | - | - | 1,247.6 |
| **As at 31 December 2015** | | | | | | | |
| Cash and cash equivalents | - | 3.1 | 0.2 | - | - | - | 3.3 |
| Interest-bearing investments | 370.1 | 900.0 | 647.8 | 127.5 | - | - | 2,045.4 |

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

**Premium and other counterparty credit risk**

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

As insurer or reinsurer, the company 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 fourteen 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 company 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 company 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 company.

The company regularly reviews the collectability of receivables and the adequacy of associated provisions for impairment. Balances are monitored on the basis of uncollected debt and debt.

None of the Company's receivables are past due, impaired or have terms that have been renegotiated and would otherwise have been past due or impaired (2015: nil).

## 4.4 Market Risk

**Overview**

Market risk is the risk of variability in the value of investments due to:

- movement in market factors (including interest rates, credit spreads and equity prices); and
- movement in foreign exchange rates.

The company's approach to managing market risk is underpinned by its market risk appetite as set by the company Board and is summarised below.

The company's approach to managing investment market movements is underpinned by the QBE Group's investment strategy which outlines QBE Group's view of the markets and its corresponding investment approach. One of the key limits set by the strategy is the probability (as determined by the Economic Scenario Generator (ESG) Model) of earning negative returns on the investment portfolio. The ESG models asset class and portfolio returns using a stochastic process based on a range of economic and financial market scenarios.

Investment market risk is also managed through the application of exposure and asset limits. These limits are based on the market risk appetite as determined by the company Board and apply to:

- initial losses generated on the investment portfolio under a market stress scenario. The scenario assumes adverse movements in credit spreads, equity markets and property markets and is designed to reflect a significant short-term market stress event. The loss generated by the stress scenario is partially offset by any gains from a downward shift in sovereign bond yields;
- interest rate risk, measured in terms of modified duration and spread duration; and
- total combined holdings in equity, investment property and other growth assets as a proportion of the company's total investment portfolio.

**Interest rate risk**

The company is exposed to interest rate risk through its holdings in interest-bearing assets. Financial instruments with a floating interest rate expose the company to cash flow interest rate risk, whereas fixed interest rate instruments expose the company to fair value interest rate risk.

The company's risk management approach, as adopted from QBE Group, 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 company predominantly 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 net central estimate of outstanding claims is discounted to present value by reference to risk-free interest rates. The company is therefore exposed to potential underwriting result volatility as a result of interest rate movements. In practice, over the longer term, an increase or decrease in interest rates is normally offset by a corresponding increase or decrease in inflation. Details are provided in note 2.3.7.

The company maintains a relatively short duration for assets backing policyholders' funds in order to minimise any further potential volatility affecting insurance profit. At 31 December 2016, the average modified duration of cash and fixed interest securities was 1.6 years (2015: 1.0 years).

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 company at the balance date is shown in the table below.

| | | PROFIT (LOSS)[1] | |
|---|---|---|---|
| | SENSITIVITY | 2016 | 2015 |
| | % | $M | $M |
| Interest rate movement – interest-bearing financial assets | +0.5 | (6.8) | (7.1) |
| | -0.5 | 6.8 | 7.1 |

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

**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 company is exposed to price risk on its interest-bearing (fixed interest) financial assets. All securities are measured at fair value through profit or loss. Movements in credit spreads impact the value of corporate interest-bearing securities, and therefore impact reported profit after tax. This risk is managed by investing in high quality, liquid interest-bearing securities and by managing the credit spread duration of the corporate securities portfolio.

The impact of either a 0.5% increase or decrease in credit spreads on interest-bearing financial assets held by the company at the balance date is shown in the table below.

| | | PROFIT (LOSS)[1] | |
|---|---|---|---|
| | SENSITIVITY | 2016 | 2015 |
| | % | $M | $M |
| Credit spread movement – corporate interest-bearing financial assets | +0.5 | (7.6) | (13.5) |
| | -0.5 | 7.5 | 13.0 |

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

**Foreign exchange**

The company's approach to foreign exchange management is underpinned by QBE Group's foreign currency strategy. The company's foreign exchange exposure generally arises as a result of either the translation of foreign currency amounts to the functional currency (operational currency risk) or due to the translation of the company's net investment in foreign operations to the presentation currency of Australian dollars (currency translation risk).

*Operational currency risk*

The company's exposure foreign currency amounts and therefore to operational risk is minimal.

Foreign exchange gains or losses arising from operational foreign currency exposures are reported in profit or loss.

The analysis below demonstrates the impact on profit after income tax of a 10% strengthening or weakening of the major currencies to which the company is exposed. The sensitivity is measured with reference to the company's residual (or unmatched) operational foreign currency exposures at the balance sheet date. Operational foreign exchange gains or losses are recognised in profit or loss in accordance with the policy set out in note 1.2.3. The sensitivities provided demonstrate the impact of a change in one key variable in isolation whilst other assumptions remain unchanged.

The sensitivities shown in the table below are relevant only at the balance sheet date, as any unmatched exposures are actively monitored by management and the exposure matched.

*Currency risk in relation to translation of foreign operations*

The company is exposed to currency risk in relation to:

- the translation of all foreign operations to the presentation currency of Australian dollars.

The company does not currently seek to use derivatives to mitigate currency translation risk on translation to the functional currency of Australian dollars for the following reasons:

- currency translation gains and losses generally have no cash flow;
- currency translation gains and losses are accounted for in the foreign currency translation reserve (a component of equity) and therefore do not impact profit or loss unless related to the disposal of an entity; and,
- management of translation risk needs to be balanced against the impact on capital requirements and liquidity risk.

## 4.5 Liquidity risk

**Overview**

Liquidity risk is the risk of insufficient liquid assets to meet liabilities as they fall due to policyholders and other creditors or only being able to do so at excessive cost. The company's liquidity risk arises due to the nature of insurance activities where the timing and amount of cash outflows are uncertain.

The company's approach to managing liquidity risk is underpinned by its liquidity risk appetite as set by the company Board and is summarised below.

The company manages liquidity risk using a number of tools, as follows:

- cash flow targeting;
- maintaining a proportion of liabilities in liquid assets;
- cash flow forecasting; and
- stress testing and contingency planning.

Liquidity is managed across the company using a number of cash flow forecasting and targeting tools and techniques. Cash flow forecasting and targeting is conducted at operational level and involves managing operational cash flow requirements utilising normal operating balances.

To supplement the cash flow targeting and to ensure that there are sufficient liquid funds available to meet insurance and investment obligations, a minimum percentage of the company's liabilities is held, at all times, in cash and liquid securities. The company also maintains a defined proportion of the funds under management in liquid assets.

The company actively forecasts cash flow requirements to identify future cash surpluses and shortages to optimise invested cash balances and limit unexpected calls from the investment pool. The company limits the risk of liquidity shortfalls resulting from mismatches in the timing of claims payments and receipts of claims recoveries by negotiating cash call clauses in reinsurance contracts and seeking accelerated settlements for large reinsurance recoveries.

The following table summarises the maturity profile of the company's financial liabilities based on the remaining contractual obligations.

| | 1 YEAR OR LESS $M | 1 TO 3 YEARS $M | 3 TO 5 YEARS $M | OVER 5 YEARS $M | TOTAL $M |
|---|---|---|---|---|---|
| **As at 31 December 2016** | | | | | |
| Trade and other payables | **52.3** | **60.0** | **4.0** | **-** | **116.3** |
| Contingent liabilities | **69.4** | **-** | **-** | **-** | **69.4** |
| **As at 31 December 2015** | | | | | |
| Trade and other payables | 81.9 | 21.2 | 7.5 | - | 110.6 |
| Contingent liabilities | 68.6 | - | - | - | 68.6 |

The maturity profile of the company's net discounted central estimate is analysed in note 2.3.6.

The maturity of the company's directly held interest-bearing financial assets is shown in the table below.

| | | INTEREST BEARING FINANCIAL ASSETS MATURING IN | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | | 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 |
| **As at 31 December 2016** | | | | | | | | |
| Fixed rate | $M | **171.9** | **-** | **100.4** | **128.7** | **125.5** | **120.6** | **647.1** |
| Weighted average interest rate | % | **2.1%** | **-** | **2.4%** | **2.9%** | **2.9%** | **2.8%** | **2.6%** |
| Floating rate | $M | **75.3** | **88.1** | **100.9** | **103.8** | **53.9** | **182.9** | **604.9** |
| Weighted average interest rate | % | **2.4%** | **2.6%** | **2.6%** | **2.8%** | **3.0%** | **3.6%** | **2.9%** |
| **As at 31 December 2015** | | | | | | | | |
| Fixed rate | $M | 177.0 | 59.4 | 26.9 | 78.5 | 210.9 | 54.0 | 606.7 |
| Weighted average interest rate | % | 2.6% | 2.9% | 2.1% | 2.4% | 2.7% | 3.4% | 2.7% |
| Floating rate | $M | 268.0 | 320.3 | 229.8 | 196.1 | 239.5 | 188.3 | 1,442.0 |
| Weighted average interest rate | % | 2.7% | 2.9% | 3.2% | 3.5% | 3.2% | 4.1% | 3.2% |

### 4.6 Operational risk

**Overview**

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events (including legal risk).

Operational risk can materialise in a number of forms including fraud perpetrated by employees or by external parties (e.g. claims fraud or cyber attacks), employment practices (losses arising from breaches of employment, health or safety laws, breach of employment contracts, payment of personal injury claims or diversity and discrimination events), improper business practices (failure to meet professional obligations or issues with the nature or design of an insurance product), disasters and other events, technology and infrastructure failures, or business and transaction processing failures.

QBE Group identifies and assesses operational risk through Risk and Control Assessment (RCA), Divisional Risk Assessment (DRA), top risks and emerging risks processes, and scenario analysis. The company has adopted these QBE Group risk processes. The RCA process identifies and assesses the key risks to achieving business objectives and is conducted at the business unit level. The DRA process creates a single, divisional-level view of risk across all of the company's risk categories. The top risks process identifies and assesses the divisional CEOs' key divisional risks. The emerging risks process identifies and assesses new risks, which are characterised by incomplete but developing knowledge or existing risks that develop in new or surprising ways. The scenario analysis process assesses the impact of potentially extreme scenarios and the appropriateness of our contingency planning. Risk assessments are also informed by Business Environment Internal Control Factor (BEICFs).

The company manages operational risk through various systems, controls and processes, including effective segregation of duties, access controls, authorisations and reconciliation procedures, business continuity management, fraud management, information security and physical security. The company monitors operational risk through control assurance, key risk indicators and internal loss events and issues and actions. Another key tool used by the company is the targeted risk review process whereby reviews are conducted to identify whether there are any unmitigated risks or inadequacies in control design and provide recommendations to enhance the management of risk. The reviews are generally conducted by the second line of defence and involve various risk management techniques and approaches.

### 4.7 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.

## 5. CAPITAL STRUCTURE

### Overview

QBE Group's objective in managing capital is to maintain an optimal balance between debt and equity in order to reduce the overall cost of capital whilst satisfying the capital adequacy requirements of regulators and rating agencies, providing financial security for our policyholders and continuing to provide an adequate return to shareholders.

The company is regulated by the Australian Prudential Regulation Authority (APRA) and its equity is denominated in Australian dollars.

Details of the company's approach to capital risk management are disclosed in note 4.1.

### 5.1 Cash and cash equivalents

| | 2016 $M | 2015 $M |
|---|---|---|
| Cash at bank on hand | **3.3** | 3.2 |
| Overnight money | **1.1** | 0.1 |
| | **4.4** | 3.3 |
| Analysed as follows: | | |
| Floating interest rate | **4.4** | 3.3 |
| | **4.4** | 3.3 |

### How we account for the numbers

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

The reconciliation of profit after income tax to cash flows from operating activities is included in note 8.3.

## 5.2 Equity and reserves

**Overview**

Ordinary shares in the company rank after all creditors, 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.

### 5.2.1 Share capital

| | 2016 NUMBER OF SHARES MILLIONS | 2016 $M | 2015 NUMBER OF SHARES MILLIONS | 2015 $M |
|---|---|---|---|---|
| Issued ordinary shares, fully paid at 1 January | **327.8** | **364.3** | 327.8 | 364.3 |
| Issued ordinary shares, fully paid at 31 December | **327.8** | **364.3** | 327.8 | 364.3 |

### 5.2.2 Reserves

| | 2016 $M | 2015 $M |
|---|---|---|
| **Foreign currency translation reserve** | | |
| At 1 January | **0.4** | 0.2 |
| Gains on translation | **0.1** | 0.2 |
| Total reserves at 31 December | **0.5** | 0.4 |

## 5.3 Dividends

**Overview**

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.

The Group's dividend policy sets the dividend payout ratio at up to 65% of full year cash profit with a likely weighting of 40% for the interim dividend and 60% for the final.

| | 2016 $M | 2015 $M |
|---|---|---|
| Dividends paid or payable | **576.5** | 226.0 |
| Dividends proposed before the financial statements were authorised but not recognised as a distribution during the period | **42.0** | 100.0 |

## 5.4 APRA capital adequacy

**Overview**

APRA Prudential Standard GPS 110 Capital Adequacy for General Insurers requires that the company maintain a capital base in excess of its prudential capital requirement as defined under the prudential standard.

**NOTES TO THE FINANCIAL STATEMENTS**
For the year ended 31 December 2016

The following table shows the capital adequacy calculated in accordance with the APRA prudential framework. The 2016 position reflects the December 2016 quarter APRA return (unaudited).

| | 2016 $M | 2015 $M |
|---|---|---|
| Eligible Tier 1 capital as defined by APRA | | |
| Contributed equity | 364.3 | 364.3 |
| General reserves | 0.5 | 0.3 |
| Retained profits [1,2] | 556.5 | 1,014.5 |
| Insurance liability surplus | 51.0 | 153.6 |
| Total equity | 972.3 | 1,532.7 |
| Less: APRA deductions | 77.4 | 78.6 |
| Total APRA capital base | 894.9 | 1,454.1 |
| APRA prudential capital requirement | 614.3 | 916.9 |
| APRA Capital adequacy multiple | 1.46 | 1.59 |

[1] Retained profits are in accordance with APRA prudential standards

[2] Dividends of $576.5 million (2015: $226.0 million) were paid during the year and dividends of $nil were declared as payable at 31 December 2016 (2015: $nil). Dividends proposed before the financial statements were authorised but not recognised as a distribution during the period were $42.0 million (2015: $100.0 million). Refer note 5.3.

## 6. TAX

### Overview

Income tax expense is the accounting tax charge for the period and is calculated as the tax payable on the current period taxable income based on the applicable income tax rate for changes in deferred tax assets and liabilities attributable to temporary differences and unused tax losses. The relationship between accounting profit and income tax expense is provided in the reconciliation of prima facie tax to income tax expense (note 6.1). Income tax expense does not equate to the amount of tax actually paid to tax authorities as it is based upon the accrual accounting concept.

Accounting income and expenses do not always have the same recognition pattern as taxable income and expenses, creating a timing difference as to when a tax expense or benefit can be recognised. These differences usually reverse over time but until they do, a deferred tax asset or liability is recognised on the balance sheet. Note 6.2 details the composition and movements in deferred tax balances and the key management assumptions applied in recognising tax losses.

The company's approach to managing tax risk is disclosed in note 4.1.

### Adoption of Voluntary Tax Transparency Code

On 3 May 2016, the Australian Treasurer released a Voluntary Tax Transparency Code. The Code recommends the publication of additional information to help educate the public about large corporate tax compliance. QBE fully supports this initiative and has signed up to the Code and will be releasing a separate report in the first half of 2017.

**NOTES TO THE FINANCIAL STATEMENTS**
For the year ended 31 December 2016

## 6.1 Income Tax

**Reconciliation of prima facie tax to income tax expense**

| | NOTE | 2016 $M | 2015 $M |
|---|---|---|---|
| Profit before income tax | | 164.1 | 301.6 |
| Prima facie tax payable at 30% | | 49.2 | 90.5 |
| Tax effect of non-temporary differences: | | | |
| Untaxed dividends | | (3.6) | - |
| Prima facie tax adjusted for non-temporary differences | | 45.6 | 90.5 |
| Overprovision in prior year | | - | - |
| Income tax expense | | 45.6 | 90.5 |
| Analysed as follows: | | | |
| Current tax | | 44.4 | 91.1 |
| Deferred tax | | 1.2 | (0.6) |
| Overprovision in prior year | | | - |
| | | 45.6 | 90.5 |
| Deferred tax (credit) expense comprises: | | | |
| Deferred tax assets recognised in profit or loss | 6.2.1 | 1.2 | (0.5) |
| Deferred tax liabilities recognised in profit or loss | 6.2.2 | - | (0.1) |
| Profit before income tax | | 1.2 | (0.6) |

**How we account for the numbers**

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. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation and establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Current tax assets and tax liabilities are offset where the entity has a legally enforceable right to offset and intends to either settle on a net basis or to realise the asset and settle the liability simultaneously. 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.

## 6.2 Deferred income tax

| | NOTE | 2016 $M | 2015 $M |
|---|---|---|---|
| Deferred tax assets | 6.2.1 | 3.9 | 5.1 |

### 6.2.1 Deferred tax assets

**The balance comprises temporary differences attributable to:**

| | NOTE | 2016 $M | 2015 $M |
|---|---|---|---|
| **Amounts recognised in profit or loss** | | | |
| Insurance provisions | | 0.8 | 0.7 |
| Other accrued expenses | | 3.2 | 4.5 |
| **Deferred tax assets before set-off** | | 4.0 | 5.2 |
| Set-off deferred tax liabilities | 6.2.2 | (0.1) | (0.1) |
| | 6.2 | 3.9 | 5.1 |

| | | |
|---|---|---|
| **Deferred tax assets before set-off analysed as follows:** | | |
| Recoverable within 12 months | 2.0 | 2.9 |
| Recoverable in greater than 12 months | 1.9 | 2.3 |
| | 3.9 | 5.2 |

**Movements:**

| | NOTE | 2016 $M | 2015 $M |
|---|---|---|---|
| At 1 January | | 5.2 | 4.9 |
| Amounts recognised in profit or loss | 6.1 | (1.2) | 0.5 |
| Prior year adjustments | | - | (0.2) |
| At 31 December | | 4.0 | 5.2 |

### 6.2.2 Deferred tax liabilities

**The balance comprises temporary differences attributable to:**

| | NOTE | 2016 $M | 2015 $M |
|---|---|---|---|
| **Amounts recognised in profit or loss** | | | |
| Insurance assets | | 0.1 | 0.1 |
| **Deferred tax liabilities before set-off** | | 0.1 | 0.1 |
| Set-off deferred tax assets | 6.2.2 | (0.1) | (0.1) |
| | | - | - |

| | | |
|---|---|---|
| **Deferred tax liabilities before set-off analysed as follows:** | | |
| Recoverable within 12 months | 0.1 | 0.1 |
| | 0.1 | 0.1 |

**Movements:**

| | NOTE | 2016 $M | 2015 $M |
|---|---|---|---|
| At 1 January | | 0.1 | 0.2 |
| Amounts recognised in profit or loss | 6.1 | - | (0.1) |
| At 31 December | | 0.1 | 0.1 |

**How we account for the numbers**

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 or if they arise from the 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 substantively 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 in the financial statements 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.

### 6.2.3 Tax losses

The company has brought to account nil tax losses (2015: nil).

**Critical accounting judgements and estimates**

**Recoverability of deferred tax assets**

The company assesses the recoverability of deferred tax assets at each balance date. In making this assessment, the company considers in particular it's future business plans, history of generating taxable profits, whether the unused tax losses resulted from identifiable causes which are unlikely to recur and if any tax planning opportunities exist in the period in which the taxable losses can be utilised.

### 6.2.4 Tax consolidation legislation

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.

## 7. COMPANY STRUCTURE

**Overview**

This section provides information to help users understand the company's structure.

### 7.1 Controlled entities

**Overview**

This section lists the company's controlled entities.

| | COUNTRY OF INCORPORATION | CARRYING VALUE | | EQUITY HOLDING | |
|---|---|---|---|---|---|
| | | 2016 $M | 2015 $M | 2016 % | 2015 % |
| QBE Mortgage Insurance (Asia) Limited | Hong Kong | 73.5 | 73.5 | 100.0 | 100.0 |

All controlled entities have a 31 December year end.

**How we account for the numbers**

**Controlled entities**
Control exists when the parent entity 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.

A change in ownership of a controlled entity without the gain or loss of control is accounted for as an equity transaction.

## 8. OTHER

**Overview**

This section includes other information that must be disclosed to comply with the Australian Accounting Standards or the *Corporations Act 2001*, but which is not deemed critical to an understanding of the company's results or balance sheet.

### 8.1 Other accounting policies

#### 8.1.1 New and amended standards adopted by the company

The company mandatorily adopted the following new or revised accounting standards which became effective for the annual reporting period commencing on 1 January 2016.

| TITLE | |
|---|---|
| AASB 2015–1 | Annual improvements to Australian Accounting Standards 2012 – 2014 Cycle |
| AASB 2015–2 | Disclosure Initiative: Amendments to AASB 101 |
| AASB 2015–3 | Amendments to Australian Accounting Standards arising from the Withdrawal of AASB 1031 Materiality |
| AASB 2015–5 | Investment Entities: Applying the Consolidation Exception |
| AASB 2014–3 | Accounting for Acquisitions of Interests in Joint Operations |
| AASB 2014–4 | Clarification of Acceptable Methods of Depreciation and Amortisation |
| AASB 2014–9 | Equity Method in Separate Financial Statements |

The adoption of these new or revised standards did not materially affect the Group's accounting policies or financial statements.

#### 8.1.2 New accounting standards and amendments issued but not yet effective

| TITLE | | OPERATIVE DATE |
|---|---|---|
| AASB 2016–1 | Recognition of Deferred Tax Assets for Unrealised Losses | 1 January 2017 |
| AASB 2016–2 | Disclosure Initiative: Amendments to AASB 107 | 1 January 2017 |
| AASB 9 | Financial Instruments | 1 January 2018 |
| AASB 15 | Revenue from Contracts with Customers | 1 January 2018 |
| AASB 2014–10 | Sale or Contribution of Assets between an Investor and its Associates or Joint Venture | 1 January 2018 |
| AASB 2016–5 | Classification and Measurement of Share-based Payment Transactions | 1 January 2018 |
| AASB 16 | Leases | 1 January 2019 |

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 company 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.

The company currently plans to 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.

AASB 9 was issued during 2014 and will replace existing accounting requirements for financial instruments. Currently, the company's investments are designated as at fair value through profit or loss on initial recognition and are subsequently remeasured to fair value at each reporting date, reflecting the business model applied by the company to manage and evaluate its investment portfolio. Under this business model, the adoption of AASB 9 is not expected to result in significant changes to accounting for Investments, with the exception of certain equity investments which are held by the company for strategic purposes. Any changes to the company's investment business model prior to the adoption of AASB 9 will require the impact of adoption to be reassessed and could result in a different outcome for accounting for investments. Other changes to the accounting for the company's financial instruments arising from the application of AASB 9 are currently expected to be minimal.

AASB 16 was issued during 2016 and will replace existing accounting requirements for leases. Under current requirements, leases are classified based on their nature as either finance leases, which are recognised on the balance sheet, or operating leases, which are not recognised on the balance sheet. The application of AASB 16 will result in the recognition of almost all leases on the balance sheet, with the exception of leases of low value assets and leases with a term of 12 months or less. As a result, the new standard is expected to impact leases which are currently classified by the company as operating leases; primarily, leases over offices, equipment, and motor vehicles.

### 8.2 Contingent liabilities

**Overview**

Contingent liabilities are disclosed when the possibility of a future settlement of economic benefits is considered to be less than probable but more likely than remote. If the expected settlement of the liability becomes probable, a provision is recognised.

In the normal course of business, the company is exposed to contingent liabilities in relation to claims litigation arising out of its insurance and reinsurance transactions and may be exposed to the possibility of contingent liabilities in relation to non-insurance litigation. Provisions are made for obligations that are probable and quantifiable.

| | 2016 $M | 2015 $M |
|---|---|---|
| Related party guarantees | 69.4 | 68.6 |

### 8.3 Reconciliation of profit after income tax to cash flows from operating activities

**Overview**

AASB 1054 *Australian Additional Disclosures* requires a reconciliation of profit after income tax to cash flows from operating activities.

| | 2016 $M | 2015 $M |
|---|---|---|
| Profit after income tax | **118.5** | 211.1 |
| Net fair value (gains) losses on financial assets | **(1.7)** | 7.5 |
| Dividends received from controlled entity | **(12.3)** | - |
| Increase (decrease) in net outstanding claims | **30.7** | (13.0) |
| Decrease in unearned premiums | **(112.9)** | (99.9) |
| Increase in unearned reinsurance commission | **25.7** | 6.5 |
| Increase in deferred insurance costs | **(184.2)** | (16.6) |
| Increase in reinsurance and other recoveries | **(62.1)** | (0.7) |
| Increase in investments | **(4.2)** | - |
| Increase (decrease) in trade and other receivables | **(3.6)** | (24.9) |
| Decrease in trade and other payables | **32.9** | 12.3 |
| Decrease (increase) in deferred tax assets | **1.2** | (0.4) |
| Increase in amounts due to parent entity or tax authorities for current tax | **(62.3)** | (42.2) |
| Cash flows from operating activities | **(234.3)** | 39.7 |

### 8.4 Key management personnel

**Overview**

AASB 124 *Related Party Disclosures* requires disclosure of the compensation of directors (executive and non-executive) and those persons having authority and responsibility for planning, directing and controlling the activities of the company, either directly or indirectly. This group of people are collectively defined as key management personnel.

Remuneration of executive directors and other executives, is paid by a related company. Where this remuneration is recharged on a time proportional basis it is disclosed below, along with an appropriate allocation of fees paid to independent non-executive directors by QBE Group companies for services provided to the company. Where the company also receives management services from the related company which includes the provision of key management personnel, these services are not recharged on a time proportional basis and are excluded from the disclosure below. They are included in an overall management fee from the related company, refer note 8.6.2.

| | 2016 $'000 | 2015 $'000 |
|---|---|---|
| Short-term employment benefits | **39** | 64 |
| Post-employment benefits | **3** | 3 |
| | **42** | 67 |

**How we account for the numbers**

**Short-term employee benefits – profit sharing and bonus plans**

A provision is recognised for profit sharing and bonus plans where there is a contractual obligation or where past practice has created a constructive obligation at the end of each reporting period. Bonus or profit sharing obligations are settled within 12 months from the balance date.

**Post-employment benefits – defined contribution plans**

Defined contribution plans are post-employment benefit plans under which an entity pays a fixed contribution into a fund during the course of employment and has no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods. Contributions to defined contribution plans are expensed as incurred.

### 8.5 Remuneration of auditors

**Overview**

The company may engage the external auditor for non-audit services other than 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. The Board believes some non-audit services are appropriate given the external auditor's knowledge of the company. External tax services are generally provided by an accounting firm other than the external auditor. Consistent with prior periods, the external auditor cannot provide the excluded services of preparing accounting records or financial reports or acting in a management capacity.

| | 2016 $'000 | 2015 $'000 |
|---|---|---|
| **PricewaterhouseCoopers (PwC) – Australian firm** | | |
| Audit of financial reports of the company | 539 | 489 |
| Audit of statutory returns and other assurance services | 142 | 143 |
| | 681 | 632 |

### 8.6 Related parties

#### 8.6.1 Parent entity

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

#### 8.6.2 Transactions with related parties

The following material transactions occurred with related parties:

| | 2016 $'000 | 2015 $'000 |
|---|---|---|
| **Revenue** | | |
| Dividends received from controlled entity | 12,258 | - |
| Management fee received from controlled entity | 813 | 684 |
| Reinsurance commission revenue | 32,440 | - |
| **Expenses** | | |
| Payments made for management fees and cost allocations to other related parties | 34,845 | 43,293 |
| Outward reinsurance premium (net of no claims bonus) to other related parties | 189,203 | 28,291 |
| Reinsurance claims received to a controlled entity | (75,924) | - |
| **Other transactions** | | |
| Dividends paid or proposed to parent | 576,500 | 160,000 |

**8.6.3 Outstanding balances arising from transactions with related parties**

The following balances are outstanding at the reporting date in relation to transactions with related parties:

| | 2016 $'000 | 2015 $'000 |
|---|---|---|
| **Current assets** | | |
| Trade and other receivables from controlled entity | **3,387** | 57 |
| Reinsurance and other related receivables | **18,074** | - |
| Tax receivable from tax consolidated group | **36,092** | - |
| Deferred reinsurance premium | **197,981** | - |
| Reinsurance and other recoveries receivable | **58,813** | - |
| **Current liabilities** | | |
| Trade and other payables to other related parties | **4,605** | 5,362 |
| Trade and other payables to ultimate parent | **-** | 26,194 |
| Unearned reinsurance commission | **44,739** | - |

**How we account for the numbers**

All transactions were made on normal commercial terms and conditions and at market rates.

Outstanding balances are unsecured and repayable in cash.

**8.6.4 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 5.3 |
| Tax sharing agreement | Note 6.2.4 |
| Amounts due from controlled and related entities | Note 2.6 |
| Investment in controlled entities | Note 7.1 |
| Amounts due to controlled and related entities | Note 2.7 |
| Remuneration of key management personnel | Note 8.4 |
| Guarantees in respect of related parties | Note 8.2 |

**8.7 Events occurring after reporting date**

The following events have occurred after balance date

(i) dividends of $42.0m were proposed before the financial statements were authorised as disclosed in note 5.3.

There is, at the date of this report, no other matter or circumstance that has arisen since 31 December 2016 that has significantly affected, or may significantly affect:

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

**QBE LENDERS' MORTGAGE INSURANCE LIMITED**

**DIRECTORS' DECLARATION**

In the directors' opinion:

(a) the financial statements and notes set out on pages 6 to 47 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's financial position as at 31 December 2016 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 1.2.1 confirms that the financial statements also comply with International Financial Reporting Standards as issued by the International Accounting Standards Board.

Signed in SYDNEY, this 17th day of February 2017 in accordance with a resolution of the directors.

Director.................................................. Director..................................................

pwc

# *Independent auditor's report*

To the shareholders of QBE Lenders' Mortgage Insurance Limited

## *Our opinion*

In our opinion:

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

(a) giving a true and fair view of the Company's financial position as at 31 December 2016 and of its financial performance for the year then ended

(b) complying with Australian Accounting Standards and the *Corporations Regulations 2001*.

### ***What we have audited***

The financial report comprises:

- the balance sheet as at 31 December 2016
- the statement of comprehensive income for the year then ended
- the statement of changes in equity for the year then ended
- the statement of cash flows for the year then ended
- the notes to the financial statements, which include a summary of significant accounting policies
- the directors' declaration.

## *Basis for opinion*

We conducted our audit in accordance with Australian Auditing Standards. Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the financial report* section of our report.

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

### ***Independence***

We are independent of the Company in accordance with the auditor independence requirements of the *Corporations Act 2001* and the ethical requirements of the Accounting Professional and Ethical Standards Board's APES 110 *Code of Ethics for Professional Accountants* (the Code) that are relevant to our audit of the financial report in Australia. We have also fulfilled our other ethical responsibilities in accordance with the Code.

pwc

### *Other information*

The directors are responsible for the other information. The other information obtained at the date of this auditor's report comprises the Directors' Report included in the annual report, but does not include the financial report and our auditor's report thereon.

Our opinion on the financial report does not cover the other information and accordingly we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial report, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial report or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

If, based on the work we have performed on the other information obtained prior to the date of this auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

### *Responsibilities of the directors for the financial report*

that 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 gives a true and fair view and is free from material misstatement, whether due to fraud or error.

In preparing the financial report, the directors are responsible for assessing the ability of the Company to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

### *Auditor's responsibilities for the audit of the financial report*

Our objectives are to obtain reasonable assurance about whether the financial report as a whole is free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the Australian Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial report.

A further description of our responsibilities for the audit of the financial report is located at the Auditing and Assurance Standards Board website at: http://www.auasb.gov.au/auditors_files/ar3.pdf. This description forms part of our auditor's report.

PricewaterhouseCoopers

PricewaterhouseCoopers

S J Hadfield
Partner

Sydney
17 February 2017

**QBE LENDERS' MORTGAGE INSURANCE LIMITED**
**New Zealand Branch**

**ANNUAL REPORT – 31 December 2016**

**CONTENTS**



This financial report includes separate financial statements for QBE Lenders' Mortgage Insurance Limited, New Zealand Branch (the "branch") as an individual entity. The financial report is presented in New Zealand dollars.

The branch is a branch of QBE Lenders' Mortgage Insurance Limited (the "company") and is a reporting entity for the purposes of the Financial Reporting Act 2013 and the Financial Markets Conduct Act 2013. Its principal place of business is:

Level 6, AMP Centre, 29 Customs Street West,
Auckland 1010 New Zealand

QBE LENDERS' MORTGAGE INSURANCE LIMITED
New Zealand Branch

## STATEMENT BY DIRECTORS

We, being two directors of QBE Lenders' Mortgage Insurance Limited, certify that the Statement of Comprehensive Income, Balance Sheet, Statement of Changes in Balances Due To Head Office, Statement of Cash Flows and notes set out on pages 4 to 33 are true copies of the Financial Statements of the New Zealand Branch of the Company for the year ended 31 December 2016.

The Board of Directors of QBE Lenders' Mortgage Insurance Limited authorised these statements for issue on 17th February 2017.

Director............................................................

Director............................................................

pwc

# *Independent Auditors' Report*

to the Directors of QBE Lenders' Mortgage Insurance Limited – New Zealand Branch

## *Report on the Financial Statements*

We have audited the financial statements of QBE Lenders' Mortgage Insurance Limited – New Zealand Branch ("the Branch") on pages 4 to 33, which comprise the balance sheet as at 31 December 2016, the statement of comprehensive income and statement of changes in balances due to head office and statement of cash flows for the year then ended, and the notes to the financial statements that include a summary of significant accounting policies and other explanatory information.

### *Directors' Responsibility for the Financial Statements*

The Directors of the Branch are responsible for the preparation of these financial statements in accordance with generally accepted accounting practice in New Zealand and that give a true and fair view of the matters to which they relate and for such internal controls as the Directors determine are necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### *Auditors' Responsibility*

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing (New Zealand). These standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider the internal controls relevant to the Branch's preparation and fair presentation of the financial statements 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 Branch's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates, as well as evaluating the overall presentation of the financial statements.

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

We are independent of the Branch. Other than in our capacity as auditors we have no relationship with, or interests in, the Branch.

pwc

*Opinion*

In our opinion, the financial statements on pages 4 to 33:

(i) comply with generally accepted accounting practice in New Zealand;

(ii) comply with International Financial Reporting Standards; and

(iii) gives a true and fair view of the financial position of the Branch as at 31 December 2016, and its financial performance and cash flows for the year then ended.

### *Report on Other Legal and Regulatory Requirements*

We also report in accordance with Sections 16(1)(d) and 16(1)(e) of the Financial Reporting Act 1993. In relation to our audit of the financial statements for the year ended 31 December 2016:

(i) we have obtained all the information and explanations that we have required; and

(ii) in our opinion, proper accounting records have been kept by the Branch as far as appears from an examination of those records.

### *Restriction on Use of our Report*

This report is made solely to the Directors of the Branch, as a body. Our audit work has been undertaken so that we might state to the Directors of the Branch those matters which we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other the Branch's Directors, as a body, for our audit work, for this report or for the opinions we have formed.

PricewaterhouseCoopers

PricewaterhouseCoopers
Chartered Accountants
17 February 2017

Sydney

I, S J Hadfield, am currently a member of Chartered Accountants Australia and New Zealand and my membership number is 276681.

PricewaterhouseCoopers was the audit firm appointed to undertake the audit of QBE Lenders' Mortgage Insurance Limited – New Zealand Branch for the year ended 31 December 2016. I was responsible for the execution of the audit and delivery of our firm's auditors' report. The audit work was completed on 17 February 2017 and an unqualified opinion was issued.

Hadfield

S J Hadfield

**QBE LENDERS' MORTGAGE INSURANCE LIMITED**
**New Zealand Branch**

## STATEMENT OF COMPREHENSIVE INCOME
For the year ended 31 December 2016

| | Note | 2016 $ | 2015 $ |
|---|---|---|---|
| Gross written premium | | - | - |
| Unearned premium movement | | 1,293,381 | 2,482,742 |
| Gross earned premium revenue | 5(A) | 1,293,381 | 2,482,742 |
| Outward reinsurance premium | | (1,782,637) | (363,340) |
| Deferred reinsurance premium movement | | 670,128 | - |
| Outward reinsurance premium expense | 5(B) | (1,112,509) | (363,340) |
| Net earned premium | | 180,872 | 2,119,402 |
| Gross claims incurred | 5(B) | 452,845 | (502,402) |
| Reinsurance and other recoveries revenue | 5(A) | 385,254 | 76,908 |
| Net claims incurred | 6(A) | 838,099 | (425,494) |
| Reinsurance commission revenue | 5(A) | 131,537 | - |
| Other acquisition costs | 5(B) | (189,489) | (321,310) |
| Underwriting and other expenses | 5(B) | (188,540) | (208,798) |
| **Underwriting result** | | 772,479 | 1,163,800 |
| Investment income on policyholders funds | 5(A) | 27,218 | 20,617 |
| **Insurance profit** | | 799,697 | 1,184,417 |
| Profit before income tax | | 799,697 | 1,184,417 |
| Income tax expense | 7(A) | (223,960) | (331,591) |
| *Profit after income tax* | | 575,737 | 852,826 |
| **Other comprehensive income** | | | |
| Other comprehensive income after income tax | | - | - |
| Total comprehensive income after income tax | | 575,737 | 852,826 |
| | | | |
| Profit after income tax attributable to Head Office Account | | 575,737 | 852,826 |
| | | 575,737 | 852,826 |
| | | | |
| Total comprehensive income after income tax attributable to: | | | |
| Head Office Account | | 575,737 | 852,826 |
| | | 575,737 | 852,826 |

The statement of comprehensive income should be read in conjunction with the accompanying notes.

**QBE LENDERS' MORTGAGE INSURANCE LIMITED**
**New Zealand Branch**

## BALANCE SHEET
As at 31 December 2016

| | Note | 2016 $ | 2015 $ |
|---|---|---|---|
| **Assets** | | | |
| Cash and cash equivalents | 8 | **1,571,358** | 445,021 |
| Trade and other receivables | 9 | **120,855** | 7,002 |
| Reinsurance and other recoveries on outstanding claims | 13(A) | **300,487** | 24,927 |
| Deferred insurance costs | 10 | **836,819** | 356,180 |
| Total assets | | **2,829,519** | 833,130 |
| **Liabilities** | | | |
| Trade and other payables | 12 | **78,858** | 27,266 |
| Current tax liabilities | | **76,752** | 249,730 |
| Deferred tax liabilities | 11 | **46,674** | 99,736 |
| Outstanding claims | 13(A) | **666,707** | 1,233,260 |
| Unearned premium | 14(A) | **1,489,173** | 2,782,554 |
| Unearned reinsurance commission | 14(B) | **151,449** | - |
| Total liabilities | | **2,509,613** | 4,392,546 |
| Net liabilities | | **319,906** | (3,559,416) |
| **Due to Head Office - Australia** | | **319,906** | (3,559,416) |

The balance sheet should be read in conjunction with the accompanying notes.

## STATEMENT OF CHANGES IN BALANCES DUE TO HEAD OFFICE

For the year ended 31 December 2016

| **2016** | **Head office account $** |
|---|---|
| As at 1 January | **(3,559,416)** |
| Profit after income tax | **575,737** |
| Other comprehensive income | **-** |
| Total comprehensive income | **575,737** |
| Net funding movements | **3,303,585** |
| As at 31 December | **319,906** |

| **2015** | |
|---|---|
| As at 1 January | (6,250,292) |
| Profit after income tax | 852,826 |
| Other comprehensive income | - |
| Total comprehensive income | 852,826 |
| Net funding movements | 1,838,050 |
| As at 31 December | (3,559,416) |

The statement of changes in balances due to Head Office should be read in conjunction with the accompanying notes.

## STATEMENT OF CASH FLOWS
For the year ended 31 December 2016

| | Note | 2016 $ | 2015 $ |
|---|---|---|---|
| **Operating activities** | | | |
| Non-reinsurance recoveries received | | 109,694 | 74,778 |
| Reinsurance commissions received | | 282,986 | - |
| Outward reinsurance paid | | (1,782,637) | (363,340) |
| Claims paid | | (113,708) | (435,736) |
| Other underwriting costs paid | | (250,801) | (199,554) |
| Interest received | | 27,218 | 20,617 |
| Income taxes paid | | (450,000) | (1,087,536) |
| Net cash flows from operating activities | 8(A) | (2,177,248) | (1,990,771) |
| **Investing activities** | | | |
| Net cash flows from investing activities | | - | - |
| **Financing activities** | | | |
| Net funding received | | 3,303,585 | 1,838,050 |
| Net cash flows from financing activities | | 3,303,585 | 1,838,050 |
| Net movement in cash and cash equivalents | | 1,126,337 | (152,721) |
| Cash and cash equivalents at the beginning of the financial year | | 445,021 | 597,742 |
| Cash and cash equivalents at the end of the financial year | 8 | 1,571,358 | 445,021 |

The statement of cash flows should be read in conjunction with the accompanying notes.

## NOTES TO THE FINANCIAL STATEMENTS
For the year ended 31 December 2016

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

The financial report includes financial statements for QBE Lenders' Mortgage Insurance Limited, New Zealand Branch (the "branch") as an individual entity. The branch is a branch of QBE Lenders' Mortgage Insurance Limited ("QBE LMI" or the "company") and is a reporting entity for the purposes of the *Financial Reporting Act 2013.*

For a complete understanding of the financial position of the company refer to the company's full financial statements as lodged with the Australian Securities and Investments Commission.

### (A) Basis of preparation

The financial statements have been prepared in accordance with New Zealand equivalents to International Financial Reporting Standards ("NZ IFRS"), other applicable Financial Reporting Standards, as appropriate for profit-oriented entities, the requirements of the *Financial Reporting Act 2013* and the *Financial Markets Conduct Act 2013.*

The sole shareholder of the company has exercised its right under section 211(3) of the *Companies Act 1993* and determined that these financial statements need not comply with paragraphs (a), and (e) to (j) of section 211(1) of the Act.

The company has applied for and has been granted an exemption from preparing consolidated financial statements by the Financial Markets Authority under the *Financial Reporting Act 2013* and the *Financial Markets Conduct Act 2013.* The company's ultimate parent, QBE Insurance Group Limited (QBE Group), prepares and will lodge consolidated financial statements with the Financial Markets Authority.

The financial statements have been prepared in accordance with the *Financial Reporting Act 2013*, the *Companies Act 1993* and the *Financial Markets Conduct Act 2013.*

The company is a for-profit entity for the purpose of preparing the financial statements.

#### (i) Compliance with IFRS

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

#### (ii) 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 recoveries at present value. Refer to note 3.

#### (iii) 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 company'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 3.

#### (iv) Significant changes

The company revised its reinsurance strategy and program entered into new reinsurance contracts effective 1 January 2016. Under the revised program, claims paid after 2015 on all policies written prior to 2016 will be reinsured to a level of 45% with a related party. Further, a stop loss reinsurance contract has been entered with external parties in relation to claims on policies written in 2016 and 2017.

#### (v) Going concern

With effect from September 2013, the branch ceased to write new insurance policies. The directors of the company believe that the branch has access to sufficient resources to meet its future liabilities and commitments. For this reason the directors continue to adopt the going concern assumption in the preparation of the branch's financial statements.

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### (B) 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.

### (C) Insurance contracts

All of the insurance products offered or utilised by the branch meet the definition of insurance contracts under New Zealand IFRS, and are accounted for and reported in accordance with these standards. These products do not contain embedded derivatives or deposits that are required to be unbundled.

### (D) 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.

### (E) 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.

### (F) 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 claims 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.

### (G) Non-reinsurance recoveries

Non-reinsurance 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.

### (H) Acquisition costs

Acquisition 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.

### (I) Investment income

Interest income is recognised on an accruals basis.

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### (J) 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 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. 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 authority.

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 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.

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.

### (K) Insurance profit

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

### (L) 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.

### (M) 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 branch 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.

### (N) 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.

**NOTES TO THE FINANCIAL STATEMENTS**
For the year ended 31 December 2016

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### (O) 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.

### (P) Functional and presentation currency
The branch's financial statements are presented in New Zealand dollars, being the functional and presentation currency of the branch.

### (Q) Goods and services tax ("GST")
GST incurred is not recoverable from the Inland Revenue Department. GST is recognised as part of the cost of acquisition of an asset or as part of an item of expense. Payables in the balance sheet and commitments are shown inclusive of GST.

### (R) Comparative figures
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 branch's financial statements.

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

A number of new standards and amendments to standards and interpretations have been issued during the year but not currently effective. The new standards and amendments are not mandatory for the branch until the operative date required. Early adoption of the new standards and amendments has not been applied in the financial statements.

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

## 3. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

The company is a lenders' mortgage insurance company underwriting business in Australia and New Zealand. The branch underwrites all business in New Zealand and none in Australia.

The company 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.

The company 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.

## 3. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (CONTINUED)

### (A) Outstanding claims provision

The branch'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 branch 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; 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 branch, 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 branch'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 4.

The determination of the amounts that the branch will ultimately pay for claims arising under insurance 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 branch's profit or loss are summarised in note 3(A)(iv).

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 non-reinsurance recoveries. Separate estimates are made of the amounts recoverable from 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 3(A)(iii).

## 3. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (CONTINUED)

### (A) Outstanding claims provision (continued)

### (ii) 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 branch's profit or loss is summarised in note 3(A)(iv).

Both the Reserve Bank of New Zealand ("RBNZ") and the Australian Prudential Regulation Authority ("APRA") require a probability of adequacy of 75% for the determination of minimum capital. For the actual probability of adequacy applied at the end of the financial year to the branch, refer to note 13(C).

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 appropriate level of risk margin is not determined by reference to a fixed probability of adequacy.

### (iii) Financial assumptions used to determine the outstanding claims provision

**Key variables**

| | 2016 | 2015 |
|---|---|---|
| Severity ('000) | $25.0 | $45.0 |
| Claim rates | 21.8% | 27.7% |
| Coefficient of variation | 53.0% | 53.0% |

- Severity is a measure of the anticipated claims cost;
- 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**

The company 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.

| | 2016<br>% | 2015<br>% |
|---|---|---|
| Discount factor | 1.8 | 2.0 |

**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 branch's net outstanding claims provision at the balance sheet date is 1.4 years (2015: 1.3 years).

## 3. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (CONTINUED)

### (iv) 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 4(D)(ii).

| | | Profit (Loss)[1] | |
|---|---|---|---|
| | **Sensitivity** | **2016** | **2015** |
| | **%** | **$** | **$** |
| Severity | +20 | **(53,217)** | (175,223) |
| | -20 | **53,217** | 175,223 |
| Claim rates | +20 | **(50,153)** | (166,247) |
| | -20 | **53,272** | 175,639 |
| Discount factors | +5 | **338** | 1,125 |
| | -5 | **(339)** | (1,129) |
| Coefficient of variation | +20 | **(11,047)** | (36,451) |
| | -20 | **11,047** | 36,451 |

[1] Net of tax at the prima facie rate of 28%.

### (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 (note 14(C)). 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 3(A).

NZ IFRS 4: Insurance Contracts 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". As NZ IFRS 4 does not explicitly define "broadly similar risks" or "managed together as a single portfolio", and the branch is a monoline insurer, the branch has interpreted these terms to represent the entire portfolio.

### (C) Unearned premium liabilities and deferred insurance costs

As highlighted in note 1, premium 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 is earned and insurance costs recognised in accordance with these patterns, adjusted for policy terminations.

During the year, in accordance with accounting standards, the company reassessed the expected pattern of risk emergence over the life of its portfolio to reflect updated claims experience. An actuarial analysis concluded there were no changes to the earning pattern for 2016, as such a release to the unearned premium liability was not recognised (2015: $236,773).

## 4. 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, and a reinsurance management strategy ("REMS"), both of which are lodged with APRA.

**4. RISK MANAGEMENT (CONTINUED)**

Risk management for the branch is managed by the company.

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

- achieve competitive advantage through better understanding the risk environment in which the company 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 company'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 company has established internal controls to manage risk in the key areas of exposure relevant to its business.

The company'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.

**(i) Capital management risk**

The company is subject to extensive prudential and other forms of regulation in the jurisdictions in which it conducts business. Prudential regulation is generally designed to protect the policyholders. Regulation covers a number of areas including solvency, change in control and capital movement limitations.

## 4. RISK MANAGEMENT (CONTINUED)

The regulatory environments in Australia and New Zealand continue 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.

In New Zealand, the Insurance (Prudential Supervision) Act 2010 provides the RBNZ regulatory authority over insurance companies. The branch has been given an exemption from compliance with the New Zealand solvency requirements on the basis of the company's compliance with the APRA solvency standards.

### (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 shews 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 reinsurence 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 branch provides lenders' mortgage insurance ("LMI") in New Zealand. In 2013, the branch ceased underwriting new policies.

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.

LMI is characterised by coverage of 100% of the loan amount however, insurance coverage may also be "top cover", where the total loss (including expenses) is paid up to a prescribed percentage of the original loan amount. Typical top cover in New Zealand ranges from 20% to 30% of the original loan amount.

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.

### (B) Insurance risk (continued)

### (i) Underwriting risks (continued)

**Concentration risk**

Concentration risk is the risk of exposure due to concentration of activity in certain geographical locations, industries or counterparties. The company operates throughout all regions in Australia and New Zealand and therefore has limited geographic concentration risk on insurance contracts; exposures are monitored but not limited by region. The branch only insures risks in New Zealand. 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.

## 4. RISK MANAGEMENT (CONTINUED)

The company 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. 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 (2015: 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 2016, the ICRC was AUD 480.6 million (2015: AUD 759.9 million) before tax benefit, which was less than the risk tolerance.

**(ii) Claims management and claims estimation risks**

The company's approach to determining the outstanding claims provision and the related sensitivities are set out in note 3. The company 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; and
- 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 3(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 company's credit risk arises mainly from investment, insurance and reinsurance protection activities. The following policies and procedures are in place to mitigate the company'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 branch did not enter into any forward foreign exchange contracts during the year; and
- 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 branch did not invest in derivatives during the year.

### (C) Credit risk (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, the company 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 fourteen 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 company does not consider a loan to be in default until it has been delinquent for three consecutive monthly payments.

## 4. RISK MANAGEMENT (CONTINUED)

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 company 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 company.

**(ii) Investment counterparty credit risk**
The company's principal exposure to credit risk from financial instruments arises from the company's holdings of fixed and floating interest rate securities and short term money market securities. Additional credit risk arises in respect of cash holdings and trade and other receivables. The branch's principal exposures related to cash.

The following table provides 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 Standard and Poor's counterparty credit ratings. AAA (2015: AAA) is the highest possible rating. Rated assets falling outside the range of AAA to BBB are classified as speculative grade.

| | Credit Rating | | | | | | |
|---|---|---|---|---|---|---|---|
| | AAA<br>$ | AA<br>$ | A<br>$ | BBB<br>$ | Speculative<br>$ | Not Rated<br>$ | Total<br>$ |
| **As at 31 December 2016** | | | | | | | |
| Cash and cash equivalents | - | - | 1,571,358 | - | - | - | 1,571,358 |
| **As at 31 December 2015** | | | | | | | |
| Cash and cash equivalents | - | 445,021 | - | - | - | - | 445,021 |

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

None of the branch's financial assets are past due or impaired or have terms that have been renegotiated and would otherwise have been past due or impaired (2015: nil).

**(C) Credit risk (continued)**
**(iii) Reinsurance counterparty credit risk**
Reinsurance risk management is the process of transferring insurance risk to another insurer for a price. The company reinsures a portion of risks underwritten to control exposure to insurance losses, reduce volatility and protect capital.

The company'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 branch has no reinsurance recoveries receivable on paid or outstanding claims at 31 December 2016 (2015: nil).

## 4. 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 company's risk appetite.

### (i) Currency risk

The company's exposure to currency risk generally arises as a result of the translation of foreign currency amounts back to the functional currency. The branch's exposure to currency risk generally arises in respect of amounts due from or payable to related parties denominated in Australian dollars. Foreign currency balances are actively monitored and exposures kept to acceptable levels.

### (ii) Interest rate risk

Financial instruments with a floating rate interest rate expose the company to cash flow interest rate risk, whereas fixed interest rate instruments expose the company 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 company 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 company is therefore exposed to potential underwriting result volatility as a result of interest rate movements. The company has a policy of maintaining a relatively short duration for assets backing policyholders' funds in order to minimise any potential volatility affecting insurance profit.

### (D) Market risk (continued)
### (ii) Interest rate risk (continued)

The contractual maturity profile of the branch's 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.

| | 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 |
| **As at 31 December 2016** | | | | | | | |
| Floating rate ($) | **1,571,358** | **-** | **-** | **-** | **-** | **-** | **1,571,358** |
| Weighted average interest rate (%) | **1.37%** | **-** | **-** | **-** | **-** | **-** | **1.37%** |
| **As at 31 December 2015** | | | | | | | |
| Floating rate ($) | 445,021 | - | - | - | - | - | 445,021 |
| Weighted average interest rate (%) | 1.55% | - | - | - | - | - | 1.55% |

Movements in interest rates impact the interest income on 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 branch at the balance date is shown in the table below.

## 4. RISK MANAGEMENT (CONTINUED)

| | Sensitivity | Profit (Loss)[1] | |
|---|---|---|---|
| | | 2016 | 2015 |
| | % | $ | $ |
| Interest rate movement | +0.5 | 5,657 | 1,602 |
| Interest-bearing financial assets | -0.5 | (5,657) | (1,602) |

[1] Net of tax at the branch's prima facie rate of 28%.

### (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 branch had no price risk at the end of either the current or prior financial year.

### (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 company's asset and liability management strategy is to ensure sufficient liquidity is maintained at all times to meet the company'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 company 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 company'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 company has a strong liquidity position. The maturity of the branch's interest-bearing financial assets is included in note 4(D)(ii).

Surplus cash flows are transferred to the company in Australia, and conversely cash flow deficits, if any, are supported by the company.

## 4. RISK MANAGEMENT (CONTINUED)

### (E) Liquidity risk (continued)

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

| | 1 year or less $ | 1 to 3 years $ | 1 to 3 years $ | Over 5 years $ | Total $ |
|---|---|---|---|---|---|
| **As at 31 December 2016** | | | | | |
| Trade and other payables | **78,858** | - | - | - | **78,858** |
| **As at 31 December 2015** | | | | | |
| Trade and other payables | 27,266 | - | - | - | 27,266 |

The branch has no significant concentration of liquidity risk.

The maturity profile of the branch's net outstanding claims provision is analysed in note 13(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 company 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 company;
- definition of the acceptable level of risk appetite and tolerance;
- assessment of those risks throughout the company 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.

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 company 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.

## 5. INCOME AND EXPENSES

### (A) Income summary

| | 2016<br>$ | 2015<br>$ |
|---|---|---|
| **Gross earned premium revenue** | | |
| Direct | 1,293,381 | 2,482,742 |
| | 1,293,381 | 2,482,742 |
| **Other revenue** | | |
| Reinsurance and other recoveries | 385,254 | 76,908 |
| Reinsurance commission revenue | 131,537 | - |
| | 516,791 | 76,908 |
| **Other income** | | |
| Interest income | 27,218 | 20,617 |
| | 27,218 | 20,617 |
| **Income** | 1,837,390 | 2,580,267 |

### (B) Expenses summary

| | 2016<br>$ | 2015<br>$ |
|---|---|---|
| Outward reinsurance premium expense | 1,112,509 | 363,340 |
| Gross claims incurred | (452,845) | 502,402 |
| Other acquisition costs | 189,489 | 321,310 |
| Underwriting expenses | 188,540 | 208,798 |
| **Expenses** | 1,037,693 | 1,395,850 |
| | | |
| **Profit before income tax** | 799,697 | 1,184,417 |

## 6. CLAIMS INCURRED

### (A) Claims Analysis

| | 2016<br>$ | 2015<br>$ |
|---|---|---|
| **Gross claims incurred and related expenses** | | |
| Direct | (452,845) | 502,402 |
| **Reinsurance and other recoveries** | | |
| Direct | (102,471) | (76,908) |
| Inward reinsurance | (282,783) | |
| **Net claims incurred** | (838,099) | 425,494 |

### (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 6(C).

| | 2016 | | | 2015 | | |
|---|---|---|---|---|---|---|
| | Current Year $ | Prior Years $ | Total $ | Current Year $ | Prior Years $ | Total $ |
| **Gross claims incurred and related expenses** | | | | | | |
| Undiscounted | 521,797 | (986,633) | (464,836) | 1,336,704 | (832,802) | 503,902 |
| Discount | (10,003) | 21,994 | 11,991 | (24,054) | 22,554 | (1,500) |
| | 511,794 | (964,639) | (452,845) | 1,312,650 | (810,248) | 502,402 |
| **Non-reinsurance recoveries** | | | | | | |
| Undiscounted | (210,261) | (180,747) | (391,008) | (23,282) | (53,692) | (76,974) |
| Discount | 4,538 | 1,216 | 5,754 | 612 | (546) | 66 |
| | (205,723) | (179,531) | (385,254) | (22,670) | (54,238) | (76,908) |
| **Net claims incurred** | | | | | | |
| Undiscounted | 311,536 | (1,167,380) | (855,844) | 1,313,422 | (886,494) | 426,928 |
| Discount | (5,465) | 23,210 | 17,745 | (23,442) | 22,008 | (1,434) |
| | 306,071 | (1,144,170) | (838,099) | 1,289,980 | (864,486) | 425,494 |

The take-up of 45% quota share reinsurance arrangement led to a $83,594 release of the net central estimate for prior years, with the remainder of the release a result of better than expected claims experience since the December 2015 valuation.

### (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 13(E). This note is a reconciliation of the amounts included in the table in note 6(B) and the current financial year movements in the claims development table.

| | 2016 | | | 2015 | | |
|---|---|---|---|---|---|---|
| | Current Year $ | Prior Years $ | Total $ | Current Year $ | Prior Years $ | Total $ |
| Net undiscounted claims development – central estimate (note 13(E)) | 244,688 | (973,450) | (728,762) | 1,053,018 | (651,440) | 401,578 |
| Movement in claims settlement costs | 12,665 | (23,376) | (10,711) | 30,185 | (29,205) | 980 |
| Movement in discount | (5,465) | 23,210 | 17,745 | (23,442) | 22,008 | (1,434) |
| Movement in risk margin | 54,183 | (170,554) | (116,371) | 230,219 | (205,849) | 24,370 |
| **Net claims incurred - discounted** | 306,071 | (1,144,170) | (838,069) | 1,289,980 | (864,486) | 425,494 |

## 7. INCOME TAX EXPENSE

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

| | 2016<br>$ | 2016<br>$ |
|---|---|---|
| Profit before income tax | 799,697 | 1,184,417 |
| Prima facie tax payable at 28% | 223,915 | 331,637 |
| Tax effect of non-temporary differences: | | |
| Non allowable expenses and non-taxable income | - | (46) |
| Prima facie tax adjusted for non-temporary differences | 223,915 | 331,591 |
| Overprovision in prior year | 45 | - |
| **Income tax expense** | 223,960 | 331,591 |
| Analysed as follows: | | |
| Current tax | 276,977 | 421,558 |
| Deferred tax | (53,062) | (89,967) |
| Overprovision in prior year | 45 | - |
| | 223,960 | 331,591 |
| Deferred tax credit comprises: | | |
| Deferred tax liabilities recognised in profit or loss | (53,062) | (89,967) |
| | (53,062) | (89,967) |

## 8. CASH AND CASH EQUIVALENTS

| | 2016<br>$ | 2015<br>$ |
|---|---|---|
| Cash at bank and on hand | 437,294 | 333,842 |
| Overnight money | 1,134,064 | 111,179 |
| Cash and cash equivalents | 1,571,358 | 445,021 |

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

| | 2016<br>$ | 2015<br>$ |
|---|---|---|
| Cash flows from operating activities | (2,177,248) | (1,990,771) |
| Decrease (increase) in net outstanding claims | 566,553 | (66,686) |
| Decrease in unearned premiums | 1,293,381 | 2,484,402 |
| Increase in unearned reinsurance commission | (151,449) | - |
| Increase (decrease) in deferred insurance costs | 480,639 | (321,310) |
| Increase in non-reinsurance recoveries | 275,560 | 2,130 |
| Increase (decrease) in trade and other receivables | 113,853 | (50,886) |
| (Increase) decrease in trade and other payables | (51,592) | 39,982 |
| Decrease in deferred tax liabilities | 53,062 | 89,967 |
| Decrease in amounts due tax authorities for current tax | 172,978 | 665,978 |
| Profit after income tax | 575,737 | 852,826 |

## 9. TRADE AND OTHER RECEIVABLES

| | 2016 $ | 2015 $ |
|---|---|---|
| Amounts due from related parties | **120,855** | 7,002 |
| Trade and other receivables | **120,855** | 7,002 |
| Amounts maturing within 12 months | **120,855** | 7,002 |
| Amounts maturing in greater than 12 months | **-** | - |
| Trade and other receivables | **120,855** | 7,002 |

### (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 branch as collateral for liabilities or contingent liabilities. No receivables are past due or impaired (2015: nil).

## 10. DEFERRED INSURANCE COSTS

| | 2016 $ | 2015 $ |
|---|---|---|
| Deferred reinsurance premium | **670,128** | - |
| Deferred acquisition costs | **166,691** | 356,180 |
| Deferred insurance costs | **836,819** | 356,180 |
| To be expensed within 12 months | **399,198** | 169,343 |
| To be expensed in greater than 12 months | **437,621** | 186,837 |
| Deferred insurance costs | **836,819** | 356,180 |

| | DEFERRED REINSURANCE PREMIUM | | DEFERRED ACQUISITION COSTS | |
|---|---|---|---|---|
| | 2016 $ | 2015 $ | 2016 $ | 2015 $ |
| At 1 January | **-** | - | **356,180** | 677,490 |
| Costs deferred in financial year | **1,252,149** | - | **-** | - |
| Amortisation of costs deferred in current and previous financial years | **(582,021)** | - | **(185,008)** | (300,218) |
| Additional (release) deferral | **-** | - | **(4,481)** | (21,092) |
| At 31 December | **670,128** | - | **166,691** | 356,180 |

QBE LENDERS' MORTGAGE INSURANCE LIMITED
New Zealand Branch

NOTES TO THE FINANCIAL STATEMENTS
For the year ended 31 December 2016

## 11. DEFERRED INCOME TAX

| | 2016 $ | 2015 $ |
|---|---|---|
| Deferred tax liabilities | 46,674 | 99,736 |

### (A) Tax jurisdiction

The branch qualifies as a permanent establishment for New Zealand tax purposes, and consequently lodges income tax returns and pays income tax in New Zealand as though it were a separate entity.

### (B) Deferred tax liabilities

(i) *The balance comprises temporary differences attributable to:*

| | 2016 $ | 2015 $ |
|---|---|---|
| **Amounts recognised in profit or loss** | | |
| Insurance assets | 46,674 | 99,736 |
| | 46,674 | 99,736 |
| **Deferred tax liabilities as follows:** | | |
| Payable within 12 months | 22,226 | 47,192 |
| Payable in greater than 12 months | 24,408 | 52,544 |
| | 46,674 | 99,736 |

(ii) Movements:

| | 2016 $ | 2015 $ |
|---|---|---|
| At 1 January | 99,736 | 189,703 |
| Amounts recognised in profit or loss | (53,062) | (89,967) |
| At 31 December | 46,674 | 99,736 |

## 12. TRADE AND OTHER PAYABLES

| | 2016 $ | 2015 $ |
|---|---|---|
| Amounts due to related entities | 15,892 | 14,215 |
| Other payables | 62,966 | 13,051 |
| Trade and other payables | 78,858 | 27,266 |
| Amounts payable within 12 months | 78,858 | 27,266 |
| Amounts payable in greater than 12 months | - | - |
| Trade and other payables | 78,858 | 27,266 |

## 13. OUTSTANDING CLAIMS

### (A) Net outstanding claims

| | 2016<br>$ | 2015<br>$ |
|---|---|---|
| Gross outstanding claims provision | **529,949** | 980,131 |
| Risk margin | **136,758** | 253,129 |
| Outstanding claims | **666,707** | 1,233,260 |
| Non-reinsurance and other recoveries on outstanding claims | **(300,487)** | (24,927) |
| Net outstanding claims provision | **366,220** | 1,208,333 |
| Analysed as follows: | | |
| Net undiscounted central estimate | **296,904** | 980,351 |
| Discount | **(7,402)** | (25,147) |
| Net discounted central estimate | **289,502** | 955,204 |
| Risk margin | **76,718** | 253,129 |
| Net outstanding claims provision | **366,220** | 1,208,333 |
| | | |
| Gross undiscounted central estimate | **531,190** | 982,652 |
| Claims settlement costs | **12,587** | 23,298 |
| | **543,777** | 1,005,950 |
| Discount to present value | **(13,828)** | (25,819) |
| Gross discounted central estimate | **529,949** | 980,131 |
| Payable within 12 months | **259,929** | 522,025 |
| Payable in greater than 12 months | **270,020** | 458,106 |
| Gross discounted central estimate | **529,949** | 980,131 |
| | | |
| Non-reinsurance recoveries on outstanding claims | **306,913** | 25,599 |
| Discount to present value | **(6,426)** | (672) |
| Non-reinsurance recoveries on outstanding claims | **300,487** | 24,927 |
| Payable within 12 months | **117,934** | 13,275 |
| Payable in greater than 12 months | **182,553** | 11,652 |
| Non-reinsurance recoveries on outstanding claims | **300,487** | 24,927 |

### (B) Maturity profile of net outstanding claims

The expected maturity of the branch's net outstanding claims provision is analysed below:

| | 1 year or less<br>$ | 1 to 2 years<br>$ | 2 to 3 years<br>$ | 3 to 4 years<br>$ | 4 to 5 years<br>$ | Over 5 years<br>$ | Total<br>$ |
|---|---|---|---|---|---|---|---|
| **At 31 December 2016** | **179,626** | **111,909** | **43,502** | **15,353** | **6,668** | **9,162** | **366,220** |
| At 31 December 2015 | 643,566 | 351,274 | 124,036 | 43,548 | 19,096 | 26,813 | 1,208,333 |

### (C) Risk margins

The process used to determine risk margins is explained in note 3(A)(ii) and details of the risk-free discount rates adopted are set out in note 3(A)(iii).

The probability of adequacy at 31 December 2016 is 75.0% (2015: 75.0%) - 75.0% is a recognised industry benchmark in New Zealand and Australia, being the minimum probability of adequacy required for licensed insurers by RBNZ and APRA. The risk margin included in net outstanding claims is 26.5% (2015: 26.5%) of the central estimate.

## 13. OUTSTANDING CLAIMS (CONTINUED)

### (D) Reconciliation of movement in outstanding claims provision

| | 2016 Gross $ | 2016 Recoveries $ | 2016 Net $ | 2015 Gross $ | 2015 Recoveries $ | 2015 Net $ |
|---|---|---|---|---|---|---|
| At 1 January | **1,233,260** | **24,927** | **1,208,333** | 1,166,594 | 22,797 | 1,143,797 |
| Increase in net claims incurred in current accident year | **511,794** | **205,723** | **306,071** | 1,312,650 | 22,670 | 1,289,980 |
| Movement in prior year claims provision | **(964,639)** | **179,531** | **(1,144,170)** | (810,248) | 54,238 | (864,486) |
| Incurred claims recognised in profit or loss | **(452,845)** | **385,254** | **838,099** | 502,402 | 76,908 | 425,494 |
| Claims payments | **(113,708)** | **(109,694)** | **(4,014)** | (435,736) | (74,778) | (360,958) |
| At 31 December | **666,707** | **300,487** | **366,220** | 1,233,260 | 24,927 | 1,208,333 |

### (E) Claims development – undiscounted net central estimate

Net undiscounted central estimate of outstanding claims for the branch for the four most recent accident years.

| | 2012 & prior years $ | 2013 $ | 2014 $ | 2015 $ | 2016 $ | Total $ |
|---|---|---|---|---|---|---|
| Estimate of net ultimate claims cost: | | | | | | |
| At end of accident year | - | 1,114,047 | 1,509,846 | 1,053,019 | 244,687 | 3,921,599 |
| One year later | - | 897,637 | 1,064,384 | 284,758 | - | 2,246,779 |
| Two years later | - | 797,452 | 966,495 | - | - | 1,763,947 |
| Three years later | - | 797,452 | - | - | - | 797,452 |
| Current central estimate cost for the four most recent accident years | - | 797,452 | 966,495 | 284,758 | 244,687 | 2,293,392 |
| Cumulative net claims payments to date | - | 797,452 | 966,495 | 201,242 | 43,885 | 2,009,074 |
| Net undiscounted central estimate | - | - | - | 83,516 | 200,802 | 284,318 |
| Discount to present value | | | | | | (7,402) |
| Net risk margin | | | | | | 76,718 |
| Claims settlement costs | | | | | | 12,586 |
| Net outstanding claims | | | | | | 366,220 |
| Net central estimate development increase (decrease) in the year | (107,299) | - | (97,889) | (768,261) | 244,687 | (728,762) |

A reconciliation of the net claims development in the table above to net incurred claims in the income statement is included in note 6(C).

The development of claims from prior accident years was better than expected at 31 December 2016, leading to an overall release of the central estimate for prior years of $937,449. The majority of this release related to the 2015 accident year primarily as claim volumes experienced were lower than anticipated at 31 December 2016.

Uncertainty surrounding claims development for the company is materially resolved within four years, and for the branch the accident years 2014 and prior are fully developed - no undiscounted central estimate is considered necessary at 31 December 2015 in respect of remaining defaults (2015: accident years 2013 and prior).

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.

**QBE LENDERS' MORTGAGE INSURANCE LIMITED**
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## 14. UNEARNED PREMIUM

### (A) Unearned premium

| | 2016 $ | 2015 $ |
|---|---|---|
| At 1 January | 2,782,554 | 5,266,956 |
| Earning of premium written in previous periods | (1,293,381) | (2,247,629) |
| Release deferral (note 3(C)) | - | (236,773) |
| At 31 December | 1,489,173 | 2,782,554 |
| Amounts to be earned within 12 months | 710,399 | 1,370,663 |
| Amounts to be earned in greater than 12 months | 778,774 | 1,411,891 |
| Unearned premium | 1,489,173 | 2,782,554 |

### (B) Net premium liabilities

| | 2016 $ | 2015 $ |
|---|---|---|
| Unearned premium | 1,489,173 | 2,782,554 |
| Unearned reinsurance commission (note 14(C)) | 151,449 | - |
| Deferred insurance costs (note 10) | (836,819) | (356,180) |
| Net premium liabilities | 803,803 | 2,426,374 |

### (C) Unearned reinsurance commission movements

| | 2016 $ | 2015 $ |
|---|---|---|
| At 1 January | - | - |
| Deferral of commission on contracts written in the financial year | 282,986 | - |
| Expensing of commission written in previous periods and current period | (131,537) | - |
| Net premium liabilities | 151,449 | - |

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

| | 2016 $ | 2015 $ |
|---|---|---|
| Undiscounted central estimate | 74,461 | 174,919 |
| Discount to present value | (24,117) | (72,038) |
| | 50,344 | 102,881 |
| Risk margin | 20,137 | 41,153 |
| Expected present value of net future cash flows for future claims including risk margin | 70,481 | 144,034 |

### (E) Liability adequacy test

The probability of adequacy of the unearned premium liability may differ 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 branch.

The application of the liability adequacy test in respect of the net unearned premium liabilities identified a surplus at 31 December 2016 and 2015.

### (F) Risk margin

The process used to determine the risk margins is explained in note 3(A)(ii).

The risk margin in expected net future cash flows for future claims as a percentage of the discounted central estimate is 40% (2015: 40%).

## 15. CAPITAL RISK MANAGEMENT

Capital is managed at a company level.

As a member of the wholly owned group, the company 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 company's activities. In order to maintain or adjust the capital structure, the company 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 company 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 company 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.

The company reviews its capital structure on an ongoing basis to optimise the allocation of capital whilst minimising the cost of capital. Active management of the business and its capital has enabled the company to maintain its insurer financial strength and credit rating, and has supported QBE Group's good access to capital markets when needed.

Management monitors the company's capital levels on an ongoing basis, with particular focus on the following performance indicators which were updated during 2016:

- The company is subject to regulatory requirements that a minimum level of capital is maintained to meet obligations to policyholders. It is the company'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; and
- Insurer financial strength ratings provided by the major rating agencies which demonstrate the company's financial strength and claims paying ability.

In addition to the management reporting and planning processes, the company 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 company is continuously monitored to ensure any potential issues are identified and remedial action, where necessary, is taken to restore effective capital performance and levels.

## 16. SOLVENCY

The table below discloses the solvency coverage for the company which includes the branch as calculated under the Australian APRA requirements.

| | 2016<br>A$000's | 2015<br>A$000's |
|---|---|---|
| APRA prescribed capital amount | **614,271** | 916,885 |
| Capital surplus | **280,613** | 537,240 |
| Solvency coverage | **1.46** | 1.59 |

QBE LENDERS' MORTGAGE INSURANCE LIMITED
New Zealand Branch

NOTES TO THE FINANCIAL STATEMENTS
For the year ended 31 December 2016

## 17. REMUNERATION OF AUDITORS

Audit fees for the company incorporate the New Zealand branch and are paid by the company. Amounts received by the company's auditors are as follows:

| | 2016<br>$ | 2015<br>$ |
|---|---|---|
| **PricewaterhouseCoopers (PwC) – Australian firm** | | |
| Audit or review of financial reports of the entity | **575,362** | 525,352 |
| Special audits required by regulators | **152,026** | 152,985 |
| | **727,388** | 678,337 |

The board believes some non-audit services are appropriate given the external auditor's knowledge of the QBE Group. The company 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.

## 18. CONTINGENT LIABILITIES

The branch had no contingent liabilities as at 31 December 2016 (2015: nil)

## 19. CAPITAL EXPENDITURE COMMITMENTS

The branch had no capital commitments as at 31 December 2016 (2015: nil).

## 20. RELATED PARTY DISCLOSURES

### (A) Parent and ultimate parent

The branch forms part of QBE LMI, a company incorporated and domiciled in Australia.

The company's ultimate parent is QBE Group, incorporated in Australia.

### (B) Transactions with related parties

The following material transactions occurred with related parties:

| | 2016<br>$ | 2015<br>$ |
|---|---|---|
| **Revenues** | | |
| Management fee received or receivable from controlled entities | **71,132** | - |

| | 2016<br>$ | 2015<br>$ |
|---|---|---|
| **Expenses** | | |
| Payments made for management fees and cost allocations to related entities | **159,438** | 159,530 |
| Payments made for management fees and cost allocations to Head Office | **-** | 11,952 |
| Outwards reinsurance premium (net of no claims bonus) | **1,112,509** | 363,340 |
| Reinsurance claims paid to a controlled entity | **(333,952)** | - |

## 20. RELATED PARTY DISCLOSURES (CONTINUED)

### (C) Outstanding balances arising from transactions with related parties

The following balances are outstanding at the reporting date in relation to transactions with related parties:

| | 2016<br>$ | 2015<br>$ |
|---|---|---|
| **Assets** | | |
| Trade and other receivables | **120,855** | 7,002 |
| Deferred reinsurance premium | **670,128** | - |
| Reinsurance and other recoveries receivable | **286,609** | - |
| **Liabilities** | | |
| Trade and other payables | **15,892** | 14,215 |
| Unearned reinsurance commission | **151,449** | - |

### (D) 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.

### (E) Other related party disclosures

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

| | Reference |
|---|---|
| Trade and other receivables | Note 9 |
| Trade and other payables | Note 12 |

## 21. EVENTS OCCURRING AFTER REPORTING DATE

There is, at the date of these statements, no other matter or circumstance that has arisen since 31 December 2016 that has significantly affected, or may significantly affect:

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

## 22. CORPORATE GOVERNANCE

Information regarding the corporate governance policies, practices and processes of QBE Group is available from www.group.qbe.com/investor-centre/corporate-governance.

QBE


QBE INSURANCE GROUP LIMITED

# Contents

QBE Insurance Group Limited Annual Report 2016
ABN 28 008 485 014



All amounts in this report are US dollars unless otherwise stated.

# Growing QBE's fundamental value

QBE recorded a 2016 financial performance at the better end of our target range. We believe this result is a milestone in the journey to delivering steady increases in QBE's fundamental value even in the face of challenging market conditions and an increasingly uncertain global political environment. We are confident shareholders will be rewarded as we work to further strengthen QBE's global franchise through a relentless focus on underwriting excellence and operating efficiency together with measured customer and partner-led growth.

## The market

The insurance market of 2016 continued to be characterised by surplus capital with corresponding downward pressure on pricing across most of the globe, particularly in commercial lines. Despite this dynamic, industry underwriting profits have generally been sustained by relatively low catastrophe claims coupled with continued prior accident year claims releases and cost efficiencies.

The near-term pricing outlook is broadly flat in most territories with the exception of Australia, where the insurance market started to harden in mid-2016 following a period of unsustainable price declines coupled with claims inflation. This means that as we look forward to 2017, the "day job" for insurers of generating underwriting profits is, as yet, no less challenging than a year ago.

Insurers are also grappling with a more uncertain political backdrop. This was evidenced in 2016 by increased anti-globalisation sentiment and concerns over immigration contributing to the Brexit vote and boosting support for populist politicians.

In the United States, proposed economic policies include large tax cuts for individuals and businesses, additional spending on infrastructure and defence and new trade barriers. Implementation of the President's policy proposals would likely provide a short-term economic stimulus; however, if enacted, these policies may lead to large budget deficits, creating inflationary pressures and increased pressure on the Federal Reserve to be more aggressive in raising interest rates.

Meanwhile, evidence is now emerging that Britain's vote to leave the European Union is feeding through to the economy of the United Kingdom in the form of rising inflation.

Predicting the impact of political change and geopolitical tension is notoriously challenging; however, it is reasonable to conclude that current uncertainty may contribute to more supportive conditions for the insurance industry. I say this because, broadly speaking, there are two things that make the operating landscape more favourable for insurers – if insurance prices are increasing or interest rates are rising. There are currently grounds for optimism on both fronts. Increased inflation in Europe will inevitably place upwards pressure on insurance pricing, while the pace of interest rate increases in the United States may accelerate as the Trump administration's impact on the economy becomes clearer.

Whether or not the headwinds faced by insurers in recent years ease, I believe we have the right strategies in place to grow QBE's fundamental value without reliance on rising interest rates or an improving pricing cycle. QBE has a differentiated global franchise and our business plans assume that the marketplace we see today is the one in which we will continue to operate.

## 2016 performance

Notwithstanding the challenging external environment, I am pleased to report that QBE delivered on our plans for the year with a financial result that was at the better end of our target range.

A notable aspect of the full year result was a substantial improvement in the performance of our Australian & New Zealand Operations in the second half of the year. Shareholders will recall that we reported an unsatisfactory performance in our Australian home market at the half year. This resulted from cumulative pricing declines coupled with heightened claims inflation in several short-tail classes, exacerbated by deterioration in the NSW compulsory third party (CTP) scheme.

While it takes more than a year for the full benefits of corrective action to be reflected in financial results once a commitment is made to remediate an insurance business, the Board is encouraged by the early progress made by Pat Regan and the team in Australian & New Zealand Operations. A carefully executed plan to restore pricing to more sustainable levels saw a 0.1% decline in Australian premium rates at the half year reversed in short order such that a full year price increase of 1.7% was recorded, including a 4.5% increase in the fourth quarter. The early benefits of these rate increases coupled with claims cost initiatives can be seen in a meaningful improvement in the division's combined operating ratio between June and December 2016.

Our North American Operations, which welcomed Russ Johnston as Chief Executive Officer during the year in a seamless transition from Dave Duclos, continued on its trajectory of performance improvement. The division is benefiting from portfolio rationalisation and a tighter focus on core businesses, with the ongoing growth of Specialty an important contributor to the result.

Our European Operations had another strong year in a marketplace that is increasingly difficult and our Emerging Markets business continues to make progress, adding meaningfully to our future growth opportunities.

We have a stated objective of achieving gross written premium growth of 3% per annum across the cycle and early in the year we anticipated that growth of around this level would be achievable in 2016. While the target was not ultimately achieved due to a combination of prudent underwriting in a challenging marketplace and our own internal remediation initiatives, in our view this level of growth remains a reasonable objective over a planning cycle.

Our balance sheet remains in excellent shape, as reflected in Standard & Poor's decision in May 2016 to revise the rating outlook on QBE's core operating entities to "positive" from "stable".

Moreover, it is pleasing to note that we have now reported five consecutive half years of positive prior accident year claims development.

## Looking to the future

This is my third annual message as Chairman, having taken on the role in April 2014 in the midst of a difficult period for the company.

Reflecting on the progress that has been made over the last three years, it is apparent that the QBE of 2017 is a hugely different company from the one that I took over as Chairman. Yet even in our darkest hour I was confident QBE had the essential attributes required to return to being an industry leader. Importantly, there was no question of QBE's solid underwriting DNA, the quality and commitment of our people or the latent benefits of being one of only a handful of truly global insurance franchises.

Achieving a return to stable and predictable earnings required that we first match these fundamental qualities with a more robust balance sheet while continuing to transform the business to strengthen and differentiate our global franchise.

The success that John Neal and his team have achieved in meeting this challenge is reflected in consecutive annual results towards the better end of our published targets and a balance sheet that is in excellent shape. Only with this hard work completed did we have the forward visibility to set out clear medium-term financial targets for QBE at our May 2016 Investor Update. These targets covered a range of metrics from growth in gross written premium to operating expense savings, reinsurance cost savings, claims efficiency, return on equity and cash remittances.

Your Board recognised this strength in our mid-year action to increase the dividend payout ratio to up to 65% of cash profits as well as our recent action to adopt a share buyback facility.

Importantly, QBE's transformation extends beyond financial measures and I am delighted that in the last year we have attracted three exceptional candidates to provide stewardship at Board level. Recent Board appointments include two of the insurance industry's foremost leaders of recent decades, Rolf Tolle and Mike Wilkins. Our third new director, Kathy Lisson, brings a rare skillset spanning digital technology, cyber security, IT risks and data analytics that is essential to shaping our company's strategic direction.

Your Board is also acutely aware that there is no room for complacency in the insurance industry of 2017. There is still work to be done to ensure our global business is operating as efficiently as possible, while the impact of technology, including disruptive technologies, on the insurance industry will only increase in coming years. More than $4 billion has been invested in Insurtech startups in the last two years and we are committed to being at the forefront of industry developments. I'm delighted that Kathy Lisson is chairing a new Board committee focused exclusively on technology and operational transformation at QBE.

While there has been a great deal of change at QBE over the last three years, one constant is our cautious approach to the way we go about our business. Whether it's through the comprehensive reinsurance we buy or our reluctance to go too far up the risk curve in our investment strategy, our over-riding goal is to deliver stable and predictable earnings.

In closing, I remain enthused and optimistic about QBE's ability to deliver high quality financial returns for our investors while fulfilling our mission for our customers through an increasingly talented global workforce and leadership team.

W. Marston Becker
**Chairman**

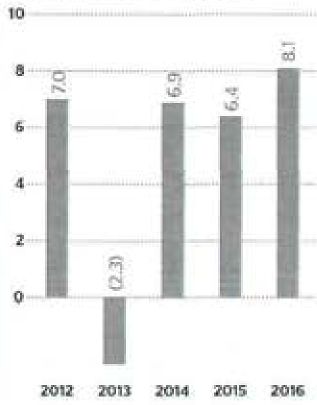
# 2016 snapshot[1]

## Performance

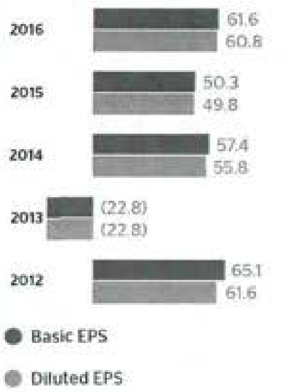
**Net profit after income tax** (US$M)


23%

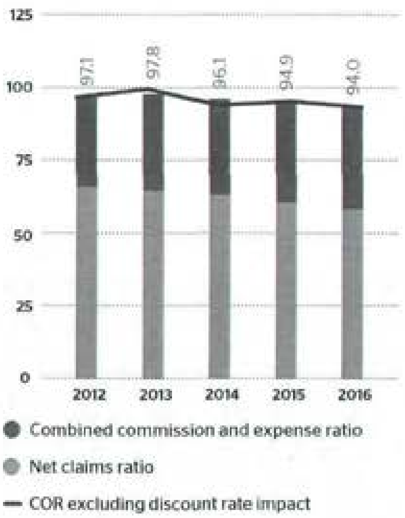
**Return on average shareholders' funds** (%)



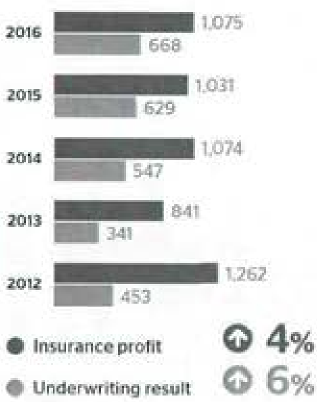

**Earnings per share (EPS)** (US¢)



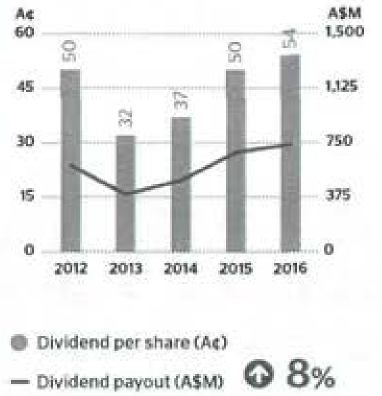

**Combined operating ratio (COR)** (%)




**Insurance profit and underwriting result** (US$M)



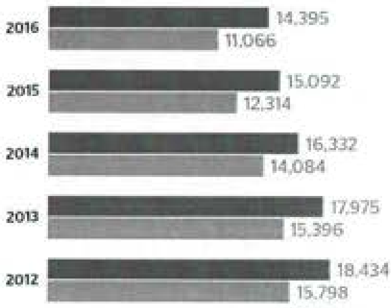

**Dividend per share** (A¢) **and dividend payout** (A$M)




1 The information in the tables above is extracted or derived from the Group's audited financial statements. The Group Chief Financial Officer's report sets out further analysis of the results to assist in comparison of the Group's performance against 2016 targets provided to the market.

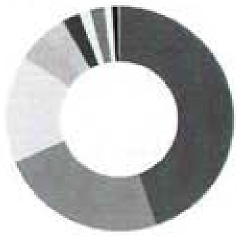
# Profile

## Gross written premium and net earned premium (US$M)




- Gross written premium ⬇ 5%
- Net earned premium ⬇ 10%

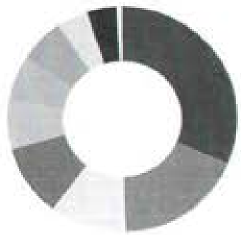
## Investments and cash at 31 December 2016



US$25,235 million

| | 2016 % | 2015 % |
|---|---|---|
| Corporate bonds | 44.9 | 46.4 |
| Government bonds | 23.8 | 15.6 |
| Short-term money | 15.7 | 22.2 |
| Property trusts/ investment property | 4.1 | 4.0 |
| Cash | 3.4 | 2.5 |
| Equities | 2.3 | 2.5 |
| Alternatives | 1.8 | 1.5 |
| Infrastructure debt | 1.8 | 1.3 |
| Emerging market debts and equities | 1.3 | 2.1 |
| High yield debt | 0.8 | 1.7 |
| Unit trusts | 0.1 | 0.2 |

## Gross earned premium by class of business



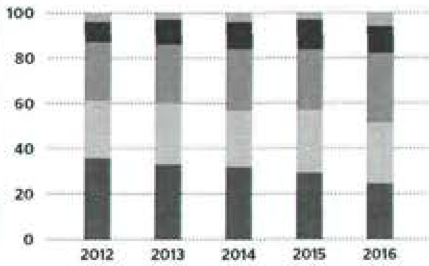
| | 2016 % | 2015 % |
|---|---|---|
| Commercial & domestic property | 31.4 | 31.0 |
| Motor & motor casualty | 18.3 | 17.7 |
| Agriculture | 10.8 | 10.8 |
| Public/product liability | 10.1 | 10.7 |
| Workers' compensation | 7.4 | 8.3 |
| Professional indemnity | 6.3 | 5.6 |
| Marine energy & aviation | 6.3 | 6.5 |
| Accident & health | 4.6 | 4.0 |
| Financial & credit | 4.0 | 4.1 |
| Other | 0.8 | 1.3 |

## Net earned premium by type

**92%** direct and facultative insurance

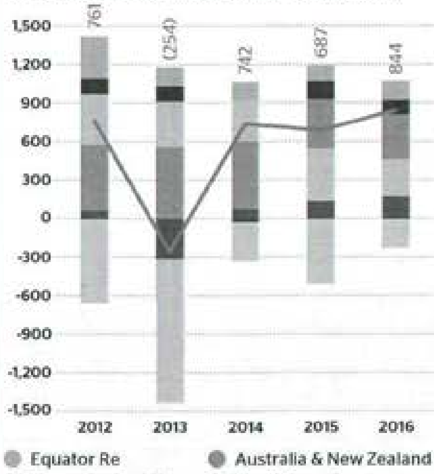
**8%** inward reinsurance

## Divisional analysis of net earned premium (%)




- Equator Re
- Emerging Markets
- Australia & New Zealand
- Europe
- North America

## Net profit after tax by division (US$M)




- Equator Re
- Emerging Markets
- Europe
- Australia & New Zealand
- North America
- Corporate & other
- — Consolidated QBE Group

# Delivering results through consistent strategy execution

QBE recorded a strong 2016 financial result including an above target combined operating ratio and an insurance profit margin towards the upper end of our target range. This performance is testament to the strength and diversification of our global franchise underpinned by a strong underwriting culture and supported by a high-quality balance sheet.

It is pleasing to report that in 2016 all key performance measures improved. Excluding the impact of discount rate movements, the combined operating ratio reduced to 93.2% from 94.3% [1] in 2015. Net profit after tax was $844 million, up 5% on 2015 [1], with an increase in investment income partially offset by an adverse discount rate movement and the impact of the stronger US dollar, particularly against sterling. On a constant currency basis, net profit after tax increased by 16%. Return on equity increased to 8.1% from 7.5% [1] last year.

Importantly, the detail below the headline result for 2016 is encouraging on a number of levels and reflects the successful transformation of QBE over the last five years. Following the restructuring of both our underwriting account and our balance sheet, our underwriting performance continues to improve year on year and we have now had five consecutive half years of positive prior accident year claims development. Our balance sheet is of high quality as recognised by the Standard & Poor's Global Ratings assessment which indicates that the Group's capital position is "well above the AA level".

Global market conditions leave little room for error and our underwriting discipline is evident across all of QBE's businesses. This is particularly the case in North American Operations, where the combined operating ratio improved to 97.7% [2] from 99.8% in 2015, when the division produced its first underwriting profit for some years. We are expecting further steady improvement towards a mid-90s combined operating ratio over the medium-term.

The strength of both QBE's market position and operational capability are reflected in early but visible signs that the remediation plan for Australian & New Zealand Operations is gaining traction. Corrective actions across underwriting and pricing together with improved discipline in our claims management functions underpinned a significant improvement in the attritional claims ratio in the second half of 2016. As a consequence, I am confident that by the end of 2017 the division will have returned to more acceptable levels of profitability.

Our 2016 performance saw QBE achieve targets for underwriting discipline, cost reduction, reinsurance savings, claims efficiency, capital ratios and cash remittances. The profit uplift coupled with strong cash flow generation has allowed the Board to both increase the final dividend by 10% to 33 Australian cents, as well as announce a three year cumulative on-market share buyback facility of up to A$1 billion.

1 2015 comparable figures exclude Argentina workers' compensation, M&LS deferred acquisition cost write-down as well as agency and other asset sales.

2 Combined operating ratio excluding discount rate impact.

## Divisional Performance

### 1. North American Operations

The turnaround in performance initiated by Dave Duclos has continued under Russ Johnston's leadership, with North American Operations' underwriting profit more than doubling in 2016. A second consecutive strong Crop performance and continued profitable growth in Specialty have aided the division's development. Actions taken to address legacy issues, including reinsuring program business run-off liabilities with a third party and exiting our mono-line commercial auto business, see the division well placed for further material performance improvement. We have the right mix of product and capability to support a well-defined plan by industry and product. Ongoing cost efficiencies are also expected to contribute to margin improvement in 2017 and beyond.

### 2. European Operations

In what is arguably the most competitive insurance market in the world, the strength of the QBE franchise in the London Market is evident in continued disciplined underwriting and an increase in positive prior accident year claims development. Richard Pryce and the team delivered a strong combined operating ratio of 90.2% [1] in a year characterised by continued deterioration in trading conditions, an industry-wide increase in large risk and catastrophe claims activity and an uncertain political and economic backdrop. This is an extremely strong performance that benefited from an ongoing commitment to underwriting excellence coupled with significant operational improvement which reduced the expense base and enhanced efficiency.

The European Operations team is advancing its plans for the reorganisation of the business should it become impractical to access the European single market from the UK as a consequence of the European Union referendum outcome (Brexit).

### 3. Australian & New Zealand Operations

The strength of our distribution partnerships is playing a pivotal role in the turnaround of Australian & New Zealand Operations which commenced during the second half of 2016. In August 2016, Pat Regan was appointed Acting CEO of Australian & New Zealand Operations to lead the remediation of the business following a marked first half deterioration in the attritional claims ratio. The deterioration was due to several years of price reductions coupled with claims inflation and deterioration in the performance of the NSW CTP portfolio.

Pat and his team quickly developed a comprehensive remediation plan, with indications of successful execution evident in an improvement in the division's attritional claims ratio from 62.0% in the first half to 58.6% in the second half of 2016. An even greater improvement was achieved in the final quarter of the year.

While insurance portfolio remediation takes time, a combination of pricing increases, enhanced underwriting discipline and claims focus is expected to return the attritional claims ratio to more acceptable levels by the end of 2017.

### 4. Emerging Markets

David Fried and the Emerging Markets team delivered constant currency gross written premium growth of 10% with a stable combined operating ratio. Growth was underpinned by an enhanced focus on driving profitable growth across specialty, commercial, SME and personal lines (via strategic partners), with the stable underwriting result achieved despite several large individual risk and catastrophe claims.

The implementation of a single strategy across Asia Pacific and Latin America has supported enhanced productivity, efficiency and consistency across the division. Financial performance is benefiting from more frequent and robust technical portfolio reviews, increased utilisation of data analytics and continued portfolio remediation.

QBE is well-positioned to benefit from the additional trade and infrastructure investment expected to be generated by the emerging markets' favourable long-term economic outlook.

### 5. Equator Re

Equator Re plays an important role in assisting the Group and our four operating divisions in managing their balance sheet and capital requirements through the provision of excess of loss reinsurance protection and proportional cover. 2016 was a successful year for Equator Re, with the division recording a significantly improved combined operating ratio of 78.9% [1]. Positive prior accident year claims development was a significant contributor to the improved underwriting performance.

1 Combined operating ratio excluding discount rate impact.

## QBE's strategy

At our Investor Update held in May 2016, QBE's leadership team introduced six themes that together form the core of our strategy: to deliver on clear medium-term financial targets by building upon our differentiated position as one of only around 15 insurers that operate on a truly global basis.

As we look forward to 2017, the focus for each of these themes will continue to develop and evolve:

- **Underwriting excellence** – underwriting performance and margin will always be our primary areas of focus. QBE's commitment to underwriting excellence is evident across the divisions, whether it be continued improvement in North American Operations, the more frequent and robust portfolio reviews now being undertaken in Latin America or maintaining discipline in a challenging market in European Operations.

  We believe there is more we can do to improve underwriting performance, and we need to be adaptable as delivering underwriting excellence will sometimes require a bespoke approach. For example, the approach adopted to remediate Australian & New Zealand Operations was to divide the business into 44 "cells" with regular, detailed reviews undertaken for each cell to ensure that new underwriting plans and remediation actions are being implemented and driving desired outcomes.
- **Customer and partner-led growth** – our target is to achieve 3% premium growth across the cycle through further improvement in QBE's market position and relationships with distribution partners. During 2016, the competitive environment did not support achievement of this target due to our over-riding focus on underwriting excellence.
- **World class talent** – QBE has made a substantial investment in building, developing and retaining the very best talent. It is four years since we launched our Leadership Academy in partnership with Duke University, with over 2,350 of our leaders having participated in Academy programs. We are now undertaking a refresh of the Leadership Academy modules to support our leadership development, while 2017 will also see the full launch of our Underwriting Academy following the successful completion of pilot programs in 2016. Our objective is for every QBE underwriter to be accredited by our academy and receive a qualification that is recognised by many of the insurance bodies around the world.
- **Operational efficiency** – our 2016 expense savings target of $150 million was met and planning is well-advanced to deliver a further $150 million in expense savings by the end of 2018, with some of these savings to be reinvested in technology. In 2017, we will also look to optimise the value of our onshore and offshore service centres.
- **Claims excellence** – we expect that half of our 2018 target of $200 million in claims run-rate savings will be achieved by the end of 2017. Initiatives to combat claims fraud are an area of ongoing focus, as is efficient claims management through the sharing of global standards.
- **Data and analytics** – after establishing data and analytics as a global function in 2016, including the development of offshore support in the Philippines and in India, our focus in 2017 will be directed towards projects that support portfolio remediation, claims initiatives and customer analysis.

## In summary

I am encouraged by QBE's response to the challenges of 2016. Following the transformation initiatives of recent years our business is more streamlined and more focused. A challenging market backdrop put us to the test in 2016, and we delivered.

While QBE's transformation has been all encompassing, I am especially pleased by our success in institutionalising a customer-centric approach. Consistent with our vision for QBE to be the insurer that builds the strongest partnerships with customers, I am seeing increasing evidence of our people thinking about each client and what we can do for them as an insurer.

For many customers our whole account management approach is a real differentiator, providing visibility upfront on everything from our technical pricing capability to our claims handling approach, our risk solutions capability and our preparedness to enter into more complex financial structures, whether that be a multi-year contract or participation in a complex captive-based arrangement. This approach was pioneered in our European Operations but through cross-pollination of thought, ideas and people, is increasingly evident in how we do business elsewhere in the world, and in our ability to serve multi-jurisdiction clients.

In closing, I want to thank our stakeholders – our customers, our people, our shareholders and our business partners – for their ongoing support. I am confident that continued focus on our strategic themes and on further embedding our commitment to customer partnerships will underpin QBE's future success.

John Neal
**Group Chief Executive Officer**

# Outlook for 2017

**2017 targets:**

| | |
|---|---|
| **Gross written premium:** | **Relatively stable**[1,2] |
| **Combined operating ratio:** | **93.5%-95.0%**[3,4,5] |
| **Investment return:** | **2.5%-3.0%** |

We anticipate the market backdrop will remain challenging in 2017, although indications of modest improvement are now emerging. The rate of decline in global insurance pricing is easing and, while there is variation between markets, we anticipate that premium rates in markets other than Australia will be broadly flat in 2017. We are also encouraged by the improved US macroeconomic outlook following the presidential election, while investment income should benefit from higher bond yields in all major markets.

The QBE franchise is positioned to support growth; however, in light of the still competitive premium pricing landscape and recent exchange rate volatility, gross written premium is expected to remain relatively stable during 2017. Continuing focus on retention is key, along with select growth expected from Emerging Markets and targeted pockets within European Operations and North American Operations.

Looking beyond the current year, the medium-term targets provided at the May 2016 Investor Update are unchanged. More specifically, we remain committed to our 2018 targeted combined operating ratio of around 93% as the full benefit of our operating expense reductions and claims savings are realised. This, together with the improving outlook for investment returns, supports our long-term return on tangible equity target of 13-15%.

1 Premium target is based on assumed foreign exchange rates relative to the US dollar as follows: AUD 0.73; GBP 1.25; and EUR 1.10.
2 Net earned premium growth will likely exceed gross written premium growth due to in excess of $350 million of reinsurance cost savings achieved as a result of the restructure and refinement of the Group's 2017 reinsurance protections.
3 Assumes risk-free rates as at 31 December 2016.
4 Assumes favourable prior accident year claims development.
5 Other than the 0.5% explicit increase in the probability of adequacy of the net central estimate for potential changes to the Ogden tables (refer page 24 for further details), the target range does not allow for a potentially more extreme legislative outcome.

1 Performance overview
Business review
Governance
Directors' Report
Financial Report
Other information

# Our strategic agenda

## 2016 ACHIEVEMENTS:

### Underwriting excellence

- Establishment of underwriting hubs in Miami and Singapore to optimise use of underwriting talent in growing economies of Latin America and Asia
- Focus on core business, including growing North American Specialty and Emerging Markets
- Continued divestment of non-core businesses and remediation of underperforming lines
- Use of data and analytics to allow data-driven underwriting decisions, focused risk selection and greater pricing accuracy
- Improved stress testing of underwriting scenarios
- Group Underwriting Committee to monitor underwriting performance and drive adherence to underwriting standards and best practices
- Rollout of QBE Underwriting Academy to embed best-in-class underwriting skills and accreditation by the appropriate Insurance Institutes

### Customer and partner-led growth

- Client relationship management system and processes implemented globally
- Multinational capability improved for customers operating across multiple geographies
- Advanced customer risk management system offers clients guidance on wider risk issues
- Data and analytics used to improve understanding of customer buying habits allowing more focused support
- Premiums4Good offers customers choices of social and environmental investments
- The QBE Digital Innovation Lab carries out research into business opportunities in areas such as Internet of Things, Blockchain and machine learning

### World class talent

- The launch of the QBE Underwriting Academy saw 233 graduates complete the program in 2016, with an additional 79 trained subject matter experts
- 2,351 leaders have attended the QBE Leadership Academy to improve our bench strength at all levels
- A focus on engagement has resulted in improved scores across the business
- Diversity and inclusion statistics continue to improve towards published targets

## Operational efficiency

- Multiple initiatives generated cost savings in excess of $150 million in 2016
- A more strategic approach to cost and infrastructure management in 2017 will see further benefit realised
- In excess of $350 million reduction in 2017 external reinsurance spend
- Further use of Group Shared Services Centre to achieve cost and efficiency benefits
- We are continuing to enhance our long-term plan and strategy for technology

## Claims excellence

- Use of data and analytics for fraud prevention, claims recoveries and litigation management
- Group Chief Claims Officer, appointed to facilitate sharing of best practice, to maximise opportunities in the areas of fraud management, claims, claims supply chain management and claims leakage
- $200 million of claims benefits targeted by 2018
- Innovative use of drone technology to deliver excellent claims service to clients

## Data and analytics

- Over 70 projects in progress to embed data and analytics to create a culture of data-driven decision-making

  This includes:
  - Claims anti-fraud and subrogated recovery
  - Customer segmentation and improved customer experience
  - Agent and broker segmentation and performance
  - Underwriting exposure, loss control and pricing analytics
  - Recruitment effectiveness

# Financial and operations overview

QBE's 2016 result demonstrates continued significant positive prior accident year claims development, a materially improved return on equity, a very strong capital position and increased divisional cash remittances, which together underpinned an 8% increase in the 2016 dividend and the establishment of a three year cumulative on-market buyback facility of up to A$1 billion.

## General overview

The Group reported a net profit after tax of $844 million, up a pleasing 5% from $807 million [1] in 2015, with an increase in investment income partially offset by an adverse discount rate movement and the impact of the stronger US dollar, particularly against sterling.

On a constant currency basis, net profit after tax increased by 16%.

Return on equity improved to 8.1% from 7.5% [1] in 2015.

Cash profit after tax was $898 million, in line with the prior year but up 12% on a constant currency basis and broadly consistent with the 8% uplift in the full year dividend to shareholders.

As in previous years, I have commented below on three broad areas of focus:

1. Driving improved financial performance;
2. Investment strategy and performance; and
3. Financial strength and capital management.

Once again we have made good progress in all three areas; however, there remain some notable areas for further improvement.

1 2015 comparable figures exclude Argentina workers' compensation, M&LS deferred acquisition cost write-down as well as agency and other asset sales.

## 1. Driving improved financial performance

Our combined operating ratio was 94.0% compared with 94.0% [1] reported in 2015.

Excluding an $80 million adverse impact caused by lower risk-free rates used to discount net outstanding claims liabilities, the combined operating ratio improved significantly to 93.2% from 94.3% [1] in 2015 and compares favourably with our 2016 targeted combined operating ratio range of 94-95%.

From my perspective, there were six key themes emerging from our 2016 underwriting result:

**(a) Reserving confidence – five consecutive halves of positive prior accident year claims development**

The Group reported $366 million of positive prior accident year claims development representing 3.3% of net earned premium, up from $147 million and 1.2% respectively in 2015. Once again our European and Australian & New Zealand Operations reported significant positive prior accident year claims development, with a small net strengthening across the rest of the Group driven by our US commercial auto business which has largely been placed into run-off.

In light of this track record, it is reasonable to expect continued positive prior accident year claims development but not at the level reported in 2016.

**(b) An improved result in Australian & New Zealand Operations**

During the first half of 2016, Australian & New Zealand Operations experienced a significant deterioration in its attritional claims ratio. We have acted swiftly and decisively to address this development implementing a comprehensive remediation plan with a strong governance framework.

Key remediation initiatives undertaken to date include premium rate increases, revised policy terms and conditions, improved risk selection, tighter management and control over claims expenses (including the removal of delegated authorities where apprppriate), focused supplier management, greater emphasis on salvage and third party recoveries and enhancements to our management information lead indicators.

After an average premium rate reduction of 0.1% in the first half, Australian premium rates finished up 1.7% for the year and were up by a significant 4.5% in the fourth quarter.

While these actions will primarily benefit our 2017 result, premium rate increases achieved in the second half and reduced claims costs contributed to the 340bps improvement in our second half attritional claims ratio relative to the first half.

**(c) Another strong result in Europe with solid progress in North America**

Despite sustained challenging market conditions, European Operations delivered another outstanding result reporting a combined operating ratio of 90.2% [2]. The division recorded positive prior accident year claims development of $273 million, continuing a long track record of significant releases and again highlighting the conservative approach taken to current accident year reserving.

North American Operations' combined operating ratio improved to 97.7% [2] from 99.8% in the prior period, reflecting an outstanding Crop result and a significantly improved expense ratio that more than offset elevated large risk and catastrophe claims experience.

Pleasingly, after experiencing an uptick during the first half of 2016, North American Operations' full year underlying attritional ratio improved relative to 2015. Moreover, we successfully reinsured legacy multi-line property and casualty (program) run-off liabilities to a third party and, after significant adverse experience, exited the mono-line commercial auto segment including discontinuing the Deep South commercial trucking program. These transactions will reduce the risk profile of North American Operations and further improve earnings predictability.

**(d) Expense reduction initiatives on track**

QBE has made a good start towards achieving our targeted expense run rate savings of $300 million by 2018. During 2016, we reduced our recurring expense base by $158 million [3] in absolute terms. Notwithstanding significant investment in Group-led strategic initiatives, further material cost reductions were achieved in North American and European Operations.

The Group's underlying expense ratio improved by 0.6%, less than our targeted ~1% improvement, reflecting lower than projected net earned premium as we sacrificed top-line in order to maintain underwriting discipline.

1 2015 comparable figures exclude Argentina workers' compensation, M&LS deferred acquisition cost write-down as well as agency and other asset sales.
2 Combined operating ratio excluding discount rate impact.
3 Excluding a one-off $22 million legal provision.

**(e) Targeted reinsurance cost savings achieved**

As a result of renegotiation of the Group's outwards reinsurance protections effective 1 January 2017, we achieved reinsurance cost savings in excess of $350 million. These savings are in addition to a modest amount of reinsurance cost savings already achieved in 2016.

Reinsurance cost savings to be earned in 2017 were achieved as a result of premium rate reductions, program refinements and restructuring and scale efficiencies, as well as increased usage of our captive reinsurer, Equator Re.

Importantly, reductions to the Group's total reinsurance spend and enhancements to program terms and conditions were achieved without a significant increase in the retained risk profile of the Group.

**(f) Strong cash remittances from subsidiaries**

Cash remittances from subsidiaries increased 55% to $1,106 million compared with $715 million in 2015 and represented 123% of Group cash profit and dividend coverage of 2.1x.

### Group head office cash flows

| FOR THE YEAR ENDED 31 DECEMBER | 2016 US$M | 2015 US$M |
|---|---|---|
| **Opening head office cash balance** | **845** | 369 |
| Total divisional dividend remittances | **1,106** | 715 |
| *Interest on parent entity borrowings* | ***(81)*** | *(89)* |
| Gross organic cash flow | **1,025** | 626 |
| Dividends paid – net of DRP | **(535)** | (359) |
| Net organic cash flow | **490** | 267 |
| Other | **(328)** | 209 |
| **Closing head office cash balance** | **1,007** | 845 |

## 2. Investment performance and strategy

During 2016 we introduced further changes to our investment portfolio, continuing the process of diversifying our asset exposures and extending the duration of our fixed income portfolio to more closely match the duration of our net outstanding claims liabilities.

To this end, the composition of the fixed income portfolio was tilted further towards corporate bond exposure, funded by reductions in our holdings of government and money market securities. Moreover, the duration of the portfolio was extended from less than one year at the beginning of 2016 to almost 1.5 years at 31 December 2016. Reflective of post balance date bond market movements, duration has since been further extended to around two years.

At the same time, we introduced some infrastructure assets to the growth asset component of the portfolio, bolstering our real asset exposure and adding another source of stable and somewhat inflation protected income. Growth assets finished the year at approximately 10.3% of the portfolio compared with 11.8% at the end of 2015 and have since been increased to around 12% of the portfolio.

The blended growth asset return achieved during 2016 was 3.0% with unlisted property a key contributor. The fixed income portfolio delivered a 2.4% net return, benefiting from narrower credit spreads at the end of the year. The overall net return achieved on the global portfolio was slightly below target at 2.4%, with the shortfall driven by mark to market capital losses on longer duration fixed income securities post the US election result.

## 3. Financial strength and capital management

Despite significant investment market volatility and foreign exchange head winds, we maintained a very strong capital position throughout the year. Our APRA PCA multiple increased again to 1.79x from 1.73x a year earlier and our excess over Standard & Poor's AA equivalent capital increased materially.

As at 31 December 2016, the probability of adequacy of outstanding claims increased to 89.5% compared with 89.0% at 31 December 2015.

In conjunction with the announcement of the 2016 final dividend and to recognise the Group's already strong and increasing surplus capital position but limited franking capacity, QBE has established a three year cumulative on-market share buyback facility of up to A$1 billion, with a current target of not more than A$333 million in any one calendar year.

# Operating and financial performance

## Summary income statement

| FOR THE YEAR ENDED 31 DECEMBER | STATUTORY RESULT 2016 US$M | STATUTORY RESULT 2015 US$M | M&LS FRONTING 2016 US$M | REINSURANCE TRANSACTIONS 2016 US$M | ADJUSTED RESULT 2016[1] US$M | ADJUSTED RESULT 2015[2] US$M |
|---|---|---|---|---|---|---|
| Gross written premium | **14,395** | 15,092 | 307 | – | **14,088** | 14,782 |
| Gross earned premium revenue | **14,276** | 14,922 | 413 | – | **13,863** | 14,606 |
| Net earned premium | **11,066** | 12,314 | – | 570 | **11,636** | 12,213 |
| Net claims expense | **(6,442)** | (7,434) | – | (581) | **(7,023)** | (7,308) |
| Net commission | **(2,034)** | (2,114) | – | – | **(2,034)** | (2,116) |
| Underwriting and other expenses | **(1,922)** | (2,137) | – | – | **(1,922)** | (2,058) |
| Underwriting result | **668** | 629 | – | (11) | **657** | 731 |
| Net investment income on policyholders' funds | **407** | 402 | – | – | **407** | 368 |
| Insurance profit | **1,075** | 1,031 | – | (11) | **1,064** | 1,099 |
| Net investment income on shareholders' funds | **339** | 263 | – | – | **339** | 239 |
| Financing and other costs | **(294)** | (244) | – | – | **(294)** | (244) |
| Losses on sale of entities | – | (2) | – | – | – | – |
| Unrealised losses on assets held for sale | **(3)** | – | – | – | **(3)** | – |
| Amortisation and impairment of intangibles | **(45)** | (95) | – | – | **(45)** | (95) |
| Profit before income tax | **1,072** | 953 | – | (11) | **1,061** | 999 |
| Income tax expense | **(228)** | (260) | – | – | **(228)** | (186) |
| Profit after income tax | **844** | 693 | – | (11) | **833** | 813 |
| Net profit attributable to non-controlling interests | – | (6) | – | – | – | (6) |
| Net profit after income tax | **844** | 687 | – | (11) | **833** | 807 |

1 Presented excluding M&LS fronting and transactions to reinsure legacy US multi-line property and casualty (program) run-off liabilities and UK long-tail liabilities.

2 Excludes Argentine workers' compensation, M&LS deferred acquisition cost write-down as well as agency and other asset sales.

### Overview of the 2016 result

To assist in the explanation of the 2016 result, the 2016 statutory result in the table above is presented after excluding the following items which, although not having a material impact on profit, materially distort key performance indicators:

- M&LS was sold in 2015; however, business continues to be written by North American Operations as part of the transition services agreement (which expires in 2017) and is fully reinsured to the purchaser with no impact on net premium or profit; and
- transactions undertaken to reinsure legacy US multi-line property and casualty (program) run-off liabilities and long-tail UK liabilities, the combined impact of which was to reduce net earned premium by $570 million and net claims expense by $581 million. Although having only a minor impact on net profit, the transactions materially impact year-on-year net earned premium comparisons and underwriting ratios, depressing the net claims ratio and inflating the combined commission and expense ratio.

Unless otherwise stated, the profit and loss and underwriting result commentary following refers to the Group's result on the basis described above.

The Group achieved a 2016 net profit after tax of $833 million, up 3% from $807 million recorded in 2015. Improved investment returns driven by foreign exchange gains more than offset an $80 million pre-tax charge associated with lower risk-free rates used to discount net outstanding claims (2015 $38 million benefit) and the impact of the stronger US dollar.

Excluding amortisation of intangibles and other non-cash items, cash profit for the year was $898 million, up slightly from $893 million reported in 2015 but up 12% on a constant currency basis.

On a constant currency basis and excluding M&LS premium written in 2015, gross written premium increased 1%, reflecting growth in Emerging Markets and Australian & New Zealand Operations, partially offset by contraction in European Operations and exacerbated by the ongoing competitive global premium pricing landscape. On the same basis, net earned premium increased 2% relative to the prior period, reflecting top line premium growth and reduced reinsurance spend.

The statutory combined operating ratio improved to 94.0% from 94.9% in the prior period despite the significant reduction in risk-free rates used to discount net outstanding claims. Excluding this impact, the combined operating ratio improved to 93.2% from 95.2% in 2015, mainly reflecting an increase in positive prior accident year claims development and an improved expense ratio, partially offset by a higher (largely Australian driven) attritional claims ratio.

The net investment return on policyholders' funds increased to 2.6% from 2.1% in the prior period, largely due to a $40 million foreign exchange gain. Excluding foreign exchange gains and other income, the net return on policyholders' funds improved slightly to 2.4% from 2.3% in 2015. This reflected higher fixed income returns on the back of reduced risk-free rates and narrower credit spreads, partially offset by significantly reduced growth asset returns. Although broadly in line with our original budget, this was less than our 2.7% return expectation announced with the release of our interim result, reflecting the significant sell-off in global bond markets during the final quarter of 2016.

The Group recorded an insurance profit of $1,064 million, down 3% from $1,099 million in the prior period, with the adverse discount rate impact largely offset by higher investment income on policyholders' funds.

Investment income on shareholders' funds increased 42% to $339 million from $239 million in the prior period. This reflected a foreign exchange gain of $85 million and higher fixed income returns on the back of reduced risk-free rates and narrower credit spreads, partially offset by lower growth asset returns (although strategic investments performed strongly relative to the prior period).

Financing and other costs increased to $294 million from $244 million in 2015, largely due to a $30 million cost of discontinuing certain North American agency arrangements and a $12 million write-down of contingent consideration on the sale of the Australian Agencies in 2015.

The effective statutory tax rate fell to 21% from 27% in the prior period and reflects the mix of statutory tax rates in the jurisdictions in which QBE operates. The 2015 rate was higher than expected due to derecognition of deferred tax in Australia and Europe.

## Cash profit

| FOR THE YEAR ENDED 31 DECEMBER | 2016 US$M | 2015 US$M |
|---|---|---|
| Cash profit before tax | 1,147 | 1,096 |
| Tax expense on cash profit | (249) | (197) |
| Profit attributable to non-controlling interests | – | (6) |
| Net cash profit after tax | 898 | 893 |
| Losses on sale of entities after tax | – | (94) |
| M&LS deferred acquisition cost write-down after tax | – | (27) |
| Amortisation and impairment of intangibles after tax [1] | (54) | (85) |
| Net profit after tax | 844 | 687 |
| Return on average shareholders' funds | 8.1% | 6.4% |
| Basic earnings per share – cash basis (US cents) | 65.6 | 65.3 |
| Dividend payout ratio (percentage of cash profit) | 51% | 56% |

1 $29 million of pre-tax amortisation expense is included in underwriting expenses (2015 $26 million).

## Premium income

Gross written premium decreased 5% to $14,088 million from $14,782 million in the prior period, reflecting the stronger US dollar (especially against sterling) and the sale of the M&LS business effective 1 October 2015.

On an average basis and compared with 2015, the Australian dollar, sterling and the euro depreciated against the US dollar by 0.9%, 11.6% and 0.4% respectively, adversely impacting gross written premium by $526 million.

On a constant currency basis and excluding $383 million of M&LS premium written in 2015, gross written premium increased 1%, reflecting growth in Emerging Markets and Australian & New Zealand Operations, partially offset by contraction in European Operations and exacerbated by the ongoing competitive global premium pricing landscape.

Group-wide premium rate reductions averaged 0.1% during 2016, an improvement relative to the 1.3% average reduction in 2015 and indicating a second half recovery following the 1.3% average rate reduction during the first half of 2016. While the majority of QBE's underwriters would classify current market conditions as remaining highly competitive, rate reductions are moderating in global reinsurance and there are clear signs of price hardening in Australia and New Zealand. Pricing was flat in North America with rate increases in personal lines and Specialty more than offset by ongoing weakness in catastrophe exposed commercial property. Pricing trends remain negative in European Operations with competition for new business being particularly acute. Premium rates remain highly competitive in Asia-Pacific although the average premium rate reduction was less than anticipated.

Excluding M&LS, North America achieved a 2% increase in gross written premium. Strong growth in Specialty and modest growth in consumer affiliated business on the back of rising housing starts outpaced declines across Property & Casualty (exacerbated by significant commercial auto remediation) and Crop.

European Operations recorded a 3% reduction in gross written premium on a constant currency basis. This is a pleasing outcome in light of the competitive pricing landscape which saw average premium rate reductions of 2.4% during the year and ongoing pressures associated with the impact of lower commodity prices, especially in the oil and gas sector. Evidencing the division's commitment to maintaining underwriting discipline, a number of significant underperforming accounts and facilities were not renewed during 2016.

Australian & New Zealand Operations reported gross written premium growth of 5% on a constant currency basis, including premium rate increases averaging 1.2%. Strong growth was achieved in compulsory third party (CTP) liability business as a result of significant premium rate increases in the NSW scheme, coupled with our entry into the recently privatised South Australian CTP market from 1 July 2016.

Emerging Markets achieved gross written premium growth of 10% on a constant currency basis, with growth in Asia Pacific and Latin America of 3% and 16% respectively. In Asia Pacific, strong growth in Malaysia, Papua New Guinea, Vietnam, Fiji and Solomon Islands supplemented the modest growth in Hong Kong and Singapore. Premium rate reductions averaged 0.1%. In Latin America, the impact of the ongoing remediation of the Colombian SOAT portfolio and a recession driven premium decline in Ecuador was more than offset by strong growth in Argentina, Brazil and Mexico with average (inflation driven) premium rate increases of 4.1%.

Excluding M&LS, the Group's reinsurance expense ratio fell to 16.1% of gross earned premium from 16.7% in the prior period, reflecting early savings from the refinement and restructuring of the Group's external reinsurance programs.

On a constant currency basis and excluding $375 million of 2015 M&LS premium, net earned premium increased 2% to $11,636 million, reflecting gross written premium growth coupled with reduced reinsurance spend.

## Underwriting performance

### Key ratios – Group

| FOR THE YEAR ENDED 31 DECEMBER | 2016 | | 2015 | |
|---|---|---|---|---|
| | STATUTORY % | %[1] | STATUTORY % | ADJUSTED[2] % |
| Net claims ratio | **58.2** | **60.4** | 60.4 | 59.8 |
| Net commission ratio | **16.4** | **17.5** | 17.2 | 17.3 |
| Expense ratio | **17.4** | **16.5** | 17.3 | 16.9 |
| Combined operating ratio | **94.0** | **94.4** | 94.9 | 94.0 |
| Combined operating ratio ex risk-free rate movement[3] | **93.2** | **93.7** | 95.2 | 94.3 |
| Insurance profit margin | **9.7** | **9.1** | 8.4 | 9.0 |

1 Presented excluding transactions to reinsure legacy US multi-line property and casualty (program) run-off liabilities and UK long-tail liabilities.

2 Excludes Argentine workers' compensation and M&LS deferred acquisition cost write-down.

3 Excludes the impact of changes in risk-free rates used to discount net outstanding claims.

## Divisional performance

### Contributions by region

| FOR THE YEAR ENDED 31 DECEMBER | GROSS WRITTEN PREMIUM 2016 US$M | GROSS WRITTEN PREMIUM 2015 US$M | NET EARNED PREMIUM 2016 US$M | NET EARNED PREMIUM 2015 US$M | COMBINED OPERATING RATIO 2016 % | COMBINED OPERATING RATIO 2015 % | INSURANCE PROFIT BEFORE INCOME TAX 2016 US$M | INSURANCE PROFIT BEFORE INCOME TAX 2015 US$M |
|---|---|---|---|---|---|---|---|---|
| North American Operations | **4,647** | 4,961 | **3,318** | 3,666 | **97.8** | 99.2 | **156** | 93 |
| European Operations | **4,076** | 4,366 | **3,115** | 3,454 | **91.6** | 89.1 | **314** | 464 |
| Australian & New Zealand Operations | **3,933** | 3,787 | **3,410** | 3,282 | **92.7** | 91.3 | **418** | 467 |
| Emerging Markets | **1,632** | 1,728 | **1,128** | 1,436 | **99.6** | 99.2 | **73** | 71 |
| Equator Re | **1,349** | 1,007 | **488** | 367 | **70.7** | 89.0 | **194** | 103 |
| Equator Re elimination | **(1,349)** | (1,007) | **–** | – | **–** | – | **–** | – |
| Corporate and other adjustments | **(200)** | (80) | **(3)** | 8 | **–** | 0.1 | **(60)** | (99) |
| Group | **14,088** | 14,782 | **11,636** | 12,213 | **94.4** | 94.0 | **1,064** | 1,099 |
| M&LS fronting[1] | **307** | 131 | **–** | (77) | **–** | – | **–** | – |
| Reinsurance transactions | **–** | – | **(570)** | – | **101.9** | – | **11** | – |
| Other 2015 adjustments | **–** | 179 | **–** | 178 | **–** | 134.3 | **–** | (68) |
| **Group statutory** | **14,395** | 15,092 | **11,066** | 12,314 | **94.0** | 94.9 | **1,075** | 1,031 |
| Direct and facultative | **13,369** | 14,138 | **10,219** | 11,511 | **94.3** | 95.2 | **958** | 921 |
| Inward reinsurance | **1,026** | 954 | **847** | 803 | **90.0** | 90.2 | **117** | 110 |
| **Group statutory** | **14,395** | 15,092 | **11,066** | 12,314 | **94.0** | 94.9 | **1,075** | 1,031 |

1 The M&LS fronting transaction incepted on 1 October 2015 and had no subsequent impact on the net underwriting result or insurance profit.

### Incurred claims

The Group's net claims ratio increased to 60.4% from 59.8% in the prior period, reflecting an increase in the attritional claims ratio coupled with an adverse impact from lower risk-free rates used to discount net outstanding claims, largely offset by increased positive prior accident year claims development.

The following table provides a summary of the major components of the 2016 net claims ratio.

### Analysis of net claims ratio

| FOR THE YEAR ENDED 31 DECEMBER | 2016 | | 2015 | |
|---|---|---|---|---|
| | STATUTORY % | %[1] | STATUTORY % | ADJUSTED %[2] |
| Attritional claims | **54.9** | **52.2** | 51.9 | 49.9 |
| Large individual risk and catastrophe claims | **9.6** | **9.1** | 8.7 | 8.7 |
| Claims settlement costs | **2.9** | **2.8** | 3.0 | 3.0 |
| Claims discount | **(1.9)** | **(1.9)** | (3.9) | (1.7) |
| Net incurred central estimate claims ratio (current accident year) | **65.5** | **62.2** | 59.7 | 59.9 |
| Changes in undiscounted prior accident year central estimate | **(3.3)**[3] | **(3.1)**[3] | (1.1)[4] | (1.2)[5] |
| Impact of one-off reinsurance transactions[6] | **(5.2)** | **–** | – | – |
| Changes in discount rates | **0.7** | **0.7** | (0.3) | (0.3) |
| Other (including unwind of prior year discount) | **0.5** | **0.6** | 2.1 | 1.4 |
| Net incurred claims ratio (current financial year) | **58.2** | **60.4** | 60.4 | 59.8 |

1 Presented excluding transactions to reinsure legacy US multi-line property and casualty (program) run-off liabilities and UK long-tail liabilities.
2 Excludes Argentine workers' compensation and M&LS deferred acquisition cost write-down.
3 Net of discount movement ($8 million cost) due to long-tail classes including dust disease in Australia and our retained Argentine business, where the level of assumed claims inflation is directly linked to the discount rate.
4 Net of discount movement ($214 million release) due to long-tail classes including dust disease in Australia and motor third party bodily injury and workers' compensation in Argentina, where the level of assumed claims inflation is directly linked to the discount rate.
5 Net of discount movement ($53 million release) due to long-tail classes including dust disease in Australia and motor third party bodily injury in Argentina, where the level of assumed claims inflation is directly linked to the discount rate.
6 Impact of transactions to reinsure legacy US multi-line property and casualty (program) run-off liabilities and UK long-tail liabilities.

The table below provides an analysis of the Group's current accident year attritional claims ratio excluding various influences that distort movement in the reported attritional claims ratio.

### Analysis of attritional claims ratio

| FOR THE YEAR ENDED 31 DECEMBER | 2016 | | 2015[1] | |
|---|---|---|---|---|
| | NEP US$M | ATTRITIONAL % | NEP US$M | ATTRITIONAL % |
| Rest of world | **11,093** | **51.9** | 11,282 | 49.3 |
| Crop insurance | **543** | **59.0** | 556 | 69.0 |
| M&LS[2] | **–** | **–** | 375 | 38.3 |
| QBE Group[3] | **11,636** | **52.2** | 12,213 | 49.9 |

1 Prior year analysis included an adjustment for $289 million of incremental group large individual risk and catastrophe (GLRC) aggregate reinsurance premium expense reflecting the purchase of the GLRC effective 1 January 2015. This adjustment is no longer relevant since both periods now include a similar level of GLRC premium expense.
2 M&LS was sold effective 1 October 2015.
3 2016 presented excluding transactions to reinsure legacy US multi-line property and casualty (program) run-off liabilities and UK long-tail liabilities.

Excluding US crop and the M&LS business that was sold effective 1 October 2015, the underlying attritional claims ratio for the remainder of the portfolio deteriorated to 51.9% from 49.3% in the prior period reflecting:

- a 1.6% increase driven by Australian & New Zealand Operations reflecting increased NSW CTP claims frequency, business mix changes (including increased CTP), higher short-tail claims costs (including parts and repair costs) and heightened trade credit claims frequency. While the attritional claims ratio increased materially to 60.2% from 55.1% in 2015, the attritional claims ratio improved from 62.0% in the first half to 58.6% in the second half of 2016;
- a 0.9% increase caused by European Operations and largely reflecting a distorting impact from the dramatic devaluation of sterling, whereby premium written in currencies other than sterling was earned at higher historical rates relative to related claims expense. On a constant currency basis, European Operations' underlying attritional claims ratio was stable. Assuming future stability of sterling, this currency effect is not expected to have a lasting impact;
- a slightly adverse divisional business mix impact driven by growth in proportional business retained by Equator Re, particularly North American Specialty; and
- a minor improvement in the attritional claims ratios in North American Operations and Emerging Markets.

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Large individual risk and catastrophe claims net of reinsurance are summarised in the table below.

### Large individual risk and catastrophe claims

| IN THE YEAR ENDED 31 DECEMBER 2016 | COST US$M | % OF NEP |
|---|---|---|
| Total catastrophe claims | **439** | **3.8** |
| Total large individual risk claims | **617** | **5.3** |
| Total large individual risk and catastrophe claims | **1,056** | **9.1** |

| IN THE YEAR ENDED 31 DECEMBER 2015 | COST US$M | % OF NEP |
|---|---|---|
| Total catastrophe claims | 424 | 3.4 |
| Total large individual risk claims | 643 | 5.3 |
| Total large individual risk and catastrophe claims | 1,067 | 8.7 |

In light of the Group's multi-year aggregate reinsurance, it is not surprising that the total net cost of large individual risk and catastrophe claims was stable at $1,056 million compared with $1,067 million in the prior period. However, the gross cost before aggregate reinsurance recoveries increased significantly reflecting heightened individual risk and catastrophe claims experience compared with a particularly benign 2015.

As summarised in the table below, the currency weighted average risk-free rate (excluding the Argentine peso) used to discount net outstanding claims liabilities was volatile during 2016, falling substantially from 1.62% at 31 December 2015 to 0.92% at 30 June 2016, then partially recovering to 1.33% as at 31 December 2016. Although US dollar risk-free rates finished 2016 up relative to the prior year, sterling and euro risk-free rates remained well below prior year levels while Australian risk-free rates were relatively stable year on year.

### Movement in weighted average risk-free rates

| CURRENCY | | 31 DECEMBER 2016 | 30 JUNE 2016 | 31 DECEMBER 2015 | 30 JUNE 2015 | 31 DECEMBER 2014 |
|---|---|---|---|---|---|---|
| Australian dollar | % | **2.26** | 1.77 | 2.37 | 2.43 | 2.46 |
| US dollar | % | **2.04** | 1.20 | 1.80 | 1.59 | 1.33 |
| Sterling | % | **0.66** | 0.56 | 1.47 | 1.53 | 1.30 |
| Euro | % | **0.19** | (0.16) | 0.59 | 0.75 | 0.58 |
| **Group weighted average (ex Argentine peso)** | **%** | **1.33** | 0.92 | 1.62 | 1.60 | 1.45 |
| **Estimated impact of discount rate movement**[1] | **$M** | **(80)** | (283) | 38 | 45 | (324) |

1 Excludes discount rate impact due to changes in yields for our Australian dust disease and Argentine peso denominated liabilities, where the level of assumed inflation is directly linked to the discount rate.

The reduction in risk-free rates gave rise to an adverse underwriting impact of $80 million that increased the net claims ratio by 0.7% compared with a benefit of $38 million in the prior period which reduced the net claims ratio by 0.3%.

The result also included $366 million of positive prior accident year claims development that benefited the claims ratio by 3.1% compared with $147 million or 1.2% in the prior period. This is the fifth consecutive half of positive development that has averaged $130 million or 2.1% of net earned premium per half over that period.

Excluding a small corporate adjustment, the Group's $366 million of positive prior accident year claims development comprised:

- European Operations once again reported strong positive development of $273 million, up slightly from $254 million in 2015, with favourable development spread across multiple portfolios in the insurance and reinsurance divisions;
- Australian & New Zealand Operations recorded $147 million of positive development, up from $120 million in the prior period, due to the emergence of favourable development across NSW CTP and long-tail portfolios;
- North American Operations incurred $121 million of adverse development, up from $85 million in the prior corresponding period, the vast majority of which related to now terminated and reinsured mono-line commercial auto business which experienced heightened claims frequency and severity;
- Emerging Markets reported $17 million of positive development, up from $11 million in the prior period, with favourable trends emerging in Singapore, Malaysia, Argentina and Ecuador; and
- Equator Re experienced $56 million of positive claims development compared with $120 million of adverse development in 2015, largely reflecting increased recoveries on a Group aggregate risk reinsurance program that experienced significantly adverse (largely currency related) development in 2015.

### Commission and expenses

The Group's combined commission and expense ratio improved marginally to 34.0% from 34.2% in the prior period.

The commission ratio increased slightly to 17.5% from 17.3% in 2015, reflecting relatively strong growth in the higher commission paying Emerging Markets division coupled with a business mix driven increase in the commission expense ratio of Australian & New Zealand Operations and Equator Re.

The Group's expense ratio improved to 16.5% from 16.9% in the prior period, due to a $136 million net reduction in operating expenses. This included a $115 million reduction in costs as a result of the sale of the M&LS business effective 1 October 2015, much of which is reflected in the significant improvement in North America's expense ratio during 2016, and is net of significant investment in Group-led strategic initiatives.

Excluding a one-off $22 million legal provision, the Group's underlying expense ratio improved by 0.6%, slightly less than our targeted ~1% improvement reflecting lower than projected net earned premium.

Net earned premium fell short of expectations in a number of portfolios/territories including as a result of significantly lower Crop premium due to higher than budgeted government cessions on the back of a better than expected Crop underwriting result. Premium levels were also adversely impacted by lower than expected commercial auto premium as a result of aggressive remediation as well as the decision not to renew a number of significant underperforming accounts and facilities in our European Operations.

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## Income tax expense

The Group's statutory income tax expense of $228 million compared with $260 million in the prior period and equated to an effective tax rate of 21% compared with 27% in 2015. The current rate reflects the mix of statutory tax rates in the jurisdictions in which QBE operates. The prior year rate was higher than expected due to derecognition of deferred tax in Australia and Europe.

QBE paid $203 million in corporate income tax to tax authorities globally in the year to 31 December 2016, including $120 million in Australia. Income tax payments in Australia benefit our dividend franking account, the balance of which stood at A$301 million as at 31 December 2016. The Group is therefore capable of fully franking A$702 million of dividends.

The combination of a higher payout ratio and increased profitability of non-Australian operations is anticipated to reduce the franking account balance and shareholders should therefore expect the franking account percentage to reduce to around 30% in 2017 and 2018.

## Foreign exchange

As a significant proportion of our underwriting activity is denominated in US dollars, the Group's financial statements are presented in this currency. Assets and liabilities of all our foreign operations that have a functional currency different from the Group's presentation currency are translated to US dollars at the closing balance date rates of exchange and income and expenses are translated at average rates of exchange for the period, with the foreign exchange movements reported through the foreign currency translation reserve (component of equity).

QBE is also exposed to currency translation risk in relation to the ultimate parent entity's net investment in foreign operations (NIFO) to its functional currency of Australian dollars. QBE does not ordinarily seek to use derivatives to mitigate this risk for the following reasons:

- currency translation gains and losses generally have no cash flow;
- currency translation gains and losses are accounted for in the foreign currency translation reserve and therefore do not impact profit or loss unless related to the disposal of an entity; and
- management of translation risk needs to be balanced against the impact on capital requirements and liquidity risk.

In extended periods of extraordinary volatility, QBE may elect to utilise derivatives to mitigate currency translation risk in order to preserve capital. Brexit is considered such an example and the Group commenced a GBP NIFO hedging program in early July.

The Group is exposed to foreign exchange risk from its various activities in the normal course of writing insurance business and aims to minimise the impact on profit or loss through the timely matching of currency assets and liabilities, with the use of currency derivatives to manage residual exposures. Foreign exchange gains or losses arising from such foreign currency exposures are reported in profit or loss, consistent with the gains or losses from related forward foreign exchange contracts. The impact of operational exchange movements in 2016 was a pre-tax gain of $125 million compared with a loss of $20 million in the prior year. The volatility of foreign exchange rates (particularly sterling) around the period following the Brexit vote combined with our hedging strategy resulted in a larger than usual foreign exchange gain in the second half of 2016.

The table below shows the impact of foreign exchange on the 2016 result and balance sheet on a constant currency basis.

### Impact of exchange rate movements

| | 2016 ACTUAL US$M | 2016 AT 2015 EXCHANGE RATES [1] US$M | EXCHANGE RATE IMPACT US$M | EXCHANGE RATE IMPACT % |
|---|---|---|---|---|
| Gross written premium | 14,395 | 14,921 | (526) | (4) |
| Gross earned premium | 14,276 | 14,782 | (506) | (4) |
| Net earned premium | 11,066 | 11,533 | (467) | (4) |
| Net profit after tax | 844 | 939 | (95) | (11) |
| Total investments and cash | 25,235 | 27,086 | (1,851) | (7) |
| Total assets | 41,583 | 44,813 | (3,230) | (8) |
| Gross outstanding claims provision | 18,321 | 20,134 | (1,813) | (10) |
| Total liabilities | 31,249 | 33,824 | (2,575) | (8) |
| Net assets | 10,334 | 10,989 | (655) | (6) |

1 Income statement items are restated to 31 December 2015 average rates of exchange and balance sheet items to 31 December 2015 closing rates of exchange.

## Balance sheet

### Capital management summary

Consistent with a significantly strengthened capital position, during 2016 Standard & Poor's changed the Group's outlook from "stable" to "positive" with Standard & Poor's further referring to QBE Group's capital adequacy as being "at the AA level".

A.M. Best and Fitch both reaffirmed the Group's financial strength and issuer credit ratings at "stable".

The Group undertook a number of capital management initiatives over the course of 2016, essentially replacing tier 2 debt subject to regulatory capital decay with new capital qualifying tier 2 subordinated debt.

Each transaction is discussed separately overleaf.

### Capital summary

| AS AT 31 DECEMBER | 2016 US$M | 2015 US$M |
|---|---|---|
| Net assets | **10,334** | 10,560 |
| Less: intangible assets | **(3,627)** | (3,604) |
| Net tangible assets | **6,707** | 6,956 |
| Add: borrowings | **3,474** | 3,529 |
| Total capitalisation | **10,181** | 10,485 |

| AS AT 31 DECEMBER | 2016[1] US$M | 2015[2] US$M |
|---|---|---|
| QBE's regulatory capital base | **9,277** | 9,737 |
| APRA's Prescribed Capital Amount (PCA) | **5,184** | 5,637 |
| PCA multiple | **1.79x** | 1.73x |

1 Indicative APRA PCA calculation at 31 December 2016.
2 Prior year APRA PCA calculation has been restated to be consistent with APRA returns finalised subsequent to year end.

At 31 December 2016, the Group's indicative APRA PCA multiple was 1.79x, up from 1.73x a year earlier and our excess over and above Standard & Poor's minimum AA equivalent capital requirement further increased.

In light of the extent to which our capital position now exceeds Standard & Poor's minimum AA equivalent capital requirement, we remain comfortable with our regulatory capital position at around 1.7x PCA.

### Key financial strength ratios

| AS AT 31 DECEMBER | BENCHMARK | | 2016 | 2015 |
|---|---|---|---|---|
| Debt to equity | 25% to 35% | % | **33.6%** | 33.6% |
| Debt to tangible equity | | % | **52.2%** | 51.1% |
| PCA multiple[1] | 1.6x to 1.8x | x | **1.79x** | 1.73x |
| Premium solvency[2] | | % | **60.6%** | 58.5% |
| Probability of adequacy of outstanding claims | 87.5% to 92.5% | % | **89.5%** | 89.0% |

1 Prior year APRA PCA calculation has been restated to be consistent with APRA returns finalised subsequent to year end.
2 Premium solvency ratio is calculated as the ratio of net tangible assets to net earned premium.

## Borrowings

As at 31 December 2016, the Group's total borrowings stood at $3,474 million, down a modest $55 million or 2% from $3,529 million a year earlier.

During 2016, the Group established:

- a $600 million two year committed revolving credit facility, which matures on 31 March 2018. The facility was undrawn at year end;
- a $4 billion medium term note issuance program in May 2016 which allows QBE to issue senior unsecured notes, capital qualifying tier 2 subordinated debt securities and additional tier 1 securities to non-US investors and subsequently incorporated the ability to issue to US investors in October 2016; and
- a $1.7 billion committed standby letter of credit facility with a $300 million accordion feature. This facility was created for the purpose of providing letters of credit to support the Group's Funds at Lloyd's requirement.

The Group also executed the following transactions during the year:

- a tender exchange for £325 million tier 2 subordinated debt securities due 24 May 2041. £291 million was tendered and exchanged for £327 million of new tier 2 subordinated debt securities maturing 24 May 2042;
- the call of £300 million of perpetual capital securities on their first call date. This transaction closed on 18 July 2016. As a result of a previous liability management exercise, QBE already owned £292 million of these securities;
- an intermediated tender exchange for $1.0 billion tier 2 subordinated debt securities due 24 May 2041. $456 million was tendered and exchanged for $524 million of new tier 2 subordinated debt securities maturing 17 June 2046; and
- a tender exchange for the full residual of $1.0 billion tier 2 subordinated debt securities due 24 May 2041 which were not exchanged as part of the intermediated tender. $372 million was tendered and exchanged for $372 million of new tier 2 subordinated debt securities maturing 21 November 2043. We issued an additional $28 million of new tier subordinated debt securities maturing 21 November 2043 at an above par price of 111.5% to bring the total issuance to $400 million.

The sterling tender exchange, the US dollar intermediated tender exchange and the US dollar tender exchange transactions were designed to both:

- further optimise the Group's capital efficiency. On 1 January 2016, the Group had $1.4 billion of tier 2 subordinated debt that had become subject to $224 million of annual regulatory capital amortisation. As a result of these transactions the annual regulatory capital amortisation has been reduced to $33 million; and
- layer additional duration into the maturity profile and normalise the Group's annual funding requirements.

At 31 December 2016, QBE's ratio of borrowings to shareholders' funds was 33.8%, up 0.2% from a year earlier and within our benchmark range of 25%-35%. Debt to tangible equity was 52.2%, up marginally from 51.1% at 31 December 2015, having been adversely impacted by the stronger US dollar.

Interest expense on borrowings for the year was $213 million, down 1% from $215 million for the same period last year. The weighted average annual cash cost of borrowings outstanding at the balance sheet date reduced from 6.2% at 31 December 2015 to 5.9% at 31 December 2016.

All debt issuance in 2016 was undertaken by way of regulatory capital qualifying tier 2 subordinated debt. The weighting towards regulatory capital qualifying tier 2 within the Group's overall borrowing mix was stable at 74%, with incremental duration being built in to the term structure.

### Borrowings maturity [1]

| AS AT 31 DECEMBER | 2016 % | 2015 % |
|---|---|---|
| Less than one year | 9 | – |
| One to five years | 27 | 30 |
| More than five years | 64 | 70 |

1 Based on first call date.

### Borrowings profile

| AS AT 31 DECEMBER | 2016 % | 2015 % |
|---|---|---|
| Subordinated debt | 74 | 74 |
| Senior debt | 17 | 17 |
| Capital securities | 9 | 9 |

Further details of borrowings are set out in note 5.1 to the financial statements.

## Net outstanding claims liabilities

| AS AT 31 DECEMBER | 2016 US\$M | 2015[1] US\$M | 2014 US\$M | 2013 US\$M | 2012 US\$M |
|---|---|---|---|---|---|
| Net outstanding claims | **13,781** | 15,379 | 16,948 | 18,208 | 18,412 |
| Central estimate – outstanding claims | **12,693** | 14,119 | 15,595 | 16,643 | 17,079 |
| Risk margin – outstanding claims | **1,088** | 1,260 | 1,353 | 1,565 | 1,333 |
| | **13,781** | 15,379 | 16,948 | 18,208 | 18,412 |
| | **%** | % | % | % | % |
| Probability of adequacy – outstanding claims | **89.5** | 89.0 | 88.7 | 90.7 | 87.5 |
| Weighted average discount rate | **1.5** | 1.9 | 1.7 | 2.8 | 2.2 |
| Weighted average term to settlement (years) | **2.9** | 3.0 | 2.8 | 3.0 | 2.9 |

1 Excludes Argentine workers' compensation business that was held for sale at 31 December 2015.

The table above summarises our provision for net outstanding claims liabilities, separately identifying the central estimate and risk margin.

As required by Australian Accounting Standards, net outstanding claims liabilities are discounted by applying sovereign bond rates as a proxy for risk-free interest rates and not the actual earning rate on our investments.

The probability of adequacy of outstanding claims increased to 89.5% compared with 89.0% at 31 December 2015. Net profit after tax would have increased by \$16 million if the probability of adequacy was maintained at 89.0%.

As at 31 December 2016, risk margins in net outstanding claims were \$1,088 million or 8.6% of the net central estimate of outstanding claims compared with \$1,260 million or 8.9% of the net central estimate of outstanding claims at 31 December 2015. The decrease in the risk margin of \$172 million includes a foreign exchange movement of \$39 million and a constant currency reduction of \$132 million.

The reduction in the absolute level of risk margins during the period cannot be considered in isolation and reflects the following significant impacts:

- reduced volatility in the net discounted central estimate as a result of both a track record of positive prior accident year claims development and transactions to reinsure legacy US multi-line property and casualty (program) run-off liabilities and UK long-tail liabilities;
- the growing proportion of outstanding claims liabilities protected against adverse deterioration by the Group's large individual risk and catastrophe aggregate reinsurance program, purchased since 1 January 2015; and
- the impact of foreign exchange which has reduced both the net central estimate and risk margins in absolute terms.

Partly offsetting the above, QBE has elected to increase the level of risk margin to reflect potential changes to statutory discount rates in relation to UK personal injury claims liabilities. Whilst the UK Ministry of Justice is expected to announce a change to the statutory rates (Ogden tables), no details of the change have been published as at the date of this report. The current allowance in the risk margin assumes a reduction in the statutory rate of around 1% (i.e. a proposed rate of 1.5% compared with the current legislated rate of 2.5%) which QBE estimates would increase the net central estimate by \$33 million. If the statutory rate reduced by a further 0.5%, this would equate to an additional increase in the net central estimate of \$20 million. Beyond this allowance, each 0.5% reduction down to a zero statutory rate would increase the net central estimate by around \$28 million, albeit that the impact is not linear.

### Intangible assets

As at 31 December 2016, the carrying value of intangible assets (identifiable intangibles and goodwill) was $3,627 million, up marginally from $3,604 million at 31 December 2015.

During the year, the carrying value of intangibles increased by $23 million primarily due to the capitalisation of expenditure in relation to various information technology projects across the Group and costs associated with the purchase of our 35% fixed share of the South Australian CTP liability market, largely offset by amortisation and exchange rate movements.

At 31 December 2016, QBE reviewed all material intangibles for indicators of impairment, consistent with the Group's policy and the requirements of the relevant accounting standard. A detailed impairment test was completed in relation to our North American goodwill balance ($1,543 million), which indicated headroom at the balance date of $98 million compared with $196 million at 31 December 2015 and $79 million at 30 June 2016. The valuation remains highly sensitive to a range of assumptions, in particular to increases in the forecast combined operating ratio used in the terminal value calculation and changes in discount rate and long-term investment return assumptions.

Details of the sensitivities associated with this valuation are included in note 7.2.1 to the financial statements.

## Investment performance and strategy

2016 was a very eventful year in terms of geopolitical and investment market developments, with significant volatility experienced throughout the year.

Bond yields in aggregate ended the year little changed from where they began, with QBE's currency-weighted two year sovereign bond yields falling 14bps to 1.0% and the 10 year equivalent falling 16bps to 2.14%.

The year included two very distinct halves in terms of investment performance. During the first half of 2016, yields fell sharply (100bps on 10 year sovereign bonds) from already historically low levels, exacerbated by the Brexit vote in late June. During the second half of the year, bond markets reversed their course with a significant steepening of global yield curves precipitated by the surprise outcome of the US election result in early November.

Credit spreads were somewhat more stable by comparison, although averaged higher levels in the first half of the year before settling into a lower range and ending the year a little tighter.

After a poor start to the year, equity markets moved higher, recovering quickly from the Brexit vote and even more quickly from the unanticipated Trump victory, to end the year having posted reasonable returns in aggregate.

The portfolio underwent some notable changes during 2016. Modified asset duration was extended from 0.9 years to 1.5 years, introducing a degree of stabilisation into performance volatility from an investment return perspective but also consistent with our strategy of reducing the mismatch between asset and liability duration over time. Although we added further modest exposure to structured credit and corporate bond holdings, the credit quality of the portfolio remains conservative relative to global peers. We also altered the mix of our allocation to alternative investments, introducing infrastructure assets for increased transparency, predictability and stability of returns but also to raise the real asset/inflation protection component of the portfolio.

Spread duration, the key measure of our sensitivity to changes in credit spreads, finished the year at a similar level to where it began at around 1.4 years; however, again it was a tale of two halves. credit duration was extended during the first half as spreads widened, then subsequently reduced as a result of profit-taking as spreads narrowed toward the end of the year.

The fixed income portfolio benefited from credit spreads finishing the year tighter and delivered a 2.4% return. Growth assets delivered a blended return of 3.0% with unlisted property a key contributor. The overall net portfolio return was slightly below target at 2.4%, with the return shortfall largely driven by mark-to-market capital losses on longer duration fixed income securities post the US election result.

Looking ahead, we expect recent market volatility to continue and will maintain our conservative stance enabling us to take advantage of any further market dips to enhance portfolio returns.

## Total net investment income

| FOR THE YEAR ENDED 31 DECEMBER | POLICYHOLDERS' FUNDS 2016 US$M | POLICYHOLDERS' FUNDS 2015 US$M | SHAREHOLDERS' FUNDS 2016 US$M | SHAREHOLDERS' FUNDS 2015 US$M | TOTAL 2016 US$M | TOTAL 2015 US$M |
|---|---|---|---|---|---|---|
| Income on growth assets | **45** | 140 | **41** | 85 | **86** | 225 |
| Fixed interest, short-term money and cash income | **341** | 264 | **220** | 160 | **561** | 424 |
| Gross investment income [1] | **386** | 404 | **261** | 245 | **647** | 649 |
| Investment expenses | **(15)** | (16) | **(9)** | (10) | **(24)** | (26) |
| Net investment income | **371** | 388 | **252** | 235 | **623** | 623 |
| Foreign exchange gain (loss) | **40** | (14) | **85** | – | **125** | (14) |
| Other income | **–** | 4 | **2** | 4 | **2** | 8 |
| Other expenses | **(4)** | (10) | **–** | – | **(4)** | (10) |
| Net investment and other income | **407** | 368 | **339** | 239 | **746** | 607 |

1 Includes total realised and unrealised gains on investments of $109 million (2015 $92 million) comprising gains on investments supporting policyholders' funds of $62 million (2015 $57 million) and shareholders' funds of $47 million (2015 $35 million).

## Gross and net investment yield

| FOR THE YEAR ENDED 31 DECEMBER | YIELD ON INVESTMENT ASSETS BACKING POLICYHOLDERS' FUNDS 2016 % | YIELD ON INVESTMENT ASSETS BACKING POLICYHOLDERS' FUNDS 2015 % | YIELD ON INVESTMENT ASSETS BACKING SHAREHOLDERS' FUNDS 2016 % | YIELD ON INVESTMENT ASSETS BACKING SHAREHOLDERS' FUNDS 2015 % | TOTAL 2016 % | TOTAL 2015 % |
|---|---|---|---|---|---|---|
| Gross [1] | **2.5** | 2.3 | **2.5** | 2.3 | **2.5** | 2.3 |
| Net [2] | **2.4** | 2.3 | **2.5** | 2.2 | **2.4** | 2.3 |
| Net investment income and other yield [3] | **2.6** | 2.1 | **3.3** | 2.3 | **2.9** | 2.2 |

1 Gross yield is calculated with reference to gross investment income as a percentage of average investment assets backing policyholders' or shareholders' funds as appropriate.

2 Net yield is calculated with reference to net investment income as a percentage of average investment assets backing policyholders' or shareholders' funds as appropriate.

3 Net investment income and other yield is calculated with reference to net investment and other income as a percentage of average investment assets backing policyholders' or shareholders' funds as appropriate.

## Total investments and cash

| AS AT 31 DECEMBER | INVESTMENT ASSETS BACKING POLICYHOLDERS' FUNDS 2016 US$M | INVESTMENT ASSETS BACKING POLICYHOLDERS' FUNDS 2015 US$M | INVESTMENT ASSETS BACKING SHAREHOLDERS' FUNDS 2016 US$M | INVESTMENT ASSETS BACKING SHAREHOLDERS' FUNDS 2015 US$M | TOTAL 2016 US$M | TOTAL 2015 US$M |
|---|---|---|---|---|---|---|
| Cash and cash equivalents | **438** | 404 | **409** | 258 | **847** | 662 |
| Short-term money | **2,215** | 3,616 | **1,739** | 2,308 | **3,954** | 5,924 |
| Government bonds | **3,621** | 2,538 | **2,375** | 1,620 | **5,996** | 4,158 |
| Corporate bonds | **6,952** | 7,560 | **4,387** | 4,825 | **11,339** | 12,385 |
| Infrastructure debt | **290** | 212 | **173** | 136 | **463** | 348 |
| Unit trusts | **19** | 39 | **12** | 25 | **31** | 64 |
| Strategic equities | **–** | – | **118** | 108 | **118** | 108 |
| Other equities | **289** | 351 | **172** | 224 | **461** | 575 |
| Emerging market equity | **21** | 155 | **13** | 99 | **34** | 254 |
| Emerging market debt | **191** | 194 | **114** | 124 | **305** | 318 |
| High yield debt | **127** | 280 | **75** | 178 | **202** | 458 |
| Alternatives | **278** | 242 | **165** | 155 | **443** | 397 |
| Property trusts | **644** | 637 | **384** | 406 | **1,028** | 1,043 |
| Investment properties | **9** | 7 | **5** | 7 | **14** | 14 |
| Total investments and cash | **15,094** | 16,235 | **10,141** | 10,473 | **25,235** | 26,708 |

## Interest bearing financial assets

| SECURITY GRADING<br>AS AT 31 DECEMBER | 2016 % | 2015 % |
|---|---|---|
| **S&P rating** | | |
| AAA | **16** | 17 |
| AA | **37** | 37 |
| A | **36** | 38 |
| <A | **11** | 8 |

| CURRENCY MIX | MARKET VALUE OF GROWTH ASSETS | | MARKET VALUE OF TOTAL INVESTMENTS AND CASH | |
|---|---|---|---|---|
| AS AT 31 DECEMBER | 2016 % | 2015 % | 2016 % | 2015 % |
| US dollar | **49** | 45 | **32** | 31 |
| Australian dollar | **28** | 37 | **31** | 30 |
| Sterling | **11** | 12 | **18** | 21 |
| Euro | **12** | 6 | **8** | 8 |
| Other | **–** | – | **11** | 10 |

### Dividend

Our dividend policy is designed to ensure that we reward shareholders relative to cash profit and maintain sufficient capital for future investment and growth of the business.

The final dividend for 2016 will be 33 Australian cents per share, up 10% compared with the 2015 final dividend of 30 Australian cents per share. Combined with the 2016 interim dividend of 21 Australian cents per share, the total dividend for 2016 will be 54 Australian cents, up 8% compared with the 2015 total dividend of 50 Australian cents per share.

The dividend will be franked at 50% and is due to be paid on 13 April 2016. The dividend reinvestment programs will continue at a nil discount with demand for shares under the Dividend Reinvestment Plan to be satisfied by acquiring shares on-market. As previously noted, the franking percentage is expected to reduce to around 30% in 2017 and 2018.

The payout for the 2016 full year is A$741 million or around 61% of cash profit calculated by converting cash profit to Australian dollars at the average rate of exchange during the period. The calculation of cash profit is shown on page 16.

In conjunction with the announcement of the 2016 final dividend and to recognise the Group's already strong and increasing surplus capital position but limited franking capacity, QBE has established a three year cumulative on-market buyback facility of up to A$1 billion, with a current target of not more than A$333 million in any one calendar year.

## Closing remarks

I am pleased with our performance during 2016, particularly in the second half of the year. We performed strongly against our combined operating ratio target of 94% – 95% and made progress in restoring the attritional claims ratio in our Australian & New Zealand Operations, particularly in the final quarter.

That said, we believe that there remain significant opportunities for improvement across the Group.

Our priorities for 2017 will focus on the following key areas;

- capitalise on the efficiency benefits of our refined and restructured reinsurance program;
- drive our expense ratio below 16%;
- achieve profitable organic growth where it is available;
- sustain earnings stability and continue to deliver positive prior accident year claims development;
- maintain a strong capital position and strong cash remittances to the Group centre; and
- provide capital and dividend growth for our shareholders.

**Patrick Regan**
Group Chief Financial Officer

# Divisions at a glance


## North American Operations

North American Operations is a specialist insurer and reinsurer with a full scope of commercial, personal and specialty lines capabilities and a focus on delivering a comprehensive suite of products through a targeted distribution model.

| Gross written premium | Net earned premium[1] |
|---|---|
| US$ million 4,647 ↑2% from 2015[2] | US$ million 3,318 ↑1% from 2015[2] |

| Combined operating ratio | Insurance profit margin |
|---|---|
| 97.8%[1] 99.2% in 2015 | 4.7%[1] 2.5% in 2015 |

## European Operations

European Operations' business units are aligned by geography and/or distribution characteristics. Retail distributes commercial and specialty products in the UK and continental Europe. International Markets is a global specialty business using the Lloyd's platform (and includes Canada) and QBE Re is a global reinsurance business.

| Gross written premium | Net earned premium[3] |
|---|---|
| US$ million 4,076 ↓7% from 2015[4] | US$ million 3,115 ↓10% from 2015[5] |

| Combined operating ratio | Insurance profit margin |
|---|---|
| 93.6%[3] 89.1% in 2015 | 10.1%[3] 13.4% in 2015 |

## Equator Re

Equator Re, as part of the broader Global Reinsurance Operations team, is instrumental in managing the Group's exposure and reinsurance risk appetites. In doing so, Equator Re works closely with divisions to bridge the gap between their risk appetites and that of the Group.

| Gross written premium[6] | Net earned premium[6] |
|---|---|
| US$ million 1,349 ↑34% from 2015 | US$ million 468 ↑28% from 2015 |

| Combined operating ratio | Insurance profit margin |
|---|---|
| 70.7%[6] 89.0% in 2015 | 35.0%[6] 28.1% in 2015 |

## Emerging Markets

This division has a meaningful footprint with leading positions across many of the world's most attractive emerging markets. With its customer base, distribution partners and product range, it is uniquely positioned to continue to deliver profitable growth over the long-term.

| Gross written premium | Net earned premium |
|---|---|
| US$ million 1,632 down 6% from 2015[7] | US$ million 1,328 down 8% from 2015[8] |

| Combined operating ratio | Insurance profit margin |
|---|---|
| 99.5% (99.2% in 2015) | 5.5% (4.9% in 2015) |

## Australian & New Zealand Operations

A diversified general insurer providing cover for commercial and personal risks. Our strong customer focus, disciplined underwriting and strong capital base assists consumers and business to mitigate and manage risk while delivering strong and stable returns.

| Gross written premium | Net earned premium |
|---|---|
| US$ million 3,933 up 4% from 2015[7] | US$ million 3,410 up 4% from 2015[9] |

| Combined operating ratio | Insurance profit margin |
|---|---|
| 92.7% (91.3% in 2015) | 12.3% (14.2% in 2015) |

1 Adjusted for transactions to reinsure run-off liabilities.
2 Prior period comparable figures exclude premium associated with the sale of M&LS in 2015.
3 Adjusted for transactions to reinsure UK long-tail liabilities.
4 Down 3% on a constant currency basis.
5 Down 6% on a constant currency basis.
6 Adjusted for North American Operations loss portfolio transfer transaction.
7 Up 10% on a constant currency basis.
8 Up 8% on a constant currency basis.
9 Up 5% on a constant currency basis.

# North American Operations business review

"North American Operations more than doubled underwriting profit in 2016, reflecting a strong Crop performance and continued profitable growth in Specialty. Ongoing cost efficiencies, coupled with a more focused Property & Casualty portfolio, bodes well for further margin improvement."

**Russ Johnston**

Chief Executive Officer • North American Operations

| Gross written premium US$ million | Net earned premium US$ million | Underwriting result US$ million | Insurance profit US$ million |
|---|---|---|---|
| 4,647 | 3,318[1] | 72[1] | 155[1] |
| ↑ 2% from 2015[2] | ↑ 1% from 2015[2] | ↑ $42M from 2015 | ↑ $62M from 2015 |
| | | Combined operating ratio 97.8%[1] (2015 99.2%) | Insurance profit margin 4.7%[1] (2015 2.5%) |

## 2016 overview

North American Operations is a specialist insurance and reinsurance franchise focused on four key business units: Property & Casualty (formerly known as Standard Lines and includes commercial and personal lines), Specialty, Crop and Assumed Reinsurance (a component of QBE's global reinsurance business headquartered in London).

Over the course of 2016, premium rates remained flat overall, compared with a modest 0.4% increase in the prior corresponding period. It has become increasingly important to drive continuous improvement in how we define, target, select and price risk while driving greater efficiency and enhancing customer experience. Our investment in both talent and analytics has helped us to improve profitability whilst ensuring that we remain focused on areas where we have a competitive advantage.

North American Operations has established a strong Specialty business that continued to grow profitably with discipline in core segments of accident and health and errors and omission. Our Crop business outperformed expectations, generating a superior underwriting return. Notwithstanding significant challenges in commercial auto, our Property & Casualty business continues to improve while results in our Reinsurance business met expectations.

During 2016, a decision was taken to exit the mono-line commercial auto segment. This included the termination of a major program and the reinsurance of all related outstanding claims and unearned premium reserves to the Group's captive, Equator Re. The exit of this portfolio represented approximately half of the overall commercial auto portfolio. We also reinsured legacy multi-line property and casualty (program) run-off liabilities to a third party.

Collectively, these strategic decisions will remove management distractions, sharpen our Property & Casualty underwriting focus, improve property and casualty earnings quality and enhance capital efficiency.

1 Adjusted for transactions to reinsure run-off liabilities.

2 Prior period comparable figures exclude premium associated with the sale of M&LS in 2015.

# Operating and financial performance

## Underwriting performance

The aforementioned reinsurance transactions resulted in a reinsurance expense of $587 million with a consequent impact on net earned premium, more than offset by a $603 million reduction in net incurred claims. In addition to reducing the level of uncertainty in the remaining net discounted central estimate, as highlighted in the table below, the reinsurance transactions improved North American Operations' combined operating ratio by 0.8% (with an 8.2% positive impact on the net claims ratio largely offset by a 7.4% adverse impact on the combined commission and expense ratio).

In order to assist year on year comparability, the underwriting commentary hereafter refers to the 2016 results excluding the impact of these reinsurance transactions.

North American Operations delivered an improved combined operating ratio of 97.8% compared with 99.2% in 2015. The results benefited from an outstanding Crop performance, largely offset by continued and significant challenges in commercial auto. We have exited our mono-line commercial auto portfolio, which reported an underwriting loss of $105 million.

Lower corn and soybean pricing coupled with farmers opting for higher deductibles adversely impacted Crop gross written premium. Nevertheless, the Crop business performed extremely well, outperforming industry average profitability.

Our maturing Specialty franchise is delivering strong and profitable growth across core business in accident and health and errors and omissions. Specialty saw 50% premium growth while continuing to diversify across a number of businesses, including directors and officers, transactional liability, aviation and inland marine.

The insurance profit margin improved to 4.7% from 2.5% in 2015.

## Underwriting result

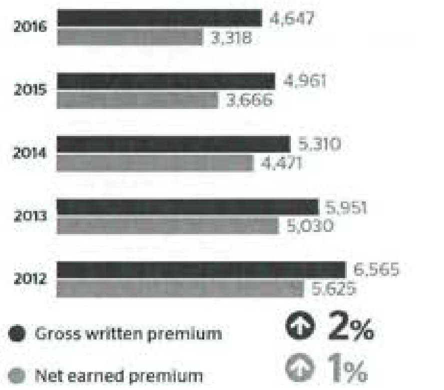
| FOR THE YEAR ENDED 31 DECEMBER | | 2016 | 2016[1] ADJUSTED | 2015[2] | 2014[2] | 2013[2] | 2012[2] |
|---|---|---|---|---|---|---|---|
| Gross written premium | US$M | **4,647** | **4,647** | 4,961 | 5,310 | 5,951 | 6,565 |
| Gross earned premium | US$M | **4,657** | **4,657** | 4,930 | 5,457 | 6,225 | 6,984 |
| Net earned premium | US$M | **2,731** | **3,318** | 3,666 | 4,471 | 5,030 | 5,625 |
| Net incurred claims | US$M | **1,528** | **2,131** | 2,323 | 3,023 | 3,804 | 4,038 |
| Net commission | US$M | **564** | **564** | 635 | 698 | 795 | 883 |
| Expenses | US$M | **556** | **551** | 678 | 788 | 1,011 | 830 |
| Underwriting result | US$M | **83** | **72** | 30 | (38) | (580) | (126) |
| Net claims ratio | % | **56.0** | **64.2** | 63.4 | 67.6 | 75.6 | 71.8 |
| Net commission ratio | % | **20.7** | **17.0** | 17.3 | 15.6 | 15.8 | 15.7 |
| Expense ratio | % | **20.4** | **16.6** | 18.5 | 17.6 | 20.1 | 14.7 |
| Combined operating ratio | % | **97.0** | **97.8** | 99.2 | 100.8 | 111.5 | 102.2 |
| Adjusted combined operating ratio[3] | % | **97.7** | **98.5** | 99.8 | 100.4 | – | – |
| Insurance profit margin | % | **6.1** | **4.7** | 2.5 | 0.2 | (10.6) | (1.0) |

1 Adjusted for transactions to reinsure run-off liabilities.

2 Comparability of prior period data is diminished as a result of the sale of M&LS and the adoption of a significantly revised crop premium earning pattern in 2015.

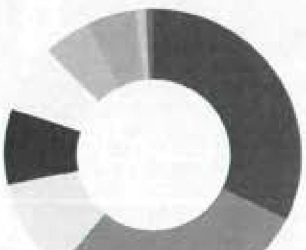
3 Combined operating ratio adjusted to exclude the impact of changes in risk-free rates used to discount net outstanding claims. Management-basis results were not reported in 2013 and prior.

**Gross written premium and net earned premium** (US$M)




**Combined operating ratio (COR) and insurance profit margin (IPM)** (%)

**Gross earned premium by class of business 2016**



| | 2016 % | 2015 % |
|---|---|---|
| Commercial & domestic property | 32.3 | 36.5 |
| Agriculture | 28.6 | 28.3 |
| Motor & motor casualty | 10.9 | 12.5 |
| Workers' compensation | 8.4 | 8.1 |
| Public/product liability | 7.6 | 7.3 |
| Accident & health | 5.3 | 3.7 |
| Professional indemnity | 5.1 | 2.0 |
| Marine energy & aviation | 1.1 | 0.9 |
| Financial & credit | 0.8 | 0.7 |

## Premium income

North American Operations' gross written premium declined 6% to $4,647 million compared with $4,961 million in 2015. Excluding $383 million of premium from the M&LS business that was sold in 2015, gross written premium increased 2%.

Strong growth in Specialty continued with gross written premium up $211 million or 50% relative to prior period. New business across the segment almost doubled with a diversity of growth across the portfolio including accident and health, errors and omissions and transactional liability, as well as from the addition of new specialty programs. Growth in Specialty outpaced reductions across Property & Casualty and Crop, resulting in modest growth overall.

Property & Casualty premium declined 5% as a result of continued underwriting action in underperforming areas and new business shortfalls, primarily in our program business. The reduction in premium was largely due to commercial lines where an increasingly competitive property premium rate environment and corrective underwriting actions in auto led to lower premium production. Conversely, we continue to see strong growth in the affiliated agencies business within Property & Casualty, which grew by 5% due to increased housing starts.

Crop gross written premium fell $135 million or 10% compared with 2015, reflecting insured buying patterns and lower commodity prices.

Allowing for the sale of M&LS and despite significantly higher government cessions on the back of better than expected crop margins, North American Operations' net earned premium increased 1% to $3,318 million.

## Claims expense

North American Operations reported a 2016 net adjusted claims ratio of 64.2% compared with 63.4% in 2015.

The claims ratio benefited from a significantly stronger Crop result offset by a heightened level of large individual risk and catastrophe claims that added an additional 2.1% to the net claims ratio following an especially benign 2015.

The net cost of catastrophe claims increased by $43 million or 1.3% as significant hail activity in Texas and hurricane Matthew impacted the affiliated agencies portfolio and the program business within the Property & Casualty portfolio. The net cost of large individual risk claims increased by 0.8%, reflecting an increase in claims across Property & Casualty and the impact of growth in Specialty.

Excluding Crop and M&LS, the attritional claims ratio improved slightly as improvements across Specialty and Property & Casualty outpaced challenges in commercial auto. This is despite a significant increase in attritional claims in our affiliated agencies business due to adverse weather in Texas that impacted industry-wide results.

Consistent with 2015, the result included $121 million of adverse prior accident year claims development that increased the net claims ratio by 3.7%. The vast majority of this relates to now terminated and reinsured mono-line commercial auto business.

### Commission and expenses

The combined commission and expense ratio improved to 33.6% from 35.8% in the prior corresponding period.

The commission ratio decreased to 17.0% from 17.3% in 2015, reflecting a lower proportion of higher commission paying program business.

North American Operations' expense ratio decreased to 16.6% from 18.5% in the prior year and included a 1.4% benefit associated with the sale of M&LS in 2015. The improvement in the expense ratio was less than anticipated due to lower than budgeted premium revenue as a result of significantly higher government cessions on the back of better than expected crop profitability.

Having stabilised net earned premium and indeed resumed (albeit modest) growth, additional expense management efforts are underway. These include streamlining and modernising our technology and operating infrastructure, consistent with a simplified business strategy. North American Operations is in the process of further consolidating its real estate footprint and increasing utilisation of the Group Shared Services Centre (GSSC) in the Philippines. Excluding the sale of M&LS, over $40 million of cost savings were achieved during 2016, which was partially offset by non-recurring rationalisation charges and investment in ongoing initiatives.

## Summary

North American Operations continues its focus on building a specialist franchise that delivers profitable organic growth by building market leading and proprietary products tailored to customer needs. Since 2013, Specialty has launched nine new business units and has developed a culture of innovation and excellence with over 30 new products brought to market. We have a well-diversified portfolio, anchored around accident and health and errors and omissions, augmented with offerings across directors and officers, transactional liability, aviation and inland marine. This has allowed us to develop an organic growth capability that we are now leveraging across the Property & Casualty portfolio. We have launched an "excess and surplus lines" business and are building out our existing personal lines platform to further enhance portfolio diversification. The Property & Casualty franchise is moving forward with a more focused distribution footprint. Our value proposition is centred around the scale of our Specialty and Property & Casualty product offerings and our delivery of integrated capabilities to customers. Our high quality Crop and Reinsurance businesses are also integral, providing additional portfolio diversification and confidence in posting a further improved underwriting result in 2017.

Implementation of a series of initiatives focused on claims, analytics and human capital are well underway as we continue to build sustainable financial results and brand value. In 2016, we started deploying advanced analytics to enable claims triage, subrogation and anti-fraud capabilities to improve recoveries as well as third party management to ensure we drive a positive customer experience with efficient and effective practices. In addition, utilisation of machine learning is improving our analytical capabilities with respect to customer analysis and underwriting which is driving improved decision making at a transactional and portfolio level across our businesses. The introduction of drone technology in our crop business has enabled us to better serve our customers. Over the course of 2017, we will increase our deployment of analytics and technology to improve business optimisation throughout the North American Operation. Moreover, continued development of a performance-driven and results-focused culture, while building in house technical expertise through the launch of our underwriting academy, further underpins our confidence in delivering on our medium-term financial targets.

2016 provides a window into the emerging strength of the North American platform. This follows significant organisational change undertaken in 2013 and the repositioning achieved thereafter. This change included the build-out of Specialty, improvements to our Crop business, remediation of Property & Casualty and the sale of M&LS, all of which contributed to a return to profitability in 2015 followed by significant further improvement in 2016. With the transformation nearing completion, our 2016 performance evidences the breadth and depth of capabilities our new operating model provides and underpins our confidence in sustaining modest growth while driving to a mid-90s combined operating ratio over the medium-term.

As we continue to strengthen the diversity of our leadership team, we were pleased to announce the appointment of Kris Hill who joined as our new Chief Financial Officer replacing Richard Dziadzio, who left the company in mid-2016. The strength of the QBE brand has positioned us well to continue to attract the best and brightest to our organisation.

# European Operations business review

> "European Operations delivered another strong underwriting performance during a year of further deterioration in trading conditions, an industry-wide increase in large risk and catastrophe claims activity and unprecedented currency fluctuation."

**Richard Pryce**

Chief Executive Officer • European Operations

| Gross written premium | Net earned premium | Underwriting result | Insurance profit |
|---|---|---|---|
| US$ million | US$ million | US$ million | US$ million |
| 4,076 | 3,115[1] | 199[1] | 314[1] |
| Down 7% from 2015[2] | Down 10% from 2015[3] | Down $178M from 2015 | Down $150M from 2015 |
| | | Combined operating ratio 93.6%[1] (2015 89.1%) | Insurance profit margin 10.1%[1] (2015 13.4%) |

## 2016 overview

Trading conditions deteriorated in line with our planning assumptions in most areas. The weighted average premium rate reduction on renewed business in the year was 2.4%, reflecting a slight improvement in the second half and better than the 3.2% average reduction experienced in 2015.

Gross written premium fell short of expectations this year due to our commitment to underwriting discipline and the lack of acceptable new business opportunities. Given our decisions not to renew a few significant underperforming accounts and facilities, the overall retention level is very pleasing. Much of the success around retention is attributable to our strong customer engagement and our commitment to building meaningful and sustainable relationships.

Following the European Union referendum in June and the increasingly likely outcome that we can no longer effectively access the European single market from the UK, we are well advanced in our business restructure planning.

1 Adjusted for transactions to reinsure UK long-tail liabilities.
2 Down 3% on a constant currency basis.
3 Down 6% on a constant currency basis.

## Operating and financial performance

### Underwriting performance

As reported at the half year, reinsurance transactions undertaken to reduce exposure to UK long-tail liabilities benefited net claims incurred by $168 million and reduced net earned premium by $166 million. Although almost profit neutral, the transactions improved European Operations' 2016 combined operating ratio by 0.4%.

In order to assist year on year comparability, the commentary hereafter refers to the 2016 results excluding the impact of these reinsurance transactions.

After a significant adverse discount rate impact during the first half of the year, risk-free rates in most of our major currencies increased during the second half. Despite this improvement, the full year underwriting result included an $89 million or 2.9% adverse impact compared with a $21 million or 0.6% benefit in 2015.

Excluding the impact of movements in risk-free rates, the combined operating ratio deteriorated slightly to 90.7% from 89.7% in the prior period. While all three business units reported strong underwriting performances, QBE Re experienced heightened catastrophe incidence following an especially benign 2015.

European Operations' insurance profit margin was 10.1% compared with 13.4% in 2015.

### Underwriting result

| FOR THE YEAR ENDED 31 DECEMBER | | 2016 | 2016[1] ADJUSTED | 2015 | 2014[2] ADJUSTED | 2013 | 2012 |
|---|---|---|---|---|---|---|---|
| Gross written premium | US$M | **4,076** | **4,076** | 4,386 | 4,526 | 5,236 | 5,162 |
| Gross earned premium | US$M | **3,878** | **3,878** | 4,338 | 4,805 | 5,146 | 4,903 |
| Net earned premium | US$M | **2,949** | **3,115** | 3,454 | 3,929 | 4,160 | 3,971 |
| Net incurred claims | US$M | **1,658** | **1,826** | 1,844 | 2,362 | 2,486 | 2,441 |
| Net commission | US$M | **574** | **574** | 634 | 718 | 768 | 699 |
| Expenses | US$M | **516** | **516** | 599 | 626 | 646 | 607 |
| Underwriting result | US$M | **201** | **199** | 377 | 223 | 260 | 224 |
| Net claims ratio | % | **56.2** | **58.6** | 53.4 | 60.1 | 59.7 | 61.5 |
| Net commission ratio | % | **19.4** | **18.4** | 18.4 | 18.3 | 18.5 | 17.6 |
| Expense ratio | % | **17.5** | **16.6** | 17.3 | 15.9 | 15.5 | 15.3 |
| Combined operating ratio | % | **93.2** | **93.6** | 89.1 | 94.3 | 93.7 | 94.4 |
| Adjusted combined operating ratio[3] | % | **90.2** | **90.7** | 89.7 | – | – | – |
| Insurance profit margin | % | **10.7** | **10.1** | 13.4 | 8.8 | 9.0 | 10.9 |

1 Adjusted for transactions to reinsure UK long-tail liabilities.
2 Adjusted for transactions to reinsure Italian and Spanish medical malpractice liabilities.
3 Combined operating ratio adjusted to exclude the impact of changes in risk-free rates used to discount net outstanding claims. Management-basis results were not reported in 2014 and prior.

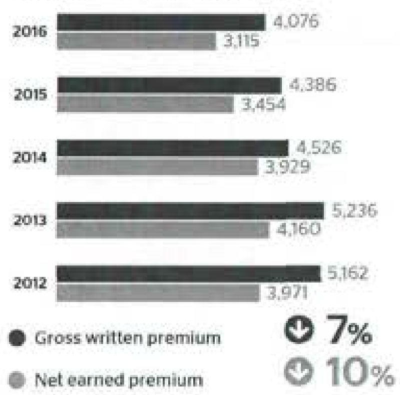
### Premium income

Headline gross written premium fell 7% to $4,076 million due to the significantly weaker sterling, disciplined underwriting actions and fewer acceptable new business opportunities.

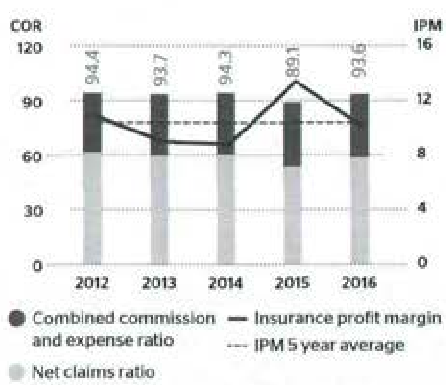
On a constant currency basis gross and net earned premium declined by 3% and 6% respectively.

During the year new business activity was less than anticipated as in many cases, new business profit margins were deemed unacceptable. Despite corrective underwriting action on a small number of high profile accounts, we recorded an improved premium retention level of 82.7% compared with 80.5% in the prior period.

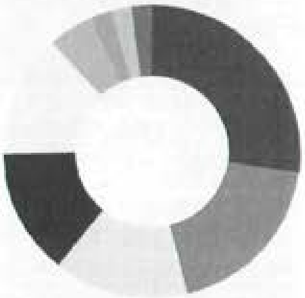
**Gross written premium and net earned premium** (US$M)




**Combined operating ratio (COR) and insurance profit margin (IPM)** (%)



**Gross earned premium by class of business 2016**



| | 2016 % | 2015 % |
|---|---|---|
| Commercial & domestic property | 27.3 | 27.3 |
| Public/product liability | 18.7 | 20.3 |
| Marine energy & aviation | 14.8 | 14.8 |
| Professional indemnity | 13.8 | 14.1 |
| Motor & motor casualty | 13.6 | 11.9 |
| Workers' compensation | 5.1 | 5.7 |
| Accident & health | 2.4 | 1.5 |
| Other | 2.3 | 2.8 |
| Financial & credit | 2.0 | 1.6 |

Our continental European insurance business continues to record higher levels of premium growth and we expect this to be maintained.

## Claims expense

The net claims ratio benefited from positive prior accident year claims development of $273 million or 8.8% of net earned premium, which emerged across multiple portfolios. This is an improvement on the $253 million or 7.3% of positive development in 2015.

The attritional claims ratio increased relative to the prior period largely due to a temporary impact from the dramatic devaluation of sterling, whereby premium written in currencies other than sterling was earned at higher historical rates relative to related claims expense that was recognised at rates of exchange prevailing when the claims were incurred. On a constant currency basis, the underlying attritional claims ratio was stable year-on-year. Assuming future stability of sterling, this currency effect is not expected to have a lasting impact.

In line with the rest of the industry, European Operations experienced an increase in large risk and catastrophe claims incidence during 2016. Although less than our annual allowances, catastrophe claims costs were materially higher, particularly with respect to QBE Re where 2015 was especially benign.

Our underwriting teams remain vigilant as to underlying claims trends and, in particular, any signs of emerging claims inflation.

## Commission and expenses

The net commission ratio was unchanged at 18.4%, an encouraging outcome in an environment where commission levels are increasing.

European Operations' expense ratio improved to 16.6% from 17.3% in the prior corresponding period. This reduction was anticipated and reflects ongoing expense management and efficiency initiatives. The reduction in our expense ratio would have been greater but for the impact of the devaluation of sterling on our non-sterling expenses.

## Summary

During a year in which the ongoing competitive landscape has been compounded by increased global large risk and catastrophe claims activity and sterling's devaluation, European Operations delivered another strong result along with operational improvements that have reduced the expense base and enhanced efficiency.

Our commitment to underwriting excellence and preserving margins remains central to our success. Regardless of market conditions we will not waiver from this principle as it is now more important than ever.

QBE's vision to build the strongest partnerships with customers is embedded in our culture and we are fortunate to have many excellent customer and broker relationships across our insurance and reinsurance businesses.

There were two changes to our Executive team in 2016 and, pleasingly, they were both internal promotions. Mike East assumed the Claims Director role and Nigel Terry was appointed Chief Risk Officer at the end of the year.

The European Operations' team remained focused and committed during a difficult year and I appreciate their support and dedication.

# Australian & New Zealand Operations business review

"Increased average claim size and frequency saw our attritional claims ratio deteriorate in the first half of 2016. Decisive action undertaken since, including premium rate increases and claims cost management initiatives, has seen the attritional claims ratio improve in the second half of 2016 with further improvement expected in 2017."

**Pat Regan**

Chief Executive Officer • Australian & New Zealand Operations

| Gross written premium US$ million | Net earned premium US$ million | Underwriting result US$ million | Insurance profit US$ million |
|---|---|---|---|
| 3,933 | 3,410 | 250 | 418 |
| ↑ 4% from 2015[1] | ↑ 4% from 2015[1] | ↓ $36M from 2015 | ↓ $49M from 2015 |
| | | Combined operating ratio 92.7% (2015 91.3%) | Insurance profit margin 12.3% (2015 14.2%) |

## 2016 overview

Three factors combined to drive an increase in our attritional claims ratio during the first half of 2016: premium pricing pressure coupled with heightened claims inflation impacted our short-tail business; increased small claims frequency in the NSW compulsory third party (CTP) scheme; and increased claims frequency and severity in our trade credit business.

During the second half of the year, we acted decisively to address the deterioration in our first half performance, implementing a comprehensive remediation plan with a strong governance framework. The division has been divided into 44 business "cells" with regular, detailed reviews undertaken for each cell to ensure that new underwriting plans and remediation actions are being executed and are generating the desired outcomes.

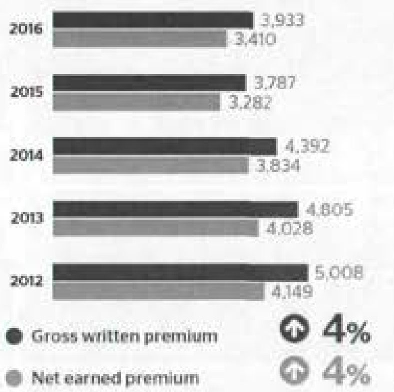
Key remediation initiatives undertaken to date include premium rate increases, revised policy terms and conditions, improved risk selection, tighter management and control over claims expenses (including the removal of delegated authorities where appropriate), focused supplier management, greater emphasis on salvage and third party recoveries and enhancements to our management information lead indicators.

Strong distribution partnerships have enabled us to lead the market in taking remediation actions. While these initiatives will primarily benefit our 2017 results, early benefits from rate increases and reduced claims costs are evident in our fourth quarter results.

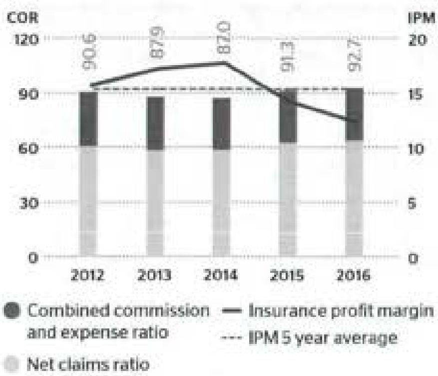
The impact of pricing initiatives undertaken to date are best evidenced by the trend in our Australian premium rate increases, up 1.7% for the full year compared with a decline of 0.1% at the half year, including a fourth quarter increase of 4.5%.

1 Up 5% on a constant currency basis.

**Gross written premium and net earned premium** (US$M)




**Combined operating ratio (COR) and insurance profit margin (IPM)** (%)




## Operating and financial performance

### Underwriting performance

Australian & New Zealand Operations reported a combined operating ratio of 92.7%, up from 91.3% in 2015. Positive prior accident year claims development, particularly in our NSW CTP and liability portfolios, largely offset the deterioration in the attritional claims ratio which increased to 60.2% from 55.1% in the prior period.

Pleasingly, the attritional claims ratio improved from 62.0% in the first half to 58.6% in the second half, driven by a significantly improved attritional claims ratio in the final quarter.

While the gross cost of catastrophe claims increased year on year due to the New Zealand earthquake and the large number of second half storms, the net cost was in line with expectations as a result of our aggregate reinsurance covers.

Our lenders' mortgage insurance (LMI) business reported a combined operating ratio of 34.9%, up from 22.2% in the prior period but broadly as expected. Premium income has continued to decline driven by regulatory pressure on mortgage lenders and stricter lending criteria. While the number of pending properties in possession and loans in arrears increased during 2016, this was partly offset by a decrease in the number and severity of claims.

### Underwriting result

| FOR THE YEAR ENDED 31 DECEMBER | | 2016 | 2015 | 2014 | 2013 | 2012 |
|---|---|---|---|---|---|---|
| Gross written premium | US$M | **3,933** | 3,787 | 4,392 | 4,805 | 5,008 |
| Gross earned premium | US$M | **3,924** | 3,753 | 4,386 | 4,626 | 4,801 |
| Net earned premium | US$M | **3,410** | 3,282 | 3,834 | 4,028 | 4,149 |
| Net incurred claims | US$M | **2,172** | 2,054 | 2,242 | 2,347 | 2,501 |
| Net commission | US$M | **511** | 481 | 532 | 572 | 555 |
| Expenses | US$M | **477** | 461 | 562 | 623 | 701 |
| *Underwriting result* | US$M | **250** | 286 | 498 | 486 | 392 |
| Net claims ratio | % | **63.7** | 62.6 | 58.4 | 58.2 | 60.3 |
| Net commission ratio | % | **15.0** | 14.7 | 13.9 | 14.2 | 13.4 |
| Expense ratio | % | **14.0** | 14.0 | 14.7 | 15.5 | 16.9 |
| Combined operating ratio | % | **92.7** | 91.3 | 87.0 | 87.9 | 90.6 |
| Adjusted combined operating ratio [1] | % | **92.4** | 91.1 | 85.4 | – | – |
| Insurance profit margin | % | **12.3** | 14.2 | 17.7 | 17.2 | 15.7 |

1 Combined operating ratio adjusted to exclude the impact of changes in risk-free rates used to discount net outstanding claims. Management-basis results were not reported in 2013 and prior.

### Premium income

Gross written premium increased 4% to $3,933 million from $3,787 million in the prior year.

On a constant currency basis, gross written premium increased 5% due to growth across a number of portfolios. Strong growth was achieved in CTP as a result of significant premium rate increases in the NSW scheme, coupled with our entry into the recently privatised South Australian market from 1 July 2016. Modest growth was also achieved in New Zealand, Elders and our intermediary business.

Remediation initiatives undertaken during the second half resulted in average rate increases for the year of 1.7% across renewed business compared with an average rate reduction of 0.1% in the first half. Rate increases for renewed business in the fourth quarter averaged 4.5%. Importantly, and despite our focus on portfolio remediation, policy retention remained positive at 83.1% compared with 81.7% in 2015. We experienced a slight fall in retention in the fourth quarter as remediation plans were implemented, however, retention remained above 80%.

Over the 24 months to the balance date, we have increased our NSW CTP premium rates by 21% with a further 3% increase applicable from 1 February 2017. We continue to work closely with the government in relation to the proposed reforms that aim to deliver a fairer and more sustainable scheme.

### Claims expense

The net claims ratio increased to 63.7% from 62.6% in the prior year due to an increase in the attritional claims ratio, which was largely offset by positive prior accident year development.

The substantial deterioration in the attritional claims ratio reported in the interim result remained a negative factor, however, and as noted previously, remediation actions have started to address this. The full effect of these initiatives will come through as premium is earned in 2017.

The increase in the attritional claims ratio was driven by an increase in NSW CTP small claims frequency (exacerbated by substantial growth in the CTP portfolio itself) and heightened claims costs across our short-tail portfolios as a result of increased average claim costs.

The gross cost of large individual risk and catastrophe claims increased in 2016 driven by the frequency of large individual risk claims throughout the year and the New Zealand earthquake in November. The net cost, however, remained within our allowances as a result of recoveries against our aggregate reinsurance cover.

Prior accident year claims development across our long-tail portfolios remained positive, contributing $147 million to the result compared with $120 million in the prior corresponding period and $83 million at the half year.

Risk-free rates used to discount net outstanding claims liabilities increased from the very low levels seen at 30 June 2016, to end the year very close to 31 December 2015 levels. As a result, the $33 million adverse discount rate impact at 30 June reduced to $9 million at 31 December 2016, in line with the full year 2015 discount rate impact.

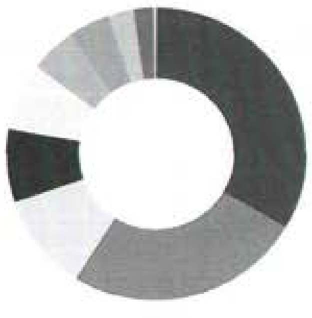
### Commission and expenses

The acquisition cost ratio remained relatively stable at 29.0% compared with 28.7% in 2015.

The commission ratio increased slightly to 15.0% from 14.7% in the prior period, reflecting the aforementioned growth in our New Zealand business at generally higher commission rates compared with our Australian business. Portfolio mix changes within our intermediary business and growth in our affinity business also contributed to the minor increase.

The underwriting expense ratio remained stable at 14.0%. Continued focus on expense management, both locally and in our Group Shared Services Centre (GSSC), offset the loss of income from our Victorian Workers' Compensation Managed Fund business (from 30 June 2016), the loss of agency income associated with the sale of CHU and UAA (from 1 April 2015) and an increase in technology investment spending – specifically the implementation of the Guidewire system for our direct and CTP businesses.

**Gross earned premium by class of business 2016**



| | 2016 % | 2015 % |
|---|---|---|
| Commercial & domestic property | 33.3 | 33.7 |
| Motor & motor casualty | 25.6 | 23.1 |
| Financial & credit | 11.0 | 12.7 |
| Public/product liability | 7.9 | 8.7 |
| Workers' compensation | 7.4 | 7.2 |
| Agriculture | 5.1 | 5.2 |
| Accident & health | 4.4 | 4.0 |
| Marine energy & aviation | 2.8 | 3.0 |
| Professional indemnity | 2.3 | 2.3 |
| Other | 0.1 | 0.1 |

## Summary

Competition remained strong in 2016. Nonetheless, our market leading position in each of the broker, underwriting agency and affinity distribution channels has stood us in good stead as we have progressed remediation actions across underperforming products.

Our remediation program, which is managed through a number of work streams with strong governance and ongoing monitoring, is focusing on improved profitability. We have already implemented a range of initiatives to improve our risk selection, claims performance and attritional claims costs.

Whilst we have acted decisively, remediation initiatives have only been in place for four months. Nevertheless, we are encouraged by the progress to date and are achieving desired premium rate increases with the market following in most areas. We have made some progress in claims management but acknowledge that there remains a significant amount of work to do in order to ensure market best practice is achieved.

The insurance market and the insurance cycle is dynamic and we recognise the need to be agile and responsive in order to ensure sustainable profitability over the cycle.

Our ongoing investment in systems, digitisation and further development of data and analytics is helping to deliver better customer experience, better customer insights and improve retention and growth.

The leadership team has been strengthened with the appointment of Declan Moore as Chief Underwriting Officer, Bettina Pidcock as Executive General Manager Marketing, Andrew Broughton as Executive General Manager Corporate Partners & Direct, Jon Fox as Executive General Manager Claims and, from 1 March 2017, Inder Singh as Chief Financial Officer.

Since assuming the position of Chief Executive Officer I have thoroughly enjoyed working closely with the talented staff in our Australian & New Zealand Operations. We have developed a strong plan to take our business forward and have already achieved a huge amount of improvement over a short period. I would like to thank everyone for their efforts and commitment and I remain optimistic and excited about the year ahead.

# Emerging Markets business review

"Emerging Markets delivered a solid result in 2016, recording a stable combined operating ratio and double-digit gross written premium growth. We remain focused on winning and retaining business where we see the highest potential for further profitable growth."

**David Fried**

Chief Executive Officer • Emerging Markets

| Gross written premium US$ million | Net earned premium US$ million | Underwriting result US$ million | Insurance profit US$ million |
|---|---|---|---|
| 1,632 | 1,328 | 6 | 73 |
| down 6% from 2015 [1] | down 8% from 2015 [2] | down $5M from 2015 | up $2M from 2015 |
| | | Combined operating ratio 99.5% (2015 99.2%) | Insurance profit margin 5.5% (2015 4.9%) |

## 2016 overview

In 2016, Emerging Markets posted solid underlying growth and a strong combined operating ratio through the continued implementation of the profitable growth strategy.

On a constant currency basis, gross written premium and net earned premium grew by 10% and 8% respectively, largely due to an enhanced focus on driving profitable growth in four key areas of business: specialty, commercial, SME and personal lines with strategic partners.

The division also recorded a stable combined operating ratio of 99.5% despite several large individual risk and catastrophe claims during the year. The underwriting results were protected by an improved reinsurance structure implemented in 2016.

This solid overall performance can be attributed to close management of portfolios, strategic remediation and tight expense control. In December 2016, following a business review to address Latin American underwriting margins, the QBE Group entered into an agreement to sell [3] its small and currently unprofitable Chilean operations to the current management team of QBE Chile Seguros Generales S.A.. Additionally, the Group finalised the buyout of the remaining 45% of paid-up shares of the joint venture operation in Indonesia previously held by PT Pool Advista Indonesia Tbk and purchased an additional 23% stake in our Indian joint venture, Raheja QBE.

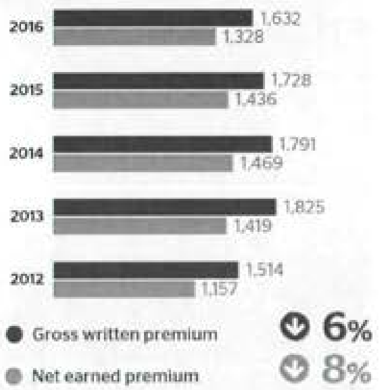
To sustain long-term growth ambitions, Emerging Markets continues to pursue improvements in productivity, efficiency and consistency through implementation of a single operating model across the division. A new operating structure has been introduced in Hong Kong to ensure QBE is well positioned to meet the evolving business needs in this market.

1 Up 10% on a constant currency basis.
2 Up 8% on a constant currency basis.
3 Subject to regulatory approval.

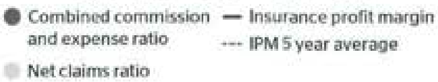
The establishment of a Centre of Excellence in Miami has delivered a more robust governance structure, strengthened relationships with major trading partners (MTPs) and enhanced underwriting expertise and control in Latin America. For example, profitable growth achieved by working more closely with MTPs in Colombia increased by more than 70% on the prior year.

The long-term outlook for Emerging Markets remains positive and will continue to drive premium growth for QBE.

**Gross written premium and net earned premium (US$M)**




**Combined operating ratio (COR) and insurance profit margin (IPM) (%)**




## Operating and financial performance

### Underwriting performance

In 2016, reported gross written and net earned premium decreased by 6% and 8% respectively. On a constant currency basis, however, gross written and net earned premium increased by 10% and 8% respectively.

Even with material impacts from Cyclone Winston in Fiji in March, a 7.8-magnitude earthquake in Ecuador and massive flooding in Chile in April, Emerging Markets recorded a combined operating ratio of 99.5% and an underwriting profit of $6 million. The total estimated gross cost of catastrophes during 2016 stands at $140 million, almost double the total gross cost incurred in 2015. However, the division's underwriting results were protected by the improved reinsurance structure implemented in 2016.

The stable underwriting result is also attributable to more frequent and robust technical portfolio reviews, increased utilisation of data analytics and continued remediation activities. Together these initiatives underpinned an improved attritional claims ratio. Remediation activities included the further closure of unprofitable points of sale in the SOAT portfolio in Colombia with the agreement to sell the Chilean business expected to benefit margins in 2017. A new operating structure in Thailand centralising operations in Bangkok will result in a better business model to meet the evolving needs of the local market.

### Underwriting result

| FOR THE YEAR ENDED 31 DECEMBER | | 2016 | 2015[1] | 2014[1] | 2013[1] | 2012[1] |
|---|---|---|---|---|---|---|
| Gross written premium | US$M | **1,632** | 1,728 | 1,791 | 1,825 | 1,514 |
| Gross earned premium | US$M | **1,588** | 1,687 | 1,706 | 1,703 | 1,423 |
| Net earned premium | US$M | **1,328** | 1,436 | 1,469 | 1,419 | 1,157 |
| Net incurred claims | US$M | **721** | 788 | 878 | 769 | 606 |
| Net commission | US$M | **312** | 336 | 354 | 346 | 289 |
| Expenses | US$M | **289** | 301 | 271 | 269 | 211 |
| Underwriting result | US$M | **6** | 11 | (34) | 35 | 52 |
| Net claims ratio | % | **54.3** | 54.8 | 59.8 | 54.2 | 52.4 |
| Net commission ratio | % | **23.5** | 23.4 | 24.1 | 24.4 | 25.0 |
| Expense ratio | % | **21.8** | 21.0 | 18.4 | 18.9 | 18.2 |
| Combined operating ratio | % | **99.5** | 99.2 | 102.3 | 97.5 | 95.6 |
| Adjusted combined operating ratio[2] | % | **99.5** | 99.2 | 102.3 | – | – |
| Insurance profit margin | % | **5.5** | 4.9 | 2.6 | 4.5 | 6.8 |

1 Excludes Argentine workers' compensation business sold in 2015.

2 Combined operating ratio adjusted to exclude the impact of changes in risk-free rates used to discount net outstanding claims. Management-basis results were not reported in 2013 and prior.

## Premium income

Through continued implementation of the profitable growth strategy, Emerging Markets recorded double-digit premium growth on a constant currency basis.

In Asia Pacific, gross written premium reached $765 million with the stronger US dollar limiting headline growth to only 1%. On a constant currency basis, however, gross written and net earned premium increased by 3% and 4% respectively, with Papua New Guinea, Vietnam, Fiji, and Solomon Islands all achieving double-digit gross written premium growth. In 2016, QBE entered into a 10-year exclusive distribution agreement with Manulife in Hong Kong, further strengthening our access to the retail segment beyond the existing bancassurance network.

In Hong Kong, QBE ranked first in market share in both engineering (9%) and workers' compensation (17%) and second in mortgage insurance (19%). QBE ranked second in market share in marine hull & liability (23%) and third in cargo (9%) in Singapore, second in marine (8%) in Malaysia and marine hull (10%) in Indonesia. QBE also retained its leading market positions in Hong Kong, Singapore and the Pacific Islands.

In Latin America, the stronger US dollar drove an 11% decline in gross written premium to $867 million. On a constant currency basis, however, gross written and net earned premium grew strongly by 16% and 11% respectively. Solid underlying growth in gross written premium was mainly driven by Argentina (36%), Brazil (21%) and Mexico (18%). A continued and deliberate shift in the business mix towards writing more commercial, specialty and SME risks also contributed to overall growth.

In Argentina, QBE ranked first in cargo insurance (19%). In Ecuador, where QBE is the third largest private general insurer with a 12% market share, QBE ranked second in both motor (16%) and property insurance (14%). We also maintained our leading position in the Brazilian travel sector with a 36% market share through partnerships with local travel assistance operators.

Collaboration between divisions continues to deliver benefits for Latin America. For example, we have had new business success with a combined hull and machinery/protection and indemnity product that drew on British Marine's expertise. Based on strengthened relationships with MTPs, several significant accounts were also added during the year, including the Museum of Latin American Art in Buenos Aires and an alliance with one of the main construction companies in Colombia.

## Claims expense

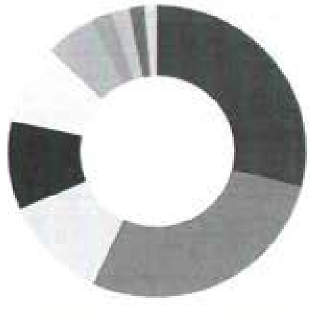
Cyclone Winston in Fiji resulted in some 90 claims totalling approximately $30 million for the QBE Group, with a $12 million net impact to Asia Pacific.

April's earthquake in Ecuador resulted in around 12,000 claims totalling approximately $80 million, which translated into a $13 million net impact to Latin America. Also in April, flooding in the business district of Chile's capital of Santiago resulted in a further $6 million net claim impact.

Despite these events, the net claims ratio improved from 54.8% to 54.3%, mainly reflecting a remediation-led improvement in the attritional claims ratio in Latin America.

Following the Ecuadorean earthquake, QBE used drone technology to expedite the handling of claims, enabling us to settle 90% of large claims within 90 days of the event. Rapid settlement of claims in Ecuador, as well as in Fiji, positively reinforced QBE's brand.

**Gross earned premium by class of business 2016**



| | 2016 % | 2015 % |
|---|---|---|
| Motor & motor casualty | 28.9 | 33.9 |
| Commercial & domestic property | 28.2 | 26.5 |
| Marine energy & aviation | 11.6 | 11.1 |
| Workers' compensation | 9.8 | 8.7 |
| Accident & health | 8.8 | 7.4 |
| Public/product liability | 5.5 | 5.8 |
| Professional indemnity | 2.4 | 2.2 |
| Life | 1.9 | 0.2 |
| Financial & credit | 1.6 | 1.3 |
| Agriculture | 1.2 | 1.4 |
| Other | 0.1 | 1.6 |

### Commission and expenses

The net commission ratio remained stable year-on-year as we continue to work closely with our key partners to strengthen relationships and to provide customer-centric solutions.

The net underwriting expense ratio was higher at 21.8%, compared with 21.0% in 2015, due to ongoing investment to support the long-term profitable growth strategy. We continue to make the necessary investment in technology to bring digital solutions to our partners and customers and also in data analytics to improve underwriting and business intelligence. We remain vigilant in closely monitoring all expenses across the division as we manage for growth.

## Summary

In line with the ongoing implementation of the Emerging Markets profitable growth strategy, the division delivered another solid result in 2016.

In Asia Pacific, profitability remains encouraging amid challenging market conditions reflecting the strength of our franchise. In Latin America, we continue to closely monitor portfolio performance and will remediate where necessary to improve underwriting performance.

In sustaining a solid growth trajectory, we will focus exclusively on winning and retaining high quality business in both Asia Pacific and Latin America. Having regard to the Group's core strengths and capabilities, we will remain focused on the four areas where we see the highest potential for profitable growth: commercial, specialty, SME and personal lines with strategic partners. In 2016, these core areas of business grew by more than 20%.

Across these four core areas and especially in segments such as marine and construction, we continue to be positively impacted by international trade flows and by rising infrastructure investment in both regions. Specific to personal lines, we are building additional strategic partnerships in both bancassurance and affinity to enable us to access target customers without needing to create our own retail distribution network.

The implementation of a single operating model across Emerging Markets is also enhancing productivity, efficiency and consistency. We continue to strengthen our underwriting capabilities through the regional centres of excellence and locally through the QBE Underwriting Academy program. A number of senior management appointments and changes have also been made to ensure the right team is in place to deliver on our profitable growth promise.

Evidencing our efforts, in 2016 we won of a number of awards. In Indonesia, we were presented with the Best Financial Performance General Insurance Company 2016 award by the Indonesian business magazine *Warta Ekonomi*. In Singapore, QBE was named the Best General Insurance Company 2016 by *World Finance* magazine. In the CFO Innovation Awards, QBE was voted the Best Trade Credit Insurance provider in Asia. QBE was also shortlisted as one of the top three insurers in the 'General Insurance Company of the Year' category in the Asia Insurance Industry Awards.

I would like to take this opportunity to thank my colleagues in Asia Pacific and Latin America for their ongoing commitment and for delivering another solid result for our shareholders.

# Equator Re business review

"Equator Re remains core to the management of the Group's risk appetite and capital through its role in optimising divisional retentions and managing the Group's innovative global ceded reinsurance program."

**Jim Fiore**

Group Chief Reinsurance Officer & President • Equator Re

| Gross written premium US$ million | Net earned premium US$ million | Underwriting result US$ million | Insurance profit US$ million |
|---|---|---|---|
| 1,349[1] | 468[1] | 137[1] | 164[1] |
| ↑ 34% from 2015 | ↑ 28% from 2015 | ↑ $97M from 2015 | ↑ $61M from 2015 |
| | | Combined operating ratio 70.7%[1] (2015 89.0%) | Insurance profit margin 35.0%[1] (2015 28.1%) |

## 2016 overview

Equator Re continues to assist the divisions in managing their balance sheet and capital requirements and, in 2016, provided a number of innovative and bespoke solutions that assisted Group capital optimisation.

Equator Re successfully developed divisional covers to complement the Group Large Risk and Catastrophe (GLRC) aggregate reinsurance program, providing increased certainty for each division around their expected large individual risk and catastrophe claims. Equator Re's top and bottom line result benefited from the provision of these divisional large risk and catastrophe (DLRC) protections.

The result also benefited from the divisions electing to novate their rights to future recoveries under the Group Aggregate Risk (GAR) reinsurance program to Equator Re. In so doing, the divisions achieved certainty with respect to these potentially volatile recoveries.

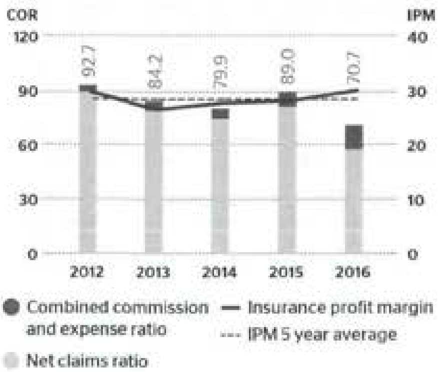
Equator Re also completed a loss portfolio transfer (LPT) transaction with North American Operations to assist in the management of commercial auto liabilities. The effect of this was to increase net earned premium by $183 million and net claims incurred by approximately $185 million. Although largely profit neutral, as highlighted in the table overleaf, the LPT transaction adversely impacted Equator Re's combined operating ratio by 8.6% (with a 12.3% adverse impact on the net claims ratio partially offset by a 3.7% positive impact on the combined commission and expense ratio).

In order to assist year on year comparability, the commentary hereafter refers to the 2016 results excluding the impact of this LPT transaction.

1 Adjusted for North American Operations LPT transaction.

**Gross written premium and net earned premium** (US$M)


**Combined operating ratio (COR) and insurance profit margin (IPM)** (%)




# Operating and financial performance

## Underwriting performance

Equator Re delivered a strong underwriting result in 2016, recording a significantly improved combined operating ratio of 70.7% compared with 89.0% in the prior corresponding period.

At the same time, Equator Re was able to increase gross written premium by 34% and net earned premium by 28%. This premium growth resulted from the successful completion of a number of initiatives implemented to assist the divisions and the Group in managing their respective balance sheet and capital requirements.

An important contributor to the improved 2016 underwriting performance was positive prior accident year claims development, largely generated by increased recoveries on the novated GAR contract. During 2015, the level of recoveries under that same reinsurance program reduced (largely due to adverse currency movements), thereby contributing to the significant adverse 2015 prior accident year claims development.

As previously noted, the development of bespoke DLRC covers benefited Equator Re's premium income and profitability.

Equator Re's result was also impacted by an increased volume of proportional business, as a result of both increased shares in divisional programs and underlying growth in the relevant divisional portfolios. This business typically generates a higher (but arguably less volatile) combined operating ratio than Equator's existing excess of loss portfolio, and will therefore create upward pressure on the combined operating ratio. In 2016, this pressure was more than offset by the profitability of the DLRC covers.

## Underwriting result

| FOR THE YEAR ENDED 31 DECEMBER | | 2016 | 2016[1] ADJUSTED | 2015 | 2014 | 2013 | 2012 |
|---|---|---|---|---|---|---|---|
| Gross written premium | US$M | **1,532** | **1,349** | 1,007 | 642 | 783 | 939 |
| Gross earned premium | US$M | **1,429** | **1,246** | 994 | 764 | 802 | 922 |
| Net earned premium | US$M | **651** | **468** | 367 | 525 | 509 | 621 |
| Net incurred claims | US$M | **453** | **268** | 297 | 389 | 400 | 553 |
| Net commission | US$M | **50** | **50** | 17 | 18 | 21 | 17 |
| Expenses | US$M | **13** | **13** | 13 | 13 | 8 | 6 |
| Underwriting result | US$M | **135** | **137** | 40 | 105 | 80 | 45 |
| Net claims ratio | % | **69.6** | **57.3** | 80.9 | 74.2 | 78.6 | 89.0 |
| Net commission ratio | % | **7.7** | **10.7** | 4.6 | 3.3 | 4.1 | 2.7 |
| Expense ratio | % | **2.0** | **2.8** | 3.5 | 2.4 | 1.5 | 1.0 |
| Combined operating ratio | % | **79.3** | **70.7** | 89.0 | 79.9 | 84.2 | 92.7 |
| Adjusted combined operating ratio[2] | % | **78.9** | **70.2** | 89.9 | 75.0 | – | – |
| Insurance profit margin | % | **24.9** | **35.0** | 28.1 | 27.7 | 26.5 | 29.7 |

1 Adjusted for North American Operations LPT transaction.

2 Combined operating ratio adjusted to exclude the impact of changes in risk-free rates used to discount net outstanding claims. Management-based results were not reported in 2013 and prior.

***Premium income***

Gross written premium increased by $342 million or 34% to $1,349 million from $1,007 million in the prior corresponding period. This growth was largely due to the provision of DLRCs to all divisions and growth in our proportional book. Growth in proportional premium reflects new cessions to Equator Re as part of the Group's external reinsurance cost saving initiative, as well as growth in the underlying business that is subject to the proportional quota shares, particularly the growing Specialty business in North America.

Net earned premium increased by $101 million or 28% to $468 million from $367 million in 2015. Gross written premium growth generated from the DLRCs was largely offset by increased outwards reinsurance expense, with Equator now incurring the entire cost of the GLRC (that was previously incurred by all divisions). In comparison, growth in proportional premium income was largely retained.

Reduced external excess of loss reinsurance costs also assisted in increasing Equator Re's net earned premium.

**Claims expense**

During 2016, Equator Re's bespoke catastrophe programs assisted Emerging Markets and Australian & New Zealand Operations in limiting the cost of a number of major catastrophic events, including Cyclone Winston that impacted Fiji in February, a devastating earthquake in Ecuador in April and a significant earthquake in New Zealand in November. Whilst the impact of these events was offset by a relatively lower frequency of northern hemisphere catastrophe activity resulting in an average catastrophe result overall for Equator Re, this nonetheless represented a deterioration compared with the especially benign 2015 catastrophe experience.

Equator Re's property risk and trade credit programs were impacted by a higher frequency and severity of claims across most divisions. Equator Re was able to absorb this adverse claims experience due to the comprehensive protection offered by the Group's large risk and catastrophe aggregate program.

The result benefited from $56 million of positive prior accident year claims development compared with $120 million of adverse development in 2015, largely reflecting increased recoveries on the novated GAR contract as previously noted.

**Commission and expenses**

The combined commission and expense ratio increased significantly to 13.5% from 8.1% reported in 2015.

Equator Re's commission ratio increased to 10.7% from 4.6% in the prior corresponding period, reflecting growth in proportional business that incurs higher commissions relative to the excess of loss portfolio. This was partially offset by a reduction in the underwriting expense ratio to 2.8% from 3.5% in 2015, which was largely driven by strong net earned premium growth.

In real terms, expenses of $13 million were in line with the prior period. During 2015, the transitioning of the majority of finance and policy administration roles to our Group Shared Services Centre (GSSC) in Manila generated a number of one-off transition related costs that were not repeated in 2016. However, the build-out of our capability in Bermuda to meet the increasing needs of our divisional customers did generate an increase in Bermuda based run rate costs in 2016.

## Summary

Overall, 2016 was a very successful year for Equator Re. We delivered a strong underwriting result while increasing the portfolio of products offered to our divisional customers. Many of these new initiatives facilitated the release of excess divisional capital, thereby assisting the Group in meeting its financial strength and capital flexibility ambitions. At the same time, Equator Re was able to pay a $450 million divideud to our parent entity.

From an operational perspective, having transitioned a number of activities to the GSSC in 2015, it was pleasing to see that we are now starting to leverage that investment. Equator Re now has a stronger platform from which to continue to support new global initiatives in a cost effective and efficient manner, with approximately 50% of our staff based in the GSSC. As part of QBE's finance transformation program, we are continually reviewing the mix of work between onshore and offshore locations to ensure the most optimal cost structure for the Group's captive. We also leverage divisional and Group resources and look for ways to better collaborate globally to create further efficiencies.

I would like to thank the Group's Global Reinsurance Operations team for all their hard work and dedication during 2016. Whilst the financial results indicate an impressive performance, this has not been achieved without significant input and effort from all of our worldwide teams.

# Divisional outlook for 2017

## North American Operations

North American Operations aims to be a top quartile, diversified specialty insurer in the markets in which we compete. The goal is to deliver sustainable, profitable growth with a strong underwriting margin.

During 2016, we further strengthened the depth and breadth of our management team while building a truly national platform, both of which are essential to remaining a profitable and growing operation. Although faced with competitive industry challenges, the outlook for 2017 remains positive. Improvements in underlying business trends indicate that the North American transformation is on track and our expanded field operations are well established with highly respected and recognised industry executives which bodes well for future growth and industry relevance.

Despite headwinds in resetting our Property & Casualty business, the growth of our Specialty franchise and diversification from our high quality Crop and Reinsurance businesses underpin our confidence in sustaining a mid-90s combined operating ratio over the medium-term.

## European Operations

European Operations is prepared for another challenging year but, as always, will remain focused on further improving an already very strong business. In this regard, several ongoing operational projects are expected to deliver additional benefits in 2017 and beyond.

Our approach to new business will be careful and considered but we expect to see even more value from our extended distribution during 2017 with most growth coming from our continental European offices.

Inevitably, managing the outcome of the European Union referendum is very important and remains a priority for the executive team.

## Australian & New Zealand Operations

The insurance market will remain competitive; however, the premium rate cycle is hardening as our competitors respond to higher claims costs and continuing low investment returns. We anticipate premium rate increases at least in line with claims inflation and in some products, particularly property and motor vehicle, at levels above inflation.

We will drive further improvement in our attritional claims ratio during 2017 as the remediation initiatives are fully embedded and earned through the underwriting account. Improved risk selection is also expected to benefit our large individual risk claims ratio.

The NSW Government remains committed to regulatory reform in the CTP market. At this stage, the exact nature of the likely changes is difficult to predict. We continue to work closely with the Government in relation to the proposed reforms that aim to deliver a fairer and more sustainable scheme.

## Emerging Markets

Emerging Markets remains committed to maintaining strong premium growth with an overarching focus on profitability. We continue to build strong partnerships with customers by providing products where the QBE Group's core strengths are best utilised. We remain focused on the areas of business where we see the highest growth potential.

In Asia Pacific, the outlook for all the markets we serve is positive. Strong growth is forecast this year in a number of economies, providing a solid platform for us to continue to expand our business in the region.

In Latin America, overall GDP growth is expected to rebound in 2017. The region has the potential to sustain strong economic growth with more than 160 million people between the ages of 15 and 29.

The favourable longer-term economic outlook for emerging markets in general should translate into additional trade and infrastructure investment, with corresponding positive implications for our business growth.

## Equator Re


Over 90% of Equator Re's portfolio renews at 1 January and our renewal pricing was in line with the broader market. While the majority of our portfolio renewed similar to expiring policy terms and structure, portfolios without claims activity saw rate changes between zero and negative 10% depending on geography and product line.

Equator Re increased its participation on some marine, crop and reinsurance programs that will provide an additional source of income in 2017. While we do not expect major changes to our portfolio during the remainder of the year, we anticipate a change in the earning pattern in 2017, reflecting the increased proportional treaty component of our business. The volume of net earned proportional business will continue to increase as business already written is earned.

The 2017 outwards reinsurance placement was achieved within budget and expectations. External reinsurance premium spend has reduced in line with expectations without any meaningful increase in the retained risk profile of the Group. The structure is as per plan and provides extensive per risk, catastrophe and aggregate protection to the QBE Group.

# Risk: Our business

**2016 saw a number of significant economic and geo-political developments across the globe, most notably the historic Brexit decision and the recent US federal elections. These developments point to a continuation of the uncertain political and economic environment in which we operate, and highlight the increasing importance of a robust approach to the identification, measurement and management of risk.**

QBE is fully committed to ensuring that we apply a disciplined approach to risk management and that our risk management practices and systems are robust, independent and aligned with global best practice. QBE's Enterprise Risk Management (ERM) framework is outlined in QBE's Risk Management Strategy and is supported by frameworks for each risk class, including strategic, insurance, operational, credit, market and liquidity risks. All risk categories are managed through Board governance, an approved risk appetite set by the Board, scenario analysis and stress testing and robust capital management. The ERM framework is applied across the Group and provides a sound foundation for reducing uncertainty and volatility in business performance.

## Risk appetite

Our risk appetite forms the basis of QBE's ERM framework and represents the level of risk that the Board and management are prepared to accept in pursuit of the organisation's objectives. Risk appetite is aligned to, and is considered in, all strategic and business planning decisions QBE makes and we monitor our exposures against the risk appetite on an ongoing basis.

## Governance

The Board plays a significant role in the ERM framework. The Board is responsible for ensuring that an effective risk management strategy is implemented and for defining the risk appetite boundaries within which risk must be managed. The Board is supported by the Board Risk and Capital Committee which meets at least quarterly and is responsible for overseeing active and appropriate management of risks according to the stated risk appetite, strategy and business plans.

QBE manages risk in accordance with the "three lines of defence" governance model. The first line is responsible for managing the risk that arises as a result of activities undertaken in our risk-taking businesses. The second line includes the risk management and compliance functions which are responsible for the maintenance and monitoring of risk management frameworks, as well as the measurement and reporting of risk performance and compliance. The third line is provided by the internal audit function, which is responsible for providing independent assurance to the Board and its various audit and risk committees that risk management and internal control frameworks are working as designed. Having defined responsibilities across all three lines of defence ensures that QBE adopts a coordinated approach to risk management and that accountabilities are clear for our staff.

## Stress and scenario testing

We use stress and scenario testing to better understand our risk profile under a range of different scenarios. Assessing the impact of extreme but plausible events helps us to better prepare for such situations and ensures that our risk exposure is acceptable to the Board.

QBE also uses sophisticated modelling techniques to estimate potential losses, manage exposure and assist in making decisions regarding risk management and coverage. This capability is critical to managing our exposure to possible events, such as natural catastrophes and economic shocks.

## Emerging risks

We recognise that the risk environment changes and evolves over time. Existing risks develop in new or unexpected ways and new risks, which are usually characterised by incomplete but developing knowledge, materialise. QBE operates emerging risk forums across the Group to identify and monitor these emerging risks, analyse their potential impact and develop strategies to mitigate or exploit opportunities.

## Capital management

Capital management is another key component of the ERM framework and aims to achieve the appropriate balance between our risk appetite and the amount of capital required to support each of our businesses. QBE uses a number of capital management tools to support the assessment of risk and allocation of capital including:

- QBE's Economic Capital Model – QBE's internal model, developed to measure overall exposure to risk as well as exposure to each of our main categories of risk, provides a quantitative base for us to understand, monitor and manage our exposures. We also use the model to make better business decisions, assess economic capital requirements and measure performance on a risk-adjusted basis.
- Analysis of regulatory and rating agency capital models – to better understand how regulatory and rating agencies assess the impact of our strategic decisions on our risk profile and capital requirements, we conduct financial modelling analysis with reference to the requirements of the various capital environments in which QBE operates.
- A number of bespoke risk assessment tools – we use catastrophe models, scenario analysis, stress tests and reverse stress tests to evaluate business plans and support our capital plan.

Another key capital management tool is QBE's Internal Capital Adequacy Assessment Process (ICAAP). The ICAAP is supported by both the Economic Capital Model and scenario analysis, and is used to:

- manage the capital held by QBE;
- monitor the risk profile against appetite;
- ensure the risks taken by QBE are commensurate with required returns;
- allocate capital to operating entities for planning and performance monitoring purposes; and
- analyse alternative reinsurance options and regulatory and rating agency submissions.

Several actions were completed during 2016 as part of our proactive management of QBE's risk profile. These included reinsurance of long-tail run-off reserves in our European and North American divisions to reduce potential future volatility in our result and balance sheet; full assessment and modelling of the Group's reinsurance arrangements to support the 2017 placements; and restructuring of our borrowings to achieve greater capital efficiency.

## Business performance oversight

As well as proactive and formalised engagement of the risk function in the review and oversight of the strategic and business planning process, we continue to apply stress and scenario testing to our performance against plan, incorporating scenario analysis to identify and quantify the risks to our business. This allows us to proactively consider the various exposures we may face as an organisation and determine what additional mitigation or remediation activities may be required.

## Risk culture

QBE defines risk culture as observable patterns of behaviour in the way employees perform their work and the judgements they take, as it relates to risk. Risk culture is an integral component of QBE's ERM framework and, like other components of the framework, we continuously enhance our risk culture approach. We are currently focusing on achieving greater alignment between risk culture, the wider organisational culture and conduct risk, as well as further embedding first line accountability for risk culture, including through remuneration and reward. This is in addition to our ongoing initiatives to maintain a strong risk culture across the Group.

## Investment, market, credit and liquidity risk

QBE actively manages its exposures to investment, market and credit risks that arise inherently from the management of a global insurance operation, including risks generated through:

- the management of a global investment portfolio;
- regular insurance activities and exposure to reinsurance counterparties; and
- global treasury operations, including exposures to foreign exchange movements, collateral management and bank counterparty risks.

Risks to earnings due to material market movements, risk concentrations and changes to credit quality are identified, measured and controlled. These are subject to risk management frameworks and oversight within defined Board-approved risk appetites that are monitored via limits structures and specific delegated authorities.

In 2016, we have made further improvements to our risk systems that will lead to an improved risk analytics capability which will further inform our decision-making process and enable improved risk-return decisions.

QBE's liquidity risk framework is designed to ensure that QBE has sufficient high-quality liquid assets at all times, including at times of severe stress, to meet our liabilities as they fall due. Liquidity risk is monitored against specified limits within the Board-approved risk appetite and supporting processes ensure that contingency plans are in place to address crisis situations.

## Regulatory risk

As a global insurance group, QBE is subject to oversight by approximately 30 prudential regulatory regimes around the world, as well as extensive legal and regulatory requirements and obligations, industry codes and business and ethical standards across its business activities.
To manage the regulatory and compliance risk we face as a global organisation, we combine local expertise with a globally consistent compliance framework.

# Board of directors

### W. Marston (Marty) Becker JD, BSBA

**Chairman | Age 64**

Marty was appointed as an independent non-executive director of QBE in 2013 and Chairman in April 2014. Marty is a member of the Audit, Investment, Remuneration, Risk and Capital, and Operations and Technology Committees. Marty is the Chairman of West Virginia Media Holdings and previously served as President and CEO of Alterra Capital Holdings Limited. Marty has over 35 years' experience in general insurance, reinsurance, investment banking and private equity and has held various insurance and reinsurance executive positions.

### Stephen Fitzgerald B Ec

**Independent non-executive director | Age 53**

Stephen was appointed as an independent non-executive director of QBE in 2014. He is Chairman of the Investment Committee and a member of the Risk and Capital, and Operations and Technology Committees. Stephen is Chairman of Affirmative Investment Management. Previously, Stephen was a member of the Board of Guardians of the Future Fund (Australia's Sovereign Wealth Fund), and Chairman of Goldman Sachs, Australia and New Zealand. He also served on the Goldman Sachs Partnership Committee.

### John M. Green B JURIS/LLB, FAICD, SF FIN

**Deputy Chairman | Age 64**

John became an independent non-executive director of QBE in 2010. As well as Deputy Chairman, he is Chairman of the Remuneration Committee, Deputy Chairman of the Investment, and Operations and Technology Committees and a member of the Risk and Capital, and Audit Committees. Previously, John was a non-executive director of WorleyParsons, and had 30 years' experience in the financial services and other sectors as an investment banker and, earlier, a lawyer. He is also a novelist and co-founder of book publisher Pantera Press.

### Margaret Leung B Ec

**Independent non-executive director | Age 64**

Margaret Leung was appointed as an independent non-executive director of QBE in 2013. Margaret is the Deputy Chairman of the Remuneration Committee and a member of the Audit Committee. Margaret is a director of Chong Hing Bank, Hong Kong Exchanges and Clearing Limited, Sun Hung Kai Properties, Li & Fung Ltd and First Pacific Company Limited. Margaret was previously the CEO of Hang Seng Bank Limited and director of China Construction Bank Corporation.

### Kathryn (Kathy) Lisson B. Sc (Honours)

**Non-executive director | Age 64**

Kathy was appointed as a non-executive director in September 2016. Kathy is Chairman of the Operations and Technology Committee, and a member of the Audit Committee. Until 2016, Kathy was a partner of Ernst & Young LLP, where she led the firm's Canadian Insurance Advisory practice, and before that she was the COO for QBE European Operations. Previously, Kathy held senior roles at Price Waterhouse and Bank of Montreal in Canada, and at Barclays Bank and Brit Insurance Holdings in the UK.

## John Neal

**Group Chief Executive Officer | Age 52**

John joined QBE in 2003 and was appointed Group CEO in 2012. Prior to this, John held the position of CEO of Global Underwriting Operations as well as several leadership positions in QBE European Operations, most recently as Chief Underwriting Officer. John has over 30 years' experience in the insurance industry and, before joining QBE, was the CEO of Ensign. John developed Ensign to become the UK's leading commercial motor insurance brand. QBE acquired Ensign in 2003.

## Sir Brian Pomeroy MA, FCA

**Independent non-executive director | Age 72**

Sir Brian was appointed as an independent non-executive director of QBE in 2014. Sir Brian is Chairman of the Audit Committee and a member of the Risk and Capital Committee. He was formerly a non-executive member of the Board of the Financial Conduct Authority in the UK, a nominated member of the Council of Lloyd's of London and a non-executive director on QBE's European regulated boards. He was the senior partner of Deloitte Consulting in the UK until 1999.

## Patrick (Pat) Regan BSc, ACA

**Group Chief Financial Officer and Chief Executive Officer, Australian & New Zealand Operations | Age 50**

Pat joined QBE as Group Chief Financial Officer and became an executive director in 2014. He was appointed CEO, Australian & New Zealand Operations in 2016, and is in the process of transitioning out of his Group Chief Financial Officer role. Prior to joining QBE, Pat was the Chief Financial Officer at Aviva Plc in London. Pat has more than 27 years' of professional accounting experience of which nearly 20 years is in insurance and financial services. Pat was previously the CFO/COO of Willis and has held several roles at RSA and AXA.

## Jann Skinner B Com, FCA, FAICD

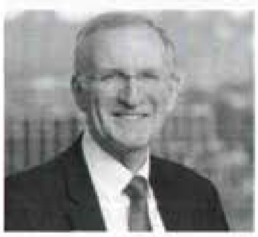
**Independent non-executive director | Age 59**

Jann was appointed as an independent non-executive director of QBE in 2014. Jann is Chairman of the Risk and Capital Committee, Deputy Chairman of the Audit Committee and a member of the Remuneration Committee. Jann was a non-executive director on QBE's Australian regulated boards, where she was also Chair of the Audit and Risk and Capital Committees. She has over 30 years' professional accounting experience and was an audit partner at PricewaterhouseCoopers.

## Rolf Tolle Dip PS, Dipl. Pol

**Independent non-executive director | Age 69**

Rolf was appointed as an independent non-executive director in March 2016. Rolf is the Deputy Chairman of the Risk and Capital Committee and a member of the Investment and Remuneration Committees. He has many years' experience in specialist insurance and reinsurance businesses, having held senior positions in a number of global companies.



## Michael (Mike) Wilkins B Com, MBA

**Independent non-executive director | Age 60**

Mike was appointed as an independent non-executive director of QBE in November 2016. Mike is a member of the Audit, Remuneration, and Operations and Technology Committees. He was the Managing Director and CEO of Insurance Australia Group Limited until November 2015. He has more than 30 years of experience in financial services, including serving as Managing Director and CEO of Promina Group Limited and Managing Director of Tyndall Australia Limited. He is currently a non-executive director of AMP Limited and has formerly held non-executive roles at Maple-Brown Abbott Limited and Alinta Limited.

# Group executive committee

## John Neal

**Group Chief Executive Officer | Age 52**

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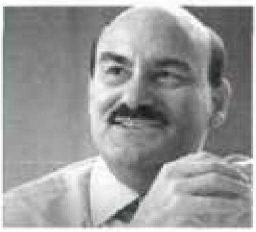
## Jason Brown B ECON ACA

**Group Chief Risk Officer | Age 47**

Jason has been involved in the financial services industry for over 20 years. He was Chief Risk Officer for QBE Australian & New Zealand Operations before being appointed Group Chief Risk Officer in 2014. Jason joined QBE in 2002 and previously held the role of Executive General Manager, Technical & Operations. Jason was previously a Principal at Ernst & Young in both assurance and consulting in Australia and the UK. He is also a Chartered Accountant.



## David Fried BA-ECON/ POLI. SCIENCE

**Chief Executive Officer, Emerging Markets | Age 55**

David joined QBE in 2013 as CEO, Asia Pacific Operations and was subsequently appointed CEO, Emerging Markets in 2014. Prior to joining QBE, David was the Regional CEO of Allianz Asia Pacific, where he was responsible for the insurer's life and non life business across 14 countries. David was previously at HSBC for 27 years, where he worked in numerous senior management and global strategic roles, including as the Group Head of Insurance.

## Russell (Russ) Johnston BSc, BF

**Chief Executive Officer, North American Operations | Age 51**

Russ joined QBE in May 2016 in the role of CEO, North American Operations. Russ has more than 25 years' experience in the insurance industry in North America, and has held a range of senior business and operational roles since joining American International Group (AIG) in 1990. Most recently, Russ was President of AIG Casualty in the Americas, with responsibility for all AIG's US, Canada, Bermuda and London based US Casualty underwriters.

## Margaret Murphy

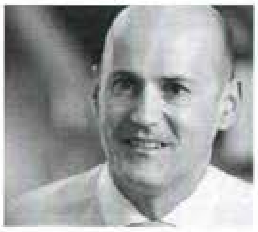
**Group Chief HR Officer | Age 44**

Margaret joined QBE in October 2016 in the role of Group Chief Human Resources Officer. Prior to this, she was the Chief of Staff to the Group HR Director at Barclays plc. After starting her career with the London Underground, Margaret worked with companies including Inchcape, BAT and J Sainsbury before spending 10 years working with Barclays. Her penultimate role at Barclays was as HR Director for Global Functions, where she led a team of 70 HR professionals providing services to over 14,000 people.

## Richard Pryce B HIS (HONS)

**Chief Executive Officer, European Operations | Age 57**

Richard joined QBE in 2012 and was appointed CEO, European Operations in 2013. Richard began his insurance career with R.W. Sturge syndicate at Lloyd's where he became Claims Director. In 1996, Richard moved to Ockham as Professional Lines Class Underwriter for Syndicate 204. Richard went on to run ACE's Financial Lines business in London before becoming President of ACE Global Markets in 2003 and ACE UK in 2007. He has worked in the London insurance market for 34 years.



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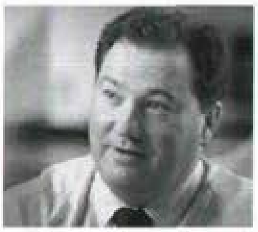


## Colin Fagen[1] B COM, MBA

**Group Chief Operations Officer | Age 49**

Colin was appointed Group Chief Operations Officer in February 2016. Prior to this, he held the positions of Group Chief Strategy Officer and CEO, Australian & New Zealand Operations. His current areas of responsibility include Global Information Technology alignment, Global Shared Service Centre, Data & Analytics, Procurement, Global Claims, and QBE's captive reinsurer, Equator Re. Colin worked for QBE for 17 years and has been involved in the insurance industry for 26 years.

1 Colin ceased employment with QBE on 9 February 2017.

# Corporate governance statement

QBE Insurance Group Limited (QBE) is committed to the highest standards of corporate governance. The QBE Group has a vision and six ONE QBE values that recognise its customers, people, shareholders and the community. QBE believes that a culture that rewards transparency, integrity and performance will promote its long-term sustainability and the ongoing success of its business.

This Corporate Governance Statement relates to the 2016 financial year, and should be read in conjunction with QBE's 2016 Annual Report and the 2016 Sustainability Review. This Corporate Governance Statement has been approved by the Board and is dated 24 February 2017.

## Board and management

### Board functions

The Board Charter sets out the matters expressly reserved for the Board and those delegated to its Committees and management. In accordance with its Charter, the Board:

- oversees corporate governance;
- selects and supervises the Group Chief Executive Officer;
- provides direction to management;
- approves the strategies and major policies of the QBE Group;
- monitors performance against plan;
- considers regulatory compliance;
- monitors people-related strategies (including people development and succession planning);
- reviews information technology and other resources; and
- ensures that an effective risk management strategy is established and maintained.

Strategic issues are reviewed at least annually by the Board. To help the Board maintain its understanding of the business and to effectively assess management, Directors have regular presentations by the divisional chief executive officers and other senior managers of the various divisions on relevant topics including budgets, three-year business plans and operating performance. The Board receives updated forecasts during the year. The Non-executive Directors also have contact with senior executives at numerous times and in various forums during the year.

Visits by Non-executive Directors to the QBE Group's offices in key locations are encouraged. The Board meets regularly in Australia and, due to QBE's substantial overseas operations, usually spends time in the United Kingdom and the United States each year. The Board visited the QBE Group's operations in New York in June and December and in London in October 2016. Delegations from the Board also visited Miami in June and Hong Kong in August 2016 to meet with and receive presentations from local management.

Each formal Board meeting normally considers reports from the Group Chief Executive Officer and the Group Chief Financial Officer, together with other relevant reports. The Non-executive Directors regularly meet in the absence of management. The Chairman and Group Chief Executive Officer in particular, and Directors in general, have substantial contact outside Board and Committee meetings.

Details of the number of Board meetings held during the 2016 financial year and attendance by Directors are set out in the Directors' Report.

The Board delegates responsibility to the Group Chief Executive Officer for management of the business on a day-to-day basis.

### Senior management functions

Management's responsibilities are to:

- develop a draft strategy, make recommendations to the Board and implement the Board approved strategy subject to market conditions;
- prepare annual budgets and three-year business plans;
- carry on day-to-day operations within the Board approved annual budget and three-year business plans subject to market conditions;
- design and maintain internal controls;
- set up and keep under review an effective risk management and compliance management system, and monitor and manage all material risks consistent with the strategic objectives, risk appetite statements and policies approved by the Board;
- inform the Board of material matters, and keep the Board and market fully informed about material continuous disclosure issues; and
- ensure succession plans exist for all senior management positions other than the Group Chief Executive Officer.

QBE has operated under an extensive written system of delegated authorities for many years. In particular, a written delegated authority with specified limits is approved by the Board each year to enable the Group Chief Executive Officer to conduct the QBE Group's business in accordance with detailed budgets and business plans. This authority deals with topics such as underwriting, reinsurance protection, claims, investments, acquisitions and expenses. The Group Chief Executive Officer delegates his authority to management throughout the QBE Group on a selective basis, taking into account expertise and past performance. Compliance with delegated authorities is monitored by management and adjusted as required for actual performance, market conditions and other factors. Management and the QBE Group's internal audit teams review compliance with delegated authorities and any breach can lead to disciplinary procedures, including dismissal.

### Chairman

The Chairman of the Board of QBE is Marty Becker, who was appointed as the independent Chairman of the Board in April 2014. In his role as Chairman, Mr Becker is responsible for ensuring that the Board functions as an effective and cohesive group. Mr Becker works closely with John Neal, the Group Chief Executive Officer, to determine the strategic direction for QBE and to establish high standards of governance and leadership.

### Committees

The Board is supported by several committees which meet regularly to consider audit, risk management, investments, remuneration, technology, operations and other matters. The main Committees of the Board are the Audit, Investment, Remuneration, Nomination, Risk and Capital and Operations and Technology Committees. Further sub-committees of the Board may be convened to confer on particular issues from time to time. Any Non-executive Director may attend a Committee meeting. The Committees have free and unfettered access to QBE's senior managers and may consult external advisers at QBE's cost, including requiring their attendance at Committee meetings, with the consent of the Chairman. A report on each Committee's last meeting is provided to the next Board meeting.

Each Committee comprises at least three independent Directors and each Committee Chairman is an independent Director who is not the Chairman of the Board (excluding the Nominations Committee, the Chairman of which is Mr Becker and the Operations and Technology Committee, the Chairman of which is Kathy Lisson). Each Committee operates under a written charter approved by the Board. These Charters are available at www.qbe.com. The membership of each Committee is provided on our website at www.qbe.com and details of the number of Committee meetings held during the 2016 financial year and attendance by Committee members at Committee meetings are set out in the Directors' Report.

Further information regarding the Committees can be found throughout this Corporate Governance Statement.

### Company Secretary

The Company Secretary acts as secretary to the Board and all of the Committees and is accountable directly to the Board, through the Chairman, on all matters to do with the proper functioning of the Board. All Directors have direct access to the Company Secretary.

The Company Secretary's role is described in the Board Charter and includes communication with regulatory bodies and the Australian Securities Exchange (ASX), all statutory and other filings, assisting with good information flows within the Board and its Committees and between Non-executive Directors and senior management, as well as facilitating induction and professional development as required. The Company Secretary may also provide guidance to Directors in respect of legal and regulatory responsibilities.

### Board skills and experience

Directors are selected to achieve a broad range of skills, experience and expertise complementary to the QBE Group's insurance activities. At the date of this Corporate Governance Statement, the Board comprised eleven Directors, being an independent Chairman, eight other Non-executive Directors, and the Group Chief Executive Officer and Group Chief Financial Officer.

The Board has a skills matrix covering the range of competencies and experience of each Director. When the need for a new Director is identified, the required experience and competencies of the new Director are considered in the context of this matrix and any gaps that may exist.

The Board's skills matrix is below.

| SKILLS | INDUSTRY |
|---|---|
| Financial literacy | General insurance |
| Legal | Reinsurance |
| Governance | Investment banking |
| Strategy | Private equity |
| Commercial expertise | Financial services |
| Risk management | Accounting |
| Government relations | Investment |
| Executive leadership | |
| Digital technology | |
| Cyber security | |
| IT risks | |
| Data analytics | |

# Corporate governance statement CONTINUED

Details of individual Directors, including their qualifications and experience, independence status and the period of office serving on the Board, are set out in the *Board of directors* section and can also be found on the QBE website at www.qbe.com.

## Independence of the Board

The majority of the Board are independent Directors, applying the "independence" definition of the ASX Corporate Governance Council. When applying this definition, the Board has determined that an independent Director's relationship with QBE as a professional adviser, consultant, supplier, customer or otherwise is not material unless amounts paid under that relationship exceed 0.1% of QBE's revenue. None of the independent Directors provide services to QBE other than in their capacity as an independent Director and they do not have a business relationship with any other Director on the Board or otherwise with QBE. The roles of QBE's Chairman and Group Chief Executive Officer are also not exercised by the same individual.

Directors are required to advise the Board on an ongoing basis of any interest they have that they believe could conflict with QBE's interests. If a potential conflict does arise, either the Director concerned may choose not to, or the Board may decide that he or she should not, receive documents or take part in Board discussions whilst the matter is being considered.

## Tenure

The mere fact that a Director has served on the QBE Board for a lengthy period of time does not, of itself, suggest a lack of independence; however, the Board has agreed that an independent Director's term should be approximately 10 years. The Board considers that a mandatory limit on tenure would deprive the QBE Group of valuable and relevant corporate experience in the complex world of international general insurance and reinsurance. The tenure of each Director is set out in the *Board of directors* section and can also be found on the QBE website at www.qbe.com.

QBE's constitution provides that no Director, except the Group Chief Executive Officer, shall hold office for a continuous period in excess of three years or past the third AGM following a Director's appointment, whichever is the longer, without submission for re-election. Under QBE's constitution, there is no maximum fixed term or retirement age for Non-executive Directors.

## Board selection process

The Board has a Nomination Committee which meets regularly during the year around the time of the Board meetings. The Committee assists the Board in appointing Directors so that the Board as a whole has the necessary range of skills, knowledge and experience to be effective. The Nomination Committee is comprised of all the Non-executive Directors of the Board and is chaired by Mr Becker.

A formal process for the selection and appointment of Directors is undertaken by the Nomination Committee and Board. Before the Board appoints a new Director or puts forward a candidate for election, appropriate background checks are undertaken. External consultants may be employed, where necessary, to search for prospective Directors. Candidates are assessed against the required skills and on their qualifications, backgrounds and personal qualities. In addition, candidates must have the required time to commit to the position. The Board regularly reviews the mix of skills that is required. Under QBE's Constitution, the size of the Board is limited to 12 Directors. The Board considers that a maximum of 12 will reflect the largest realistic size of the Board that is consistent with:

- maintaining the Board's efficiency and cohesion in carrying out its governance duties on behalf of shareholders;
- reducing the risk of a Director being insufficiently involved and informed in the business of QBE; and
- providing individual Directors with greater potential to contribute and participate.

QBE also provides shareholders with all material information in its possession that is relevant to a decision on whether or not to elect or re-elect a Director through a number of channels, such as the Notice of Meeting, Director biographies and other information contained in the Annual Report.

The Board adopted revised Non-executive Director Nomination, Performance Evaluation and Tenure Guidelines in September 2014. The Board believes that orderly succession and renewal contributes to strong corporate governance and is achieved by careful planning and continual review. As an ongoing evaluation, the Board regularly discusses its make up in relation to an appropriate mix of skills and experience, tenure, age spread, general diversity (including gender) and geographic location of Directors to meet the needs of QBE.

## Director induction and training

Upon appointment, each Non-executive Director (and senior executive) is provided with a written agreement which sets out the terms of their appointment. Directors also attend induction sessions upon their appointment, where they are briefed on QBE's history and vision, strategy, financials, and risk management and governance frameworks.

The Board ensures it has the information it requires to be effective including, where necessary, independent professional advice. A Non-executive Director may seek such advice at QBE's cost with the consent of the Chairman. Directors are also provided with ongoing professional development and training programs to enable them to develop and maintain their skills and knowledge at QBE's cost, with the consent of the Chairman.

## Performance evaluation and remuneration

### Performance evaluation – Board and Directors

The Chairman oversees the performance of the Board, its Committees and each Director. The Board regularly reviews its performance through internal and external assessments, and recommendations for either improvement or increased focus are agreed and then implemented.

In 2016, a Board evaluation was undertaken using the services of external consultants. The review covers the performance of the Board and its Committees. The result of the review was reported to the Chairman and discussed in detail by the Board in 2016.

### Performance evaluation – senior management

The Remuneration Committee oversees the performance of senior management. In addition, the Board continually monitors the performance of senior management through regular contact and reporting.

In 2016, QBE continued to use a balanced scorecard of individual key performance indicators (KPIs) to ensure that a broader view of performance and specific strategic priorities are considered when assessing performance and incentive outcomes. Other than as set out in the Remuneration Report, senior management have 20% of their Short Term Incentive outcome determined with reference to individual KPIs.

The scorecard is aligned to QBE's business plans and measures objectives which support the elements of QBE's value creation model. The Remuneration Report sets out a summary of the key objectives and outcomes for the Group Chief Executive Officer. The Group Chief Executive Officer's scorecard was formulated initially through a discussion between the Group Chief Executive Officer and the Chairman and was approved by the Board. The scorecards for the rest of senior management (which are consistent with and support the scorecard for the Group Chief Executive Officer) were approved by the Remuneration Committee.

The 2016 objectives for senior management were used to measure their performance for the 2016 year. These performance evaluations occurred in 2017.

### Remuneration Committee

The Board has a Remuneration Committee which meets at least quarterly to assist it in overseeing major remuneration practices of the QBE Group. The Remuneration Committee is comprised of independent Directors and is chaired by John M Green.

### Remuneration policies and practices

Details of QBE's policies and practices regarding the remuneration of executives and Non-executive Directors (being Key Management Personnel) are set out in the Remuneration Report.

Other than meeting statutory superannuation requirements, QBE does not have in place any retirement benefit schemes for Non-executive Directors.

QBE's Trading Policy for dealing in securities of QBE Insurance Group Limited or other entities outlines QBE's approach to derivatives or otherwise limiting the economic risk of participating in an equity-based remuneration scheme. The Trading Policy is available at www.qbe.com.

## Group governance

### Group governance framework

The Board approved a new framework in 2013, which has continued to evolve. The framework includes, in particular:

- revised roles for the boards of divisional holding companies and divisional insurers; and
- divisions having committees similar to the QBE Board.

There is now a greater liaison between the QBE Board and the divisional holding boards. The QBE Board also meets separately with local independent Directors at least once a year. These changes followed a review of governance at QBE Group and divisional levels.

### Group guidelines

The QBE Group has adopted a Code of Business Ethics and Conduct that applies to all employees of the QBE Group worldwide. The Code of Business Ethics and Conduct builds on our company values and is an essential resource and guide for our people. It outlines a range of business ethics and standards of conduct and requires our employees to be respectful, professional, considerate and to maintain high ethical standards, uphold QBE's reputation and report unethical or illegal behaviour. The Code covers matters such as a commitment to compliance with laws and regulations, the giving and receiving of bribes and gifts, conflict of interests, use of company resources and external activities. The Code is available at www.qbe.com.

Director conduct is covered by the Non-executive Directors' Nomination, Performance Evaluation and Tenure Guidelines. These Guidelines cover Director conduct, particularly in regard to tenure, performance and evaluation. The Guidelines are available at www.qbe.com.

# Corporate governance statement CONTINUED

The QBE Group has also adopted global policies in key compliance areas, including Anti-Bribery and Anti-Corruption, Sanctions, Whistleblowing and Diversity and Inclusion. These policies, like the Code of Business Ethics and Conduct, recognise that our employees (including our contractors, Directors and agents) are key to maintaining a compliant and ethical approach to our business practices. The global policies are supported by Group Guidelines that provide additional information to support our employees.

In Australia, QBE complies with the General Insurance Code of Practice; a self-regulated code developed by the Insurance Council of Australia relating to the provision of products and services to customers of the general insurance industry in Australia. QBE's Australian business is also a member of the Financial Ombudsman Service; an ASIC approved external dispute resolution body which deals with general insurance disputes between consumers and insurers.

### Continuous disclosure

The Board adopted a revised Continuous Disclosure Policy in February 2015, which is available at www.qbe.com.

QBE takes its continuous disclosure obligations seriously and issues market releases during the year to satisfy those obligations. ASX announcements are set out on QBE's website at www.qbe.com.

## Diversity and inclusion

QBE offers a dynamic workplace culture, one that values and leverages the ideas, capabilities and experiences of our global workforce. We believe this strengthens our ability to deliver on our business goals, particularly as it relates to innovation, performance and our focus on customers. It also supports our approach to responsible management of our people, culture and community. For additional information please see QBE's 2016 Sustainability Review.

QBE's Global Diversity & Inclusion Policy, sets out a set of principles that highlight how we guide our actions and ensure dignity and respect in the workplace. At its core this policy looks to drive equality and consciously remove barriers, eliminating all forms of discrimination and harassment; ensuring equal opportunity and access for all people, both within QBE and externally with our key stakeholders.

Annual reporting to the QBE Board and quarterly discussions of the Group Diversity & Inclusion Council (represented by the Group Executive Committee) as well as divisional leadership teams have continued this year, with noticeable progress summarised below:

| COMMITMENT | ACHIEVEMENTS |
|---|---|
| **Diverse leadership representation** *– looking to foster inclusive, gender balanced leadership teams* | • Female representation at senior levels (L0-3) has increased to 28% (up 1% over the year) (see Table A).<br>• In addition to an ongoing focus on retaining and developing Level 2 high potential females, we expanded our pipeline focus looking at identifying high potentials at Level 3, 36% of whom are female.<br>• Our annual pay equity analysis was expanded to assess outcomes of pay decisions (for example, at annual salary reviews, on hire or promotion of senior roles). Each division worked locally to identify hotspots and develop strategies to address gaps across certain levels and job families, as well as targeted segments e.g. high potential talent. |
| **Inclusive capabilities** *– effectively manage and drive collaboration and inclusion in teams, leveraging flexibility to increase productivity and retention* | • There have been significant efforts to promote our commitment to 'Inclusive Leadership' across divisions. Initiatives included mentoring programs; employee network events led by senior leaders; globally coordinated celebration and awareness sessions relating to gender equality, LGBT inclusion, importance of work/life balance and building awareness of providing opportunities for people with disability.<br>• We continue to invest in educating and upskilling our leaders through the ***Global Leadership Academy***: an additional 531 employees globally attended the programs, of which 43% were female. A total of 2,351 employees have participated in the Academy since its introduction in 2013 (42% being female).<br>• New ***Leadership Insights*** 360 & 180 feedback surveys were launched, supporting greater self-awareness and education on inclusive leadership capabilities – a total of 327 employees have undertaken these surveys (45% being female). |

| COMMITMENT | ACHIEVEMENTS |
| --- | --- |
| **Strong pipeline of diverse talent** – *offer all employees the opportunity to develop and progress their careers – maximising the ability to attract, retain and optimise all talent* | • A new Career Development Portal was developed and launched on our global intranet site, providing tools, tips and other resources to help employees in managing their career aspirations. |
| **Higher engagement of all employees** – *create a fair, inclusive and respectful environment for all employees* | • We have seen our overall engagement score improve from last year (now at 64%) with pleasing progress in the proportion of employees who feel we provide a work environment that is collaborative, supportive of flexibility and respectful of differences.<br>• Across Divisions, we have upgraded our employee benefits and leave provisions, offering enhanced support and options for employees with caring responsibilities. QBE North America was named as one of the best Adoption-Friendly Workplaces in the U.S. by the Dave Thomas Foundation for Adoption. |
| **Customer satisfaction and retention** – *harness our global workforce to drive innovation and creativity in supporting diverse customer needs* | • We have introduced a global Innovation Lab to explore ways to engage our diverse workforce in creating new ideas with technologies in our lab to support how we enhance customer solutions.<br>• To be closer to the customer we continue to produce selected product materials and documents into languages other than English across various countries including Hong Kong, Indonesia, Thailand, French Polynesia, New Caledonia and Vietnam.<br>• Our global product innovation, Premiums4Good, allows targeted customers to direct a proportion of their premium to be invested in securities with an additional social objective. Examples of these investments include Social Impact Bonds, green bonds and investments into infrastructure projects with social benefits some of which focus on carers of children, youth mental health and employment as well as children's education. |

## Gender diversity measures

In December 2015, the Remuneration Committee set a new Board gender goal of 30% by 2020, aligned with the QBE objective of fostering inclusive, gender balanced leadership. QBE's global workforce as at 31 December 2016 is made up of 53% (7,526) women and 47% (6,698) men.

Details of gender representation across management levels together with targets set for achievement by 2020 are set out below:

### Table A

| GENDER REPRESENTATION | ACTUAL 31 DECEMBER 2016 | BASELINE 31 DECEMBER 2015 | GENDER TARGET BY 2020 |
| --- | --- | --- | --- |
| QBE Board | **27%** | 22% | 30% |
| Group Executive positions (Level 0) | **11%** | 10% | |
| Level 1 | **22%** | 20% | |
| Level 2 | **22%** | 21% | |
| Level 3 | **30%** | 29% | |
| Women in management (Total % of Levels 0, 1, 2 &3) | **28%** | 27% | 35% |
| Women in workforce | **53%** | 53% | |

# Corporate governance statement CONTINUED

## Respecting the rights of shareholders

QBE respects the rights of its shareholders by providing them with appropriate information and facilities to allow them to exercise those rights effectively.

QBE aims to provide shareholders with up-to-date information. QBE also provides regular communications to shareholders and other stakeholders through a number of publications including the Annual Report, Half Year Report, Annual Review and Sustainability Report. Hard copies of these documents are sent to shareholders who have opted to receive these in printed form. All reports are available at www.qbe.com. The website also provides information about QBE's history, vision and corporate governance, as well the biographies about Directors and the QBE Group Executives.

QBE provides shareholders the option to receive all communications from QBE and its share registry electronically, and encourages shareholders to do so where possible. Shareholders can discuss their shareholding with either the shareholder services department or the share registry, both located in Sydney.

QBE welcomes shareholder participation at its Annual General Meeting (AGM), either in person or by proxy. The AGM is held in Sydney each year and webcast to shareholders that are unable to attend in person. Shareholders are also encouraged to provide questions or comments ahead of the meeting, and ask any direct questions to the Chairman or the external auditor at the AGM. All resolutions in the Notice of Meeting have explanatory notes. Shareholder Communication Guidelines are available at www.qbe.com.

QBE has a comprehensive investor relations program that facilitates effective communication with its investors. The Group Chief Executive Officer, Group Chief Financial Officer, Group Chief Risk Officer, Group Chief Operations Officer, Group General Counsel and Company Secretary, Global Head of Investor Relations, divisional chief executives and divisional finance officers generally deal with analysts, investors, media, rating agencies and others, taking account of regulatory guidelines including those issued by the ASX on continuous disclosure. The presentations on the 30 June and 31 December results and other major presentations are sent to the ASX before the presentations commence and are available promptly on the QBE Group's website. The 30 June and 31 December presentations are also webcast live and subsequently archived on the QBE Group's website.

## Financial and other reporting

### Audit Committee

The Board has an Audit Committee which meets at least quarterly to support the Board in overseeing the effectiveness of the QBE Group's financial reporting and risk management framework. In particular, the Audit Committee oversees and monitors the integrity of the QBE Group's financial reporting. The Audit Committee is comprised of Non-executive Directors, a majority of whom are independent Directors, and is chaired by Sir Brian Pomeroy.

### CEO and CFO declaration

Prior to the Audit Committee's review and the Board's approval of the 2016 Annual Report, the Group Chief Executive Officer and Group Chief Financial Officer provided a declaration to the Board that, in their opinion, the financial records were properly maintained, that the financial statements complied with the appropriate accounting standards and that they gave a true and fair view of the financial position and performance of the QBE Group. The declaration also provides that the opinion of the Group Chief Executive Officer and Group Chief Financial Officer was based on a sound system of risk management and internal control which is operating effectively.

### External auditor independence

QBE firmly believes that the external auditor must be, and must be seen to be, independent. The external auditor confirms its independence and the Audit Committee confirms this by separate enquiry. The Audit Committee meets with the external auditor in the absence of management as part of each Committee meeting. The external auditor attends the AGM and a representative is available to answer questions from shareholders relevant to the audit.

The Audit Committee has free and unfettered access to the external auditor. The external auditor, the Group Head of Internal Audit and the Group Chief Actuary have free and unfettered access to the Audit Committee.

QBE has issued an internal guideline on external auditor independence. Under this guideline, the external auditor is not allowed to provide the excluded services of preparing accounting records, financial reports or asset or liability valuations. Furthermore, it cannot act in a management capacity, as a custodian of assets or as a share registry.

The Board believes some non-audit services are appropriate given the external auditor's knowledge of the QBE Group. QBE may engage the external auditor for non-audit services other than 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.

The Audit Committee approves the audit plan each year and receives regular information on the external auditor's fees. QBE also considers the terms of engagement of the external auditor every few years; the last occasion concluding in February 2015. The *Corporations Act 2001* and Australian professional auditing standards require rotation of the lead engagement partner after five years. The lead engagement partner of the external auditor was last rotated in 2014.

In the event that the Audit Committee thought it appropriate to change the firm undertaking QBE's external audit, it would conduct an appropriate competitive tender process.

### Actuarial review

It is a longstanding practice of the Directors to ensure that the QBE Group's insurance liabilities are assessed by actuaries. The central estimate of QBE Group's insurance liabilities, comprising outstanding claims and premium liabilities, is determined by experienced internal actuarial staff. Actuarial staff form an independent view, separate from management, of both the central estimate and the probability of adequacy of outstanding claims and premium liabilities. At 31 December 2016, in excess of 98% of QBE's outstanding claims central estimate was also reviewed by external actuaries. The material exception is North American Crop that is quick to settle and where an accurate estimate of ultimate claims cost is obtained very close to the reporting date. External actuaries are generally from organisations that are not associated with the external auditor.

### Internal audit

A global internal audit function is critical to the risk management process. QBE's internal audit function reports to the Group Chief Executive Officer and the Audit Committee on the monitoring of the QBE Group's worldwide operations. Internal audit provides independent assurance that the design and operation of the controls across the QBE Group are effective. The internal audit function operates under a written charter from the Audit Committee. Other governance documents include a reporting protocol, internal audit manual, internal audit issue rating system, internal audit opinion levels and internal audit timetables. A risk-based internal audit approach is used so that higher risk activities are reviewed more frequently.

## Risk management

QBE is in the business of managing risk. The Board and management are fully committed to ensuring that a disciplined approach to managing risk delivers leading practice and that QBE Group's risk management processes and systems are robust and independent. QBE's risk framework supports its businesses across all divisions and provides a sound foundation for reducing uncertainty and volatility in business performance.

### Risk and Capital Committee

The Board monitors the QBE Group's performance and, as such, plays a significant role in ensuring that an effective risk management strategy is established and maintained. The Board has a Risk and Capital Committee which meets at least quarterly to support the Board in overseeing the effectiveness of QBE Group's risk and capital management frameworks. The proper oversight of these frameworks supports strategic objectives, informs business plans and ensures that current and future risks are identified, assessed and monitored in line with risk appetite. Under its Charter, the Risk and Capital Committee is required to review the risk framework periodically to confirm it continues to be sound. This review was undertaken during 2016 as part of the annual refresh of the Risk Management Strategy.

The Risk and Capital Committee is comprised of independent Directors and is chaired by Jann Skinner. The Risk and Capital Committee has access to the Group Chief Risk Officer and other relevant senior management.

### Economic, social and environmental risk

Information about how QBE approaches sustainability and environmental, social and governance (ESG) issues more broadly can be found in the 2016 Sustainability Review.

The Sustainability Review provides an overview of steps taken in 2016 to strengthen governance of QBE's ESG activities and ensure a coordinated approach across the Group. Central to these efforts was the formation of an ESG Committee, formalised as an executive committee reporting to the Group Board Risk and Capital Committee (BRCC), to provide oversight and guidance to QBE's ESG-related projects, activities and initiatives other than those of the QBE Foundation, which has separate governance arrangements.

Further details of how QBE manages risk are set out in the Chief Risk Officer's Report. An overview of QBE's risk management framework, including QBE's key economic material risks and how these are mitigated, is also set out in note 4 to the Financial Report.

# Directors' Report

FOR THE YEAR ENDED 31 DECEMBER 2016

Your directors present their report on QBE Insurance Group Limited and the entities it controlled at the end of, or during, the year ended 31 December 2016.

## Directors

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

Marty Becker (Chairman)
Stephen Fitzgerald
John M Green (Deputy Chairman)
Margaret Leung
John Neal
Sir Brian Pomeroy
Patrick Regan
Jann Skinner

Mr Rolf Tolle was appointed to the Board on 11 March 2016. Ms Kathryn Lisson was appointed to the Board on 1 September 2016. Mr Michael Wilkins was appointed to the Board on 1 November 2016. Ms Lisson and Messrs Becker and Wilkins offer themselves for election at the 2017 Annual General Meeting.

## Consolidated results

| | STATUTORY RESULT | |
|---|---|---|
| | 2016 US$M | 2015 US$M |
| Gross written premium | 14,395 | 15,092 |
| Gross earned premium revenue | 14,276 | 14,922 |
| Net earned premium | 11,066 | 12,314 |
| Net claims expense | (6,442) | (7,434) |
| Net commission | (2,034) | (2,114) |
| Underwriting and other expenses | (1,922) | (2,137) |
| Underwriting result | 668 | 629 |
| Net investment income on policyholders' funds | 407 | 402 |
| Insurance profit | 1,075 | 1,031 |
| Net investment income on shareholders' funds | 339 | 263 |
| Financing and other costs | (294) | (244) |
| Losses on sale of entities | – | (2) |
| Unrealised losses on assets held for sale | (3) | – |
| Amortisation and impairment of intangibles | (45) | (95) |
| Profit before income tax | 1,072 | 953 |
| Income tax expense | (228) | (260) |
| Profit after income tax | 844 | 693 |
| Net profit attributable to non-controlling interests | – | (6) |
| Net profit after income tax | 844 | 687 |

## Result

Net profit after tax for the year to 31 December 2016 was $844 million, up 23% compared with a net profit of $687 million last year.

Net earned premium of $11,066 million was down 10% compared with $12,314 million last year. The decrease mainly reflects the impact of a generally stronger US dollar and a higher reinsurance expense following the reinsurance of long tail liabilities in European Operations and discontinued program business in our North American Operations. The overall reinsurance transactions had a small positive impact on net profit with reinsurance expense of $570 million more than offset by a reduction in net incurred claims of $581 million.

The Group's underwriting result was a profit of $668 million compared with a profit of $629 million last year, reflecting a combined operating ratio of 94.0% compared with 94.9% last year. The net claims ratio of 58.2% (2015 60.4%) was impacted by a reduction in risk-free rates used to discount claims liabilities of $80 million or 0.7% of net earned premium and the reinsurance recoveries mentioned above. Combined commission and underwriting expenses were down in absolute terms compared with last year, primarily due to the benefit of expense initiatives and the disposal of our high cost base M&LS business. The reported combined commission and expense ratio was up, however, (35.8% compared with 34.5%) due to the lower net earned premium as described above.

Excluding the impact of lower risk-free rates used to discount claims liabilities, the statutory combined operating ratio would have been 93.2%, lower than our target range of 94%-95%.

Net investment income was $746 million compared with $665 million last year, including foreign exchange gains of $125 million compared with foreign exchange losses of $20 million last year. The overall net return was 2.4%, slightly below target and impacted by mark to market losses on longer duration fixed income securities following the US election result.

The tax rate was 21% of net profit, down from 27% last year, reflecting the mix of corporate tax rates in the countries in which QBE operates.

## Dividends

The directors are pleased to announce a final dividend of 33 Australian cents per share, up 10% from the final dividend of 30 Australian cents per share for 2015. The dividend will be franked at 50%. The total dividend payout is A$741 million, or around 61% of full year cash profit, compared with A$585 million for 2015, or around 58% of cash profit.

Our objective is to deliver a stable and growing dividend to our shareholders. Our current dividend policy sets the full year dividend payout ratio at up to 65% of cash profit.

## Activities

The principal activities of QBE during the year were underwriting general insurance and reinsurance risks, management of Lloyd's syndicates and investment management.

## Presentation currency

The Group has presented the Financial Report in US dollars because a significant proportion of its underwriting activity is denominated in US dollars. The US dollar is also the currency that is widely understood by the global insurance industry, international investors and analysts.

## Operating and financial review

A review of the Group's operations during the year and the results of those operations is set on pages 4 to 49 of this Annual Report. These pages also deal with the Group's operations, financial position, business strategies and prospects for future financial years.

## Outstanding claims liability

The net central estimate of outstanding claims is determined by the Group Chief Actuary after consultation with internal and external actuaries. The assessment takes into account the statistical analysis of past claims, allowance for claims incurred but not reported, reinsurance and other recoveries and future interest and inflation factors.

As in previous years, the directors consider that substantial risk margins are required over the actuarial net central estimate to mitigate the inherent uncertainty in the net central estimate. The probability of adequacy of the outstanding claims liability at 31 December 2016 was 89.5% compared with 89.0% last year. The Australian Prudential Regulation Authority (APRA) prudential standards provide a capital credit for outstanding claims in excess of a probability of adequacy of 75%.

## Group indemnities

Article 78 of the company's constitution provides that the company indemnifies past and present directors, secretaries or other officers against any liability incurred by that person as a director, secretary or other officer of the company or its subsidiaries. The indemnity does not apply to any liability (excluding legal costs):

- owed to the company or a related body corporate (e.g. breach of directors' duties);
- for a pecuniary penalty under section 1317G or a compensation order under sections 1317H or 1317HA of the *Corporations Act 2001* (or a similar provision of the corresponding legislation in another jurisdiction); or
- that is owed to someone other than the company or a related body corporate and which did not arise out of conduct in good faith.

The indemnity extends to legal costs other than where:

- in civil proceedings, one or more of the above exclusions apply;
- in criminal proceedings, the person is found guilty;
- the person is liable in proceedings brought by the Australian Securities and Investments Commission (ASIC), a corresponding regulator in another jurisdiction or a liquidator (unless as part of the investigation before proceedings are commenced); or
- the court does not grant relief after an application under the *Corporations Act 2001* or corresponding legislation in another jurisdiction.

In addition, a deed exists between the company and each director which includes an indemnity in similar terms to article 78 of the company's constitution.

## Directors' and officers' insurance

QBE pays a premium each year in respect of a contract insuring directors, secretaries, senior managers and employees of the Group together with any natural person who is either a trustee or a member of a policy committee for a superannuation plan established for the benefit of the Group's employees against liabilities past, present or future. The officers of the Group covered by the insurance contract include the directors listed on pages 52 and 53, the Group Company Secretary, Carolyn Scobie, and Deputy Company Secretary, Peter Smiles.

In accordance with normal commercial practice, disclosure of the amount of premium payable under, and the nature of liabilities covered by, the insurance contract is prohibited by a confidentiality clause in the contract.

No such insurance cover has been provided for the benefit of any external auditor of the Group.

## Significant changes

There were no significant changes in the Group's state of affairs during the financial year other than as disclosed in this Annual Report.

## Likely developments and expected results of operations

Likely developments in the Group's operations in future financial years and the expected results of those operations have been included in the review of operations on pages 4 to 49 of this Annual Report.

# Directors' Report CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2016

## Events after balance date

In conjunction with the announcement of the 2016 final dividend and to recognise the Group's already strong and increasing surplus capital position but limited franking capacity, QBE has established a three year cumulative on-market buyback facility of up to A$1 billion, with a current target of not more than A$333 million in any one calendar year.

The directors are not aware of any other matter or circumstance that has arisen since the end of the year that has significantly affected, or may significantly affect, the Group's operations, the results of those operations and the Group's state of affairs in future financial years, other than as described.

## Material business risks

As a global insurance and reinsurance business, QBE is subject to a substantial variety of business risks. The Board believes that effective management of these risks is critical to delivering value for QBE's stakeholders. It is QBE's policy to adopt a rigorous approach to managing risk throughout the Group. Risk management is a continuous process and an integral part of QBE's governance structure, QBE's broader business processes and, most importantly, QBE's culture.

Some of the material business risks that QBE faces include strategic, insurance, credit, market, liquidity and operational risks. Explanations of these risks and their mitigations are set out in more detail in note 4 to the financial statements which we recommend you read. Further details of how QBE manages risk are set out in the Chief Risk Officer's Report, on pages 50 to 51 of this Annual Report, the section of the Corporate Governance Statement addressing the ASX Corporate Governance Council's Principle 7: Recognise and Manage Risk on page 63 of this Annual Report and the Sustainability Review.

The Corporate Governance Statement and the Sustainability Review are available on the QBE website at www.qbe.com.

The Group makes judgements and estimates in respect of the reported amounts of certain assets and liabilities, the most significant of which are in relation to the determination of the outstanding claims liability, the application of the liability adequacy test and the valuation of deferred tax assets and goodwill in North American Operations. More detail of each of these is included in notes 2.3, 2.5.1, 6.2.3 and 7.2.1 respectively.

## Meetings of directors

| | FULL MEETINGS OF DIRECTORS [1] | | MEETINGS OF NON-EXECUTIVE DIRECTORS | | MEETINGS OF COMMITTEES: AUDIT | | INVESTMENT | | REMUNERATION | | RISK & CAPITAL | | GOVERNANCE & NOMINATION | | OPERATIONS & TECHNOLOGY | | SUB-COMMITTEES [2] | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | H | A | H | A | H | A | H | A | H | A | H | A | H | A | H | A | H | A |
| Marty Becker | 8 | 8 | 6 | 6 | 5 | 5 | 4 | 4 | 6 | 6 | 6 | 6 | 5 | 5 | 1 | 1 | 2 | 2 |
| Stephen Fitzgerald | 8 | 8 | 6 | 6 | – | – | 4 | 4 | – | – | 6 | 6 | 5 | 5 | 1 | 1 | – | – |
| John M Green | 8 | 8 | 6 | 6 | 2 | 2 | 4 | 4 | 6 | 6 | 6 | 6 | 5 | 5 | 1 | 1 | 2 | 2 |
| Margaret Leung | 8 | 8 | 6 | 5 | 5 | 5 | – | – | 6 | 6 | – | – | 5 | 4 | – | – | – | – |
| Kathryn Lisson | 3 | 3 | 2 | 2 | 2 | 2 | – | – | – | – | – | – | 1 | 1 | 1 | 1 | – | – |
| John Neal [3] | 8 | 8 | – | – | – | – | – | – | – | – | – | – | – | – | – | – | 2 | 2 |
| Sir Brian Pomeroy | 8 | 8 | 6 | 6 | 5 | 5 | – | – | – | – | 6 | 6 | 5 | 5 | – | – | 3 | 3 |
| Patrick Regan [3] | 8 | 8 | – | – | – | – | – | – | – | – | – | – | – | – | – | – | 3 | 3 |
| Jann Skinner | 8 | 8 | 6 | 6 | 5 | 5 | – | – | 6 | 6 | 5 | 5 | 5 | 5 | – | – | 3 | 3 |
| Rolf Tolle | 7 | 7 | 5 | 3 | – | – | 3 | 3 | – | – | 5 | 5 | 4 | 2 | – | – | – | – |
| Michael Wilkins | 2 | 2 | 1 | 1 | 1 | 1 | – | – | 1 | 1 | – | – | – | – | 1 | 1 | – | – |

H number of meetings held while a Board or Committee member.

A number of meetings attended while a Board or Committee member.

1 Included meetings in the UK and the US.

2 Ad hoc committees of the Board were convened during the year in relation to the financial results and reporting matters. Members of the ad hoc committees attended all meetings they were required to attend.

3 Messrs Neal and Regan attended Audit, Investment and Risk & Capital Committee meetings by invitation, not being members of these committees. Mr Neal also attended Remuneration Committee meetings by invitation, not being a member of that Committee.

Further meetings occurred during the year, including meetings of the Chairman and Group Chief Executive Officer and meetings of the directors with management. From time to time, directors attend meetings of committees of which they are not currently members.

## Directorships of listed companies held by the members of the Board

From 1 January 2014 to 24 February 2017, the directors also served as directors of the following listed entities:

| | POSITION | DATE APPOINTED | DATE CEASED |
|---|---|---|---|
| **John M Green** | | | |
| WorleyParsons | Director | 11 October 2002 | 25 October 2016 |
| **Margaret Leung** | | | |
| China Construction Bank Corporation | Director | 12 December 2013 | 17 June 2016 |
| Chong Hing Bank Limited | Director and Deputy Chairman | 14 February 2014 | – |
| First Pacific Company Limited | Director | 21 December 2012 | – |
| Hong Kong Exchanges and Clearing Limited | Director | 24 April 2013 | – |
| Li & Fung Ltd | Director | 1 April 2013 | – |
| Sun Hung Kai Properties Limited | Director | 1 March 2013 | – |
| **Michael Wilkins** | | | |
| AMP Limited | Director | 12 September 2016 | – |

## Qualifications and experience of directors

The qualifications and experience of each director are set out on pages 52 to 53 of this Annual Report.

## Qualifications and experience of company secretaries

**Carolyn Scobie, BA, LLB, MA, AGIA and ACIS**
Ms Scobie is Group General Counsel and Group Company Secretary. Prior to joining QBE, Ms Scobie was Group General Counsel at the ASX-listed multinational Goodman Group for 17 years, where she ran a multi-disciplinary legal team working on matters across 16 countries and over 800 entities. Ms Scobie has extensive experience in compliance, regulatory matters, litigation and managing the complexity of multiple jurisdictions.

**Peter Smiles, LLB, MBA, AGIA and ACIS**
Mr Smiles is Deputy Company Secretary of QBE Insurance Group Limited and a company secretary of various QBE subsidiaries in Australia. He has 25 years of insurance experience, which includes 18 years as a corporate lawyer. Prior to commencing employment with QBE in 2002, Mr Smiles worked for the NRMA Insurance Group in various corporate roles. In addition to his current company secretarial duties, he acts as a corporate lawyer advising QBE Group head office departments and Asia Pacific offices.

## Directors' interests and benefits

**Ordinary share capital**
Directors' relevant interests in the ordinary share capital of the company at the date of this report are as follows:

| DIRECTOR | NUMBER OF SHARES HELD |
|---|---|
| Marty Becker | 105,306 |
| Stephen Fitzgerald | 37,704 |
| John M Green | 37,258 |
| Margaret Leung | 21,914 |
| Kathryn Lisson | 1,463 |
| John Neal | 291,178 |
| Sir Brian Pomeroy | 12,141 |
| Patrick Regan | 582,214 |
| Jann Skinner | 38,000 |
| Rolf Tolle | 18,901 |
| Michael Wilkins | 5,670 |

**Options and conditional rights**
At the date of this report, John Neal had 1,399,612 (2015 825,252) conditional rights to ordinary shares of the company and Patrick Regan had 903,008 (2015 697,843) conditional rights to ordinary shares of the company. No executives hold options at the date of this report. Details of the schemes under which options and rights are granted are provided in the Remuneration Report and in note 8.4 to the financial statements.

The names of all persons who currently hold options granted under the Employee Share and Option Plan (the Plan) and conditional rights to ordinary shares of the company are entered in the registers kept by the company pursuant to section 168 of the *Corporations Act 2001*.

**Loans to directors and executives**
Information on loans to directors and executives is set out in the Remuneration Report.

## Environmental regulation

The Group is not currently required to report under any significant environmental regulations under either Commonwealth, State or Territory legislation.

# Remuneration Report

## To our shareholders:

On behalf of the Board, I present QBE's Remuneration Report for 2016.

### 2016 performance and remuneration

In 2016, despite a challenging operating environment and difficult investment markets, our financial performance was at the better end of the target range. This continues the improvement in our results as we moved through a period of refocus and stabilisation. Our STI outcomes for 2016 further reflect this. LTI awards which require sustained performance over multiple years have not vested.

Our statutory return on equity (ROE) was 8.1%. We have maintained our approach from previous years and reversed 50% of the effect of actual discount rate movements versus our budget assumptions from the statutory result. In 2015, this reduced the ROE outcome for management by 0.2% while in 2016 it increased the ROE outcome by 0.3%. Consequently the Group ROE outcome for 2016 STI purposes was 8.4%, i.e. 0.1% below our target of 8.5%.

Details on the STI outcomes for executives are set out in section 3.1.

### Changes to the remuneration structure for 2017

We announced in last year's Remuneration Report our intention to conduct a review of incentive structures to ensure they remain fit for purpose and aligned with the evolving QBE strategy. This review was conducted in the context of an operating environment which over the past three years has seen ongoing economic volatility, political uncertainty, regulatory change and changes at QBE.

In recognising shareholder and community concerns on executive remuneration, the Remuneration Committee followed a process which was thorough and included consultation with independent advisers, regulators and internal and external stakeholders. I am grateful for the continued support and engagement we have with shareholders and their representative bodies, especially during consultation on the remuneration review.

The review found that, on the whole, STI has demonstrated strong alignment between performance and incentive outcomes, although it could be improved with broader and more clearly defined performance measures. LTI, on the other hand, has not worked as well. Setting appropriate three-year performance hurdles in a volatile macro-economic environment has been challenging, as has finding a suitable globally diversified insurance TSR peer group as a benchmark. Consequently, the current LTI scheme is not well-understood or valued by our executives, and is not sufficiently driving strategy delivery or creating shareholder value.

The review prompted us to consider ways of making LTI more effective for all stakeholders, and enhancing long-term alignment through increased share ownership. The resultant QBE Executive Incentive Plan (EIP) combines STI and LTI into a single, simpler incentive plan which we believe provides better correlation to performance and shareholder outcomes and is more tangible for our executives. Importantly, in an increasingly volatile business environment, the model is more adaptable to the evolution of our strategy, changing business cycles and the external operating environment.

Details on the changes to be implemented for 2017 and how they will apply to the Group CEO are set out in section 7.

### Incentive targets for 2017

Each year we set incentive targets that reflect the Group's business plans and the operating environment. For 2017, we will replace statutory ROE with a mix of cash ROE, combined operating ratio (COR) and value-creation measures reflecting our strategic priorities.

Cash ROE will use cash profit after tax, the same basis used to determine shareholder dividends. However, other than in exceptional circumstances, losses due to unplanned amortisation or impairment of intangibles will be added back so that executives remain accountable for the management of intangible assets. The target range for 2017 is 7.0% to 11.0%, with on-target performance at 9.0%.

COR has been introduced as it is the most relevant measure of the profitability of our insurance operations. The target range for 2017 is 96.3% to 92.3% with on target performance set at 94.3%. In line with previous years, this excludes the effect of unbudgeted discount rate movements. Also, for 2017, an adjustment will be made for the impact of changes, if any, to the Ogden tables in the UK beyond the provision included in the business plan.

Measures of progress against our longer-term strategic imperatives of operational efficiency and claims excellence have been introduced for 2017. We are targeting generation of expense savings of $109m in 2017 through operational excellence, automation and sourcing capability. A further $170m of projected savings is targeted from initiatives to be undertaken in 2017 through leveraging our global claims and data analytics capabilities to improve fraudulent claims detection, claims handling and recoveries performance.

John M Green
**Chairman, Remuneration Committee**
**Group Deputy Chairman**

# Remuneration Report contents

# Remuneration Report CONTINUED

## 1. INTRODUCTION

### Overview

This Remuneration Report sets out QBE's remuneration framework and provides detail of remuneration outcomes for key management personnel (KMP) for 2016 and how this aligns with QBE's performance.

Accounting standards define KMP as those executives and non-executive directors with the authority and responsibility for planning, directing and controlling the activities of the Group, either directly or indirectly.

The 2016 Remuneration Report has been prepared and audited in accordance with the disclosure requirements of the *Corporations Act 2001*.

### 1.1 Key management personnel

| NAME | POSITION | COUNTRY OF RESIDENCE | TERM AS KMP IN 2016 |
|---|---|---|---|
| **Current executives** | | | |
| John Neal | Group Chief Executive Officer<br>Executive Director | Australia | Full year |
| Jason Brown | Group Chief Risk Officer | Australia | Full year |
| Colin Fagen [1] | Group Chief Operations Officer | Australia | Full year |
| David Fried | Chief Executive Officer, Emerging Markets | Hong Kong | Full year |
| Russell Johnston | Chief Executive Officer, North American Operations | United States of America | Commenced 2 May 2016 |
| Margaret Murphy | Group Chief Human Resource Officer | Australia | Commenced 1 October 2016 |
| Richard Pryce | Chief Executive Officer, European Operations | United Kingdom | Full year |
| Patrick Regan [2] | Group Chief Financial Officer<br>Chief Executive Officer, Australian & New Zealand Operations<br>Executive Director | Australia | Full year |
| **Former executives** | | | |
| David Duclos | Chief Executive Officer, North American Operations | United States of America | Ceased 31 May 2016 |
| Mike Emmett | Group Executive Officer, Operations | Australia | Ceased 23 February 2016 |
| Tim Plant | Chief Executive Officer, Australian & New Zealand Operations | Australia | Ceased 17 August 2016 |
| Jenni Smith | Group Executive Officer, People and Communications | Australia | Ceased 31 October 2016 |
| **Non-executive directors** | | | |
| Marty Becker | Chairman, Non-executive director | United States of America | Full year |
| Stephen Fitzgerald | Non-executive director | United Kingdom | Full year |
| John M Green | Deputy Chairman, Non-executive director | Australia | Full year |
| Margaret Leung | Non-executive director | Hong Kong | Full year |
| Kathryn Lisson | Non-executive director | Canada | Commenced 1 September 2016 |
| Sir Brian Pomeroy | Non-executive director | United Kingdom | Full year |
| Jann Skinner | Non-executive director | Australia | Full year |
| Rolf Tolle | Non-executive director | United Kingdom | Commenced 11 March 2016 |
| Michael Wilkins | Non-executive director | Australia | Commenced 1 November 2016 |

1 Colin Fagen was in the role of Group Chief Strategy Officer prior to becoming the Group Chief Operations Officer on 23 February 2016. Colin Fagen ceased being a KMP on 9 February 2017.

2 While retaining his existing Group Chief Financial Officer responsibilities, Pat Regan became Chief Executive Officer, Australian & New Zealand Operations on 17 August 2016.

## 2. SUMMARY OF REMUNERATION OUTCOMES FOR 2016

### 2.1 Remuneration and incentive outcomes in 2016

This section provides a summary of the remuneration outcomes for executives and non-executive directors in 2016. Further details of remuneration outcomes are found in section 6 of the Remuneration Report.

| COMPONENT | 2016 OUTCOMES |
|---|---|
| Fixed remuneration | • There were no increases in fixed remuneration to the Group CEO and executives in 2016 and none have been budgeted for 2017. |
| Short-term incentive (STI) | • STI outcomes have been improving since 2013 as we moved through a period of refocus and stabilisation. An STI for the Group CEO of A$2,199,953 (or 50.0% of maximum opportunity) was awarded in 2015 and A$1,307,000 (or 31.1% of maximum opportunity) in 2014.<br>• Our statutory return on equity (ROE) for 2016 was 8.1%. We have maintained our approach from previous years and reversed 50% of the effect of actual discount rate movements versus our budget assumptions from the statutory result. In 2015, this reduced the ROE outcome for management by 0.2% while in 2016 it increased the ROE outcome by 0.3%. Consequently the Group ROE outcome for 2016 STI purposes was 8.4%, i.e. 0.1% below our target of 8.5%.<br>• Based on this and the Board's assessment of the Group CEO's performance against his balanced scorecard, an STI of A$2,762,646 would have been awarded. The Group CEO has had a commendable year and delivered a strong full year result for QBE. His performance is well regarded by the Board. However, both parties agree some recent personal decisions by the CEO have been inconsistent with the Board's expectations. Therefore, the Board has decided that his 2016 STI will be reduced by 20%. Consequently, the Group CEO's 2016 STI was adjusted to A$2,210,117 (or 50.2% of maximum opportunity).<br>• 50% of the Group CEO's STI is deferred in the form of conditional rights vesting in two equal tranches over two years subject to service conditions and malus provisions.<br>• The average STI awarded to executives, other than the Group CEO, was 61.1% of the maximum opportunity, 33% of which is deferred in the form of conditional rights.<br>• The average STI awarded to executives, other than the Group CEO, in 2015 and 2014 was 57.9% and 39.1% of the maximum opportunity respectively. |
| Long-term incentive (LTI) | • LTI grants were made in 2016 in accordance with the target remuneration mix for each executive.<br>• Performance hurdles for LTI awards made in 2012 and 2014 were tested in February 2017 and did not meet the level of performance required to vest.<br>• No LTI has vested since awards were introduced in 2010. |
| Awards vesting | • Deferred equity awards (DEA) made under the 2010 DEA, 2012 DEA and 2014 STI plans vested during the year upon satisfaction of service conditions. |
| Other payments | • Russell Johnston was granted 50,000 conditional rights to QBE shares to compensate for incentives forfeited on ceasing his previous employment to join QBE. Vesting of these conditional rights is subject to the achievement of Group targets over three performance years and service conditions. The award will vest in three equal tranches on 15 March 2017, 2018 and 2019. |
| Non-executive director fees | • Total amount paid to non-executive directors in 2016 was A$3,113,000 (2015: A$2,957,000).<br>• There were no increases to director fees in 2016 and none have been budgeted for 2017.<br>• Total remuneration pool available to non-executive directors remained at A$3,500,000 in 2016. For 2017, the Board will be recommending for shareholders' approval at the AGM that the pool be increased to A$4,000,000. This will allow scope for an increase in the number of directors on the Board, the formation of a new Operations and Technology Committee, as well as to enable the Group to manage the Board succession planning. |

# Remuneration Report CONTINUED

## 2.2 Realised 2016 remuneration

### Overview

QBE is required to disclose actual remuneration outcomes in the financial period under review. The values reported include the accrued STI cash award for the 2016 financial year and the value of any equity awards that vested during the year. The value of vested equity awards has been calculated using the closing share price on the vesting date.

The figures in this table are different from those shown in the statutory table in section 6.1 of the Remuneration Report. For example, the statutory table includes an apportioned accounting value for all unvested equity held during the year, which remains subject to performance and service conditions and consequently may or may not ultimately vest.

The table below sets out the actual value of the remuneration realised by executives in 2016.

| | REMUNERATION EARNED IN 2016 | | | DEFERRED EQUITY OUTCOME IN 2016 | | |
|---|---|---|---|---|---|---|
| EXECUTIVES | FIXED REMUNERATION US$000 | STI CASH[1] US$000 | OTHER[2] US$000 | CONDITIONAL RIGHTS VESTED[3] US$000 | TERMINATION BENEFITS[4] US$000 | TOTAL REMUNERATION REALISED IN 2016 US$000 |
| **Group head office** | | | | | | |
| John Neal | 1,635 | 821 | 97 | 476 | – | 3,029 |
| Jason Brown | 520 | 347 | 27 | 172 | – | 1,066 |
| Colin Fagen[5] | 971 | – | 109 | 451 | – | 1,531 |
| Margaret Murphy | 139 | 92 | 87 | – | – | 318 |
| Patrick Regan | 1,189 | 992 | 103 | 1,174 | – | 3,458 |
| **Divisional** | | | | | | |
| David Fried | 920 | 576 | 1,547 | 415 | – | 3,458 |
| Russell Johnston | 584 | 429 | 18 | – | – | 1,031 |
| Richard Pryce | 966 | 801 | 149 | 410 | – | 2,326 |
| **Former executives** | | | | | | |
| David Duclos | 475 | 296 | 17 | 367 | – | 1,155 |
| Mike Emmett | 106 | 65 | (10) | – | 900 | 1,061 |
| Tim Plant | 442 | 149 | 30 | 191 | 357 | 1,169 |
| Jenni Smith | 462 | 303 | 57 | 92 | 457 | 1,371 |

1 The STI cash amount in respect of performance in 2016 is payable in March 2017. For further details, refer to section 4.4 of the Remuneration Report.

2 "Other" includes provision of motor vehicles, health insurance, spouse travel, staff insurance discount benefits received during the year, life assurance and personal accident insurance and the applicable taxes thereon. It also includes the deemed value of interest-free share loans, the movement in annual leave and long service leave provisions, tax payments and other one-off expenses. For David Fried, this also includes expatriate benefits including a housing allowance, education assistance, a cost of living adjustment and associated taxes thereon. For Margaret Murphy, this includes cost of relocation.

3 The value of conditional rights has been determined by reference to the closing share price on the relevant vesting date. For Patrick Regan, this includes the second tranche of conditional rights granted on 20 August 2014 which vested on 1 March 2016. For further details, refer to section 6.4.3 of the Remuneration Report.

4 "Termination benefits" in respect of Mike Emmett, Tim Plant and Jenni Smith includes apportioned fixed remuneration paid for the balance of the notice period to the termination date and STI cash awards from the date of ceasing to be a KMP to the date of termination. For Mike Emmett this also includes a redundancy payment and a restraint payment. For further details, refer to section 6.2 of the Remuneration Report.

5 At the time of publishing the Remuneration Report, the 2016 STI award to Colin Fagen has not been determined. The award will be determined in accordance with the STI Plan Rules.

## 3. DETAILED REMUNERATION OUTCOMES FOR 2016

### Overview

This section explains the link between our reward framework and the key financial profit drivers that encourage achievement of Group business plans and create long-term shareholder value.

The incentive structure and financial targets are approved annually by the Remuneration Committee. ROE and total shareholder return (TSR) are the primary measures for at-risk remuneration purposes. Achievement of these targets demonstrates the alignment between financial performance over time and incentive awards for Group executives.

### 3.1 The impact of QBE's 2016 performance on remuneration

The table below shows 2016 Group and divisional financial performance targets for 2016 and the 2016 Group ROE and divisional return on allocated capital (RoAC) performance for executive incentive purposes. The ROE/RoAC targets reflect market factors in each division.

| | ROE/ROAC PERFORMANCE % | | | | |
|---|---|---|---|---|---|
| | NORTH AMERICAN OPERATIONS | EUROPEAN OPERATIONS | AUSTRALIAN & NEW ZEALAND OPERATIONS | EMERGING MARKETS | GROUP |
| Threshold | 3.3 | 6.5 | 9.7 | 5.6 | 6.0 |
| Target | 7.8 | 11.5 | 14.7 | 13.6 | 8.5 |
| Superior | 13.3 | 16.5 | 19.7 | 21.6 | 12.0 |
| Performance | 6.8 | 12.7 | 11.7 | 13.0 | 8.4 |
| % achievement of target | 82.2 | 112.1 | 52.5 | 93.8 | 97.7 |

The table below shows the performance and total 2016 STI outcomes (both the cash and deferred portions) achieved by executives for the year ended 31 December 2016.

| | PERFORMANCE AS A % OF TARGET | | | | TARGET STI | ACTUAL STI OUTCOME [1] | | | |
|---|---|---|---|---|---|---|---|---|---|
| EXECUTIVES | GROUP ROE % | DIVISIONAL ROAC % | BALANCED SCORECARD % | TOTAL STI OUTCOME % | % OF FIXED REMUNERATION % | % OF FIXED REMUNERATION % | TOTAL US$000 | STI CASH US$000 | STI DEFERRED US$000 |
| **Group head office** | | | | | | | | | |
| John Neal [2] | 78.2 | N/A | 64.0 | 75.3 | 133.3 | 100.5 | 1,642 | 821 | 821 |
| Jason Brown | 97.7 | N/A | 101.3 | 99.5 | 100.0 | 99.5 | 518 | 347 | 171 |
| Patrick Regan | 97.7 | N/A | 127.5 | 103.7 | 120.0 | 124.4 | 1,480 | 992 | 488 |
| Colin Fagen [3] | – | – | – | – | 100.0 | – | – | – | – |
| Margaret Murphy [4] | 97.7 | N/A | 100.0 | 98.2 | 100.0 | 98.2 | 137 | 92 | 45 |
| **Divisional** | | | | | | | | | |
| Russell Johnston [4] | 97.7 | 82.2 | 82.5 | 86.9 | 120.0 | 104.3 | 640 | 429 | 211 |
| David Fried | 97.7 | 93.8 | 82.5 | 92.7 | 100.0 | 92.7 | 860 | 576 | 284 |
| Richard Pryce | 97.7 | 112.1 | 115.6 | 108.5 | 100.0 | 108.5 | 1,196 | 801 | 395 |
| **Former executives** | | | | | | | | | |
| David Duclos [4] | 97.7 | 82.2 | 82.5 | 86.9 | 120.0 | 104.3 | 442 | 296 | 146 |
| Mike Emmett [4] | 97.7 | N/A | 82.5 | 94.7 | 100.0 | 94.7 | 97 | 65 | 32 |
| Tim Plant [4,5] | 67.7 | 36.4 | 57.5 | 50.0 | 100.0 | 50.0 | 222 | 149 | 73 |
| Jenni Smith [4] | 97.7 | N/A | 82.5 | 94.7 | 100.0 | 94.7 | 452 | 303 | 149 |

1 The STI award is calculated as a percentage of fixed remuneration as at 31 December 2016.

2 As referred to in section 2.1, the STI award for John Neal was reduced by 20%.

3 At the time of publishing the Remuneration Report, the 2016 STI award to Colin Fagen has not been determined. The award will be determined in accordance with the STI Plan Rules.

4 The STI awards for Margaret Murphy, Russell Johnston, David Duclos, Mike Emmett, Tim Plant and Jenni Smith reflect the proportion of 2016 during which they were KMP.

5 The financial component of Tim Plant's STI was reduced by 30% at the discretion of the Board.

## 3.2 Measuring performance

### Overview

All executives have 20% of their STI outcome determined with reference to individual key performance indicators (KPIs) (50% for the Group Chief Operations Officer, Colin Fagen, and the Group Chief Risk Officer Jason Brown, reflecting the specific priorities of their roles). A balanced scorecard of individual KPIs is used to ensure that a broader view of performance and specific strategic priorities is considered when assessing performance and incentive outcomes.

The balanced scorecard is aligned with QBE's business plans and measures objectives which support the elements of QBE's value creation model.

The balanced scorecard for each executive is reviewed by the Remuneration Committee to ensure it is appropriate. The table below sets out a summary of the key objectives for the Group Chief Executive Officer for 2016. The objectives for other executives are consistent.

| VALUE CREATION COMPONENT | 2016 OBJECTIVES | OUTCOME | COMMENTS |
| --- | --- | --- | --- |
| Strategic management | • Achieve Group performance targets<br>• Strengthen stress testing approach | On target | • Plan executed successfully in challenging markets and notwithstanding ANZO challenges<br>• Business review and stress testing continues to provide stronger lead warnings |
| Profitable growth and diversification | • Achieve growth and profitability targets in Emerging Markets<br>• Achieve new growth opportunities which support core strategy | Slightly below target | • Targets achieved in Latin America but profitability still challenged in Latin America where focus has been on rationalisation and remediation<br>• Focus on strengthening core rather than new opportunities |
| Leadership in our core business | • Progress growth initiatives around core<br>• Sponsor improved business retention<br>• Embed data analytics<br>• Strengthen distribution relationships | On target | • Good progress on Multinational capability<br>• Customer retention improved by 1% across the business<br>• Hub and spoke model designed to embed analytics with focus on customer, expense and claims insights. 70 active projects underway<br>• Excellent relationships maintained although growth continues to be challenging |

| VALUE CREATION COMPONENT | 2016 OBJECTIVES | OUTCOME | COMMENTS |
|---|---|---|---|
| **Operational excellence - global reach and scale** | • Achieve run rate cost reduction of $100 million<br>• Strengthen operating model to achieve synergies and economies of scale<br>• 15% reduction in reinsurance costs by 2018 | On target | • Target achieved with plans for further reduction in 2017<br>• Procurement, IT and HR centralised to achieve benefits of global solutions and economies of scale<br>• Target exceeded in 2017 through lower brokerage and programme restructure |
| **Financial strength and flexibility** | • Drive strong cash flow remittances >$700 million<br>• Maintain a strong capital position consistent with S&P 'AA'<br>• Achieve target investment return | On target | • Exceeded target, cash flow remittances of $1,100 million<br>• Target achieved<br>• Net investment return of 2.4%, slightly below target |
| **World class talent and leadership** | • Strengthen leadership and succession plans across QBE<br>• Modernise culture and improve engagement scores by 5%<br>• Achieve diversity targets<br>• Implement corporate communications strategy to drive ONE QBE thinking | Slightly below target | • Executive leadership bench strength improved. Succession plans are developing<br>• Engagement scores improved by 3% – still work in progress<br>• Diversity statistics improving<br>• Global Head of Communications recruited to drive communications strategy |

The Group CEO has had a commendable year and delivered a strong full year result for QBE. His performance is well regarded by the Board. However, both parties agree some recent personal decisions by the CEO have been inconsistent with the Board's expectations. Therefore, the Board has decided that his 2016 STI will be reduced by 20%.

# Remuneration Report CONTINUED

## 3.3 Long-term performance and incentive outcomes

The following table shows KPIs of the Group over the last five years.

| FINANCIAL RESULTS | | 2016 | 2015 | 2014 | 2013 | 2012 |
|---|---|---|---|---|---|---|
| Combined operating ratio | % | **94.0** | 94.9 | 96.1 | 97.8 | 97.1 |
| **Profitability measures** | | | | | | |
| Net profit (loss) after income tax (NPAT) | US$M | **844** | 687 | 742 | (254) | 761 |
| Diluted earnings per share | US cents | **60.8** | 49.8 | 55.8 | (22.8) | 61.6 |
| Weighted average risk-free discount rate [1] | % | **1.3** | 1.6 | 1.4 | 2.2 | 1.6 |
| Net investment yield | % | **2.4** | 2.3 | 2.4 | 2.6 | 4.1 |
| **Return on equity** | | | | | | |
| Return on average shareholders' funds | % | **8.1** | 6.4 | 6.9 | (2.3) | 7.0 |
| ROE for STI purposes [2] | % | **8.4** | 7.8 | 8.1 | N/A | N/A |
| **Return to shareholders** | | | | | | |
| Dividend per share | Australian cents | **54** | 50 | 37 | 32 | 50 |
| Share price at 31 December | A$ per share | **12.42** | 12.59 | 11.21 | 11.51 | 10.90 |
| Underwriting profit | US$M | **668** | 629 | 547 | 341 | 453 |
| Total Shareholder Return [3] | % | **5.32** | 15.24 | (0.37) | 7.72 | (11.44) |

1 Excludes the Argentine peso.

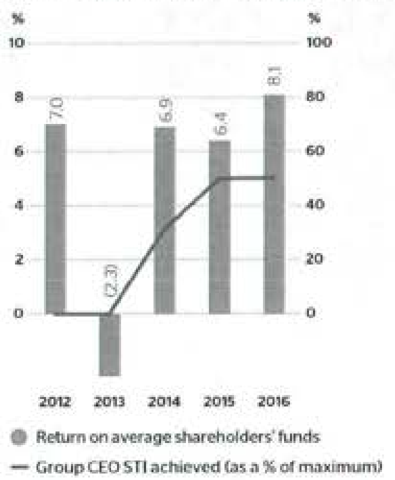
2 For STI purposes, statutory ROE is adjusted in limited cases to better reflect underlying performance. These include an adjustment for 50% of any unbudgeted change in discount rates and to exclude the impact of unbudgeted acquisitions or divestments.

3 Total Shareholder Return is a performance measure for LTI, being the change in the value of QBE's share price over the year plus the value of reinvested dividends as a percentage of the QBE share price at the start of the year.

### How performance translated to remuneration outcomes

The chart on the right shows the return on average shareholders' funds (i.e. Group statutory ROE) over the past five years and STI outcomes for the Group CEO as a percentage of maximum opportunity. This shows a high level of correlation between performance and STI outcomes and a steady improvement in results since 2013 as we have moved through a period of refocus and stabilisation. The status of performance against outstanding LTI awards is shown in the table below.

**STI outcomes and company performance**




**LTI tracking of unvested awards**

| YEAR | PERFORMANCE MEASURES | VESTING DATE | TRACKING |
|---|---|---|---|
| **2012** | Diluted EPS and statutory ROE/COR | March 2017 | Will not vest |
| **2013** | Diluted EPS and statutory ROE/COR | March 2018 | Unlikely to vest |
| **2014** | Statutory ROE and relative TSR | March 2017 | Will not vest |
| **2015** | Statutory ROE and relative TSR | March 2018 | Tracking above threshold |
| **2016** | Statutory ROE and relative TSR | March 2019 | Too early to measure |

## 4. 2016 REMUNERATION EXPLAINED

### Overview

QBE's remuneration strategy is designed to provide market competitive remuneration that motivates and retains QBE's executives, aligned with the creation of sustained shareholder value. QBE's executive remuneration structure comprises a mix of fixed and at-risk remuneration reflecting a balance of short and long-term incentives. This section provides an overview of the remuneration components and their link to strategy.

### 4.1 QBE's remuneration principles

#### Overview

QBE's remuneration principles have been developed to promote robust risk management practices to manage remuneration across the Group. These are summarised below.

**Reflect ONE QBE**

**Simple**

At-risk reward methodology that is easily understood by internal stakeholders and transparent to external shareholders.

**Linked to strategy**

Incentive performance measures that provide significant alignment and linkage to QBE's key strategic priorities.

**Globally competitive**

A common global remuneration design that provides flexibility to calibrate local financial targets, enabling QBE to compete in key markets.

**Motivating**

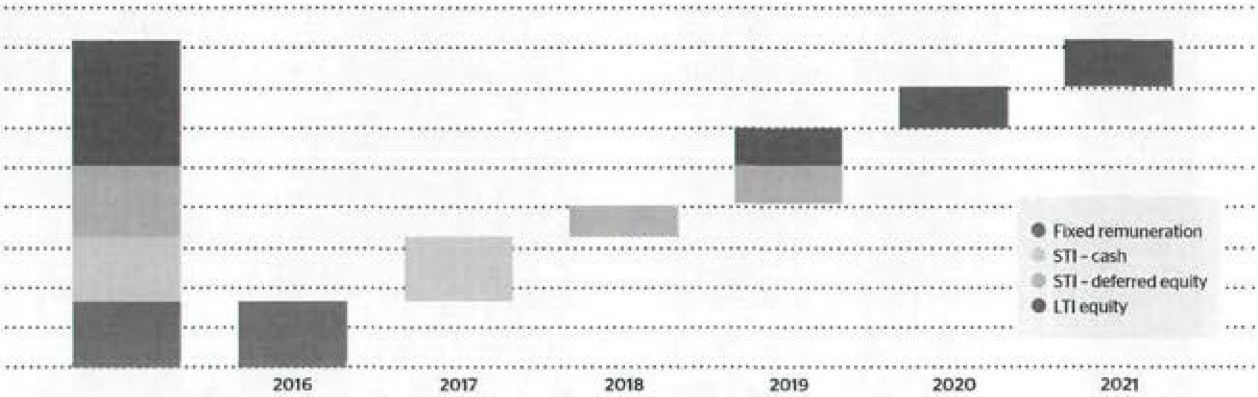
At-risk reward schemes that combine "stretch" targets and performance measures linked to statutory disclosures and business plans, providing transparency and motivating participants.

**Shareholder aligned**

Significant levels of deferred equity resulting from performance against key investor metrics that align reward arrangements to shareholder interests. Executive minimum shareholding requirements further link their interests to those of shareholders.

## 4.2 Remuneration framework

The diagram below illustrates the payment profile for the Group CEO of the 2016 total remuneration framework.



### 4.2.1 Target remuneration mix

**Overview**

QBE's remuneration mix is designed to remunerate executives competitively and suitably reward for the achievement of the Group's performance targets, whilst providing strong governance to protect the financial soundness of the Group and shareholders' interests.

The mix of total remuneration is reflective of an executive's ability to influence QBE's financial results, therefore the range is varied. The mix between short-term cash, deferred STI and LTI is focused towards the longer term time horizon, enhancing alignment with the delivery of QBE's long-term strategy and shareholders' interests.

The diagram below shows the remuneration mix for 2016, assuming on-target performance.


### 4.2.2 2016 maximum incentive opportunity

The table below shows the 2016 maximum incentive opportunity for executives. In the case of STI, this is 150% of target opportunity.

| | 2016 INCENTIVE OPPORTUNITY AS A % OF FIXED REMUNERATION | | |
|---|---|---|---|
| EXECUTIVES | MAXIMUM STI % | MAXIMUM LTI % | MAXIMUM INCENTIVE % |
| Group CEO | 200 | 200 | 400 |
| Group CFO | 180 | 150 | 330 |
| Group head office executives | 150 | 75-125 | 225-275 |
| Divisional CEOs | 150-180 | 100 | 250-280 |

## 4.3 Fixed remuneration

The following outlines key details of executives' fixed remuneration.

### Description

Fixed remuneration comprises cash salary, superannuation/pension and packaged benefits, additional annual benefits and associated taxes.

Additional annual benefits may include health insurance, life assurance, personal accident insurance, car allowances, expatriate benefits and the applicable taxes thereon.

Excludes deemed interest on employee share loans and long service leave accruals.

Delivered in accordance with terms and conditions of employment.

### Determining fixed remuneration levels

Fixed remuneration considers the diversity, complexity and expertise required of individual roles. Remuneration quantum is set in the context of QBE's broader reward strategy and internal relativities.

To assess the competitiveness of fixed remuneration, the Remuneration Committee considers market data and recognised published surveys. In addition, external market reviews are undertaken periodically to inform the setting of competitive fixed remuneration levels.

Executive roles that are Australian based are generally benchmarked to the ASX30 peer group of companies, with a specific focus on global companies and companies in the financial services industry.

Overseas-based executives or roles that have a global reach are compared with a peer group consisting of global insurers. The peer group of companies used for remuneration benchmarking purposes in 2016 is set out in the table below.

| PEER GROUP | DESCRIPTION |
|---|---|
| ASX30 peer group | Excludes infrastructure trusts and companies domiciled overseas.<br>The financial services company sub-peer group is determined based on the industry classification listed on the ASX and includes commercial banks and insurers.<br>The sub-peer group of global companies in the ASX30 is determined based on the global complexity of the organisation using the following criteria:<br>• companies with greater than 25% revenue from overseas; and<br>• companies operating in greater than two geographic locations. |
| Global insurance peer group | Consists of large, global insurance companies in the Dow Jones Insurance Titans Index excluding life and health insurance, reinsurance and insurance brokers.<br>RSA and Hartford are included in this peer group given their similarities to QBE. |

## 4.4 Short-term incentives

The following outlines the key details of the STI plan. STI awards made in 2016 are summarised in section 3.1 of the Remuneration Report.

### Description

The STI is a performance based incentive delivered in the form of an annual cash payment and a deferred award in the form of conditional rights to QBE shares. For executives in the United Kingdom, the deferred award is in the form of zero exercise price options (ZEPOs). Performance is measured over a 12 month period.

### Performance measures and rationale

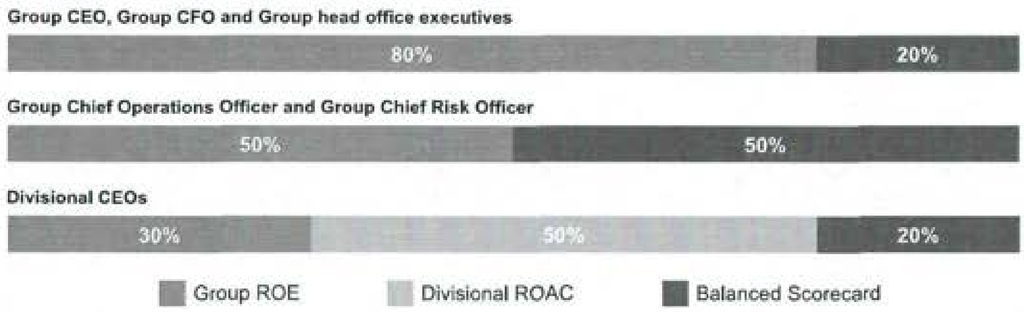
STI outcomes are based on performance against Group statutory ROE and divisional RoAC targets in the case of divisional executives, as well as individual performance against a balanced scorecard of KPIs relevant to each executive's role.

Group statutory ROE is calculated as statutory consolidated net profit after tax as a percentage of average shareholders' funds. Statutory ROE was selected as it is transparent and a strong measure of value created for shareholders. The STI rules provide suitable discretion to the Remuneration Committee to adjust any formulaic outcome to ensure STI awards appropriately reflect performance. Adjustments are typically made in limited cases to better reflect underlying performance. These include an adjustment for 50% of any unbudgeted change in discount rates and to exclude the impact of unbudgeted acquisitions or divestments. For 2016, the only adjustment to ROE related to unbudgeted changes in discount rates.

RoAC is calculated as the divisional management basis profit divided by allocated capital, as determined by the Group's economic capital model.

The balanced scorecard comprises financial and non-financial KPIs relevant to each executive's role which are aligned to the QBE value creation model. Executive performance against the balanced scorecard is evaluated annually by the Group CEO and by the Chairman in respect of the Group CEO, through formal business review assessments.

The following table details the weighting of the performance measures for the STI.




### Vesting schedule

The STI vesting schedule is outlined below:

| | THRESHOLD | TARGET | SUPERIOR |
|---|---|---|---|
| % of STI opportunity achieved | 20% | 100% | 150% |

### Instrument and deferral mechanics

67% of any STI award is delivered in cash (50% in the case of the Group CEO); and

33% of any STI award is deferred as conditional rights to QBE shares (50% in the case of the Group CEO).

Deferred STI vests in two tranches – 50% on the first anniversary of the award and the other 50% on the second anniversary of the award. Vesting is subject to service conditions and malus provisions during the deferral period.

To calculate the number of conditional rights to be granted, the award value is divided by the volume weighted average sale price of QBE shares over the five trading days prior to the grant date.

Notional dividends accrue during the deferral period.

# Remuneration Report CONTINUED

### Leaver provisions

"Good leaver" provisions (e.g. retirement, redundancy, ill health, injury) will apply such that:

- STI opportunity is reduced to a pro-rata amount to reflect the proportion of the performance year in service;
- deferred awards remain in the plan subject to the original vesting conditions; and
- on voluntary termination, dismissal or termination due to poor performance, all awards are forfeited.

### Malus provisions

STI deferral is subject to malus provisions, enabling awards to be either forfeited or reduced at the discretion of the Remuneration Committee. See section 4.6 of the Remuneration Report for more details on malus.

## 4.5 Long-term incentives

The following outlines the key details of the LTI plan. LTI awards made in 2016 are summarised in section 6.4.2 of the Remuneration Report.

### Description

The LTI plan consists of an award of conditional rights to QBE shares. Conditional rights are awarded at no cost to the executive.

LTI awards for the Group CEO and Group CFO in 2016 were approved by shareholders at the Annual General Meeting.

### Performance measures

Vesting is subject to two performance conditions measured over a three year performance period:

1. Average Group statutory ROE over three years – for 50% of the award.
2. Relative TSR – for 50% of the award.

### LTI allocation

To calculate the number of conditional rights to be granted, the award value is divided by the volume weighted average price of QBE shares over the five trading days prior to the grant date.

### Vesting schedules

GROUP ROE

The Group ROE vesting schedule for 2016 awards is outlined below:

| ROE PERFORMANCE | PERCENTAGE OF CONDITIONAL RIGHTS IN THE ROE TRANCHE TO VEST |
|---|---|
| Below 7.0% | 0% |
| At 7.0% | 20% |
| Between 7.0% and 10.6% | Straight line between 20% and 100% |
| At or above 10.6% | 100% |

The Remuneration Committee may use, and intends to use, discretion when assessing the extent to which the Group statutory ROE performance target has been met, to adjust the vesting outcome upwards or downwards in circumstances where there has been a material variance in the risk-free discount rate over the performance period from that assumed when setting the target. This acknowledges that QBE's results are heavily influenced by movements in risk-free discount rates that are beyond the influence of participants.

**RELATIVE TOTAL SHAREHOLDER RETURN**

The relative TSR vesting schedule is outlined below:

| QBE RTSR RANKING RELATIVE TO THE COMPARATOR GROUP | PERCENTAGE OF CONDITIONAL RIGHTS IN THE RTSR TRANCHE TO VEST |
|---|---|
| Less than the 50th percentile | 0% |
| At the 50th percentile | 50% |
| Between the 50th and the 75th percentile | Straight line between 50% and 100% |
| 75th percentile or greater | 100% |

The relative TSR comparator group will generally consist of companies in the Dow Jones Insurance Titans Index group adjusted for those with most relevance to QBE's business operations. The comparator group for the 2016 LTI award is Allstate Corp (US), Allianz SE-Reg (Germany), American International Group (US), Assicurazioni Generali (Italy), Aviva Plc (UK), AXA – SA (France), Chubb Corp (US), IAG Ltd (Australia), RSA Group (UK), Suncorp Group Ltd (Australia), The Hartford (US), The Travelers Cos Inc (US), QBE Insurance Group Ltd (Australia) and Zurich Insurance Group (Switzerland).

## Vesting of LTI

Following assessment of performance measures at the end of the three year performance period, conditional rights will vest in three tranches as set out in the table below, subject to service conditions and malus provisions.

| TRANCHE | VESTING DATE | PORTION OF ELIGIBLE CONDITIONAL RIGHTS TO VEST |
|---|---|---|
| 1 | End of the three year performance period | 33% |
| 2 | First anniversary of the end of the performance period | 33% |
| 3 | Second anniversary of the end of the performance period | 34% |

"Good leaver" provisions (e.g. retirement, redundancy, ill health, injury) will apply such that a pro-rata amount (applied over the three year performance period) of LTI conditional rights remain subject to the original performance and vesting conditions.

Notional dividends accrue during the vesting period.

## Malus

LTI is subject to malus provisions such that awards may be either forfeited or reduced at the discretion of the Remuneration Committee. See section 4.6 of the Remuneration Report for more details on malus.

# Remuneration Report CONTINUED

## 4.6 Keeping executives' and shareholders' interests aligned

QBE has a number of practices which ensure executives' interests are aligned with those of QBE's shareholders.

### Minimum shareholding

The minimum shareholding requirement (MSR) encourages executives to build their shareholding and ensures they have significant exposure to QBE's share price and, by doing so, confirms their long-term interests are aligned with shareholders.

Under the requirement, all executives must accumulate a minimum shareholding in QBE equivalent to one year's fixed remuneration and 1.5 times fixed remuneration for the Group CEO by 31 March each year. From 2017, the MSR will increase to 3.0 times fixed remuneration for the Group CEO and 1.5 times for other executives. This minimum holding is to be maintained for as long as the executive remains employed by QBE. New executives are required to build their shareholding over a three year period after becoming an executive.

For the 2016 test, the following components were included in the calculation:

- all fully owned shares – using the closing share price as at 1 April 2016; and
- all unvested conditional rights without a performance condition – using the greater of the value at grant date and the closing share price as at 1 April 2016.

If an executive does not meet the minimum shareholding at the annual review date, QBE may impose a restriction on the future sale of any equity grants. Individual executive requirements are recalculated annually to consider fixed remuneration increases and changes in the share price or exchange rates.

The total shareholding investment of executives against the MSR at the 2016 test date (31 March 2016) is shown in the table in section 9.4 of the Remuneration Report.

### Malus

The "malus" provision gives the Remuneration Committee discretion to reduce the amount of an unvested award (including to zero) in certain circumstances during the retention period including in the case of:

- serious misconduct; or
- circumstances that materially undermine the reputation or performance of QBE; and

on the basis that, in each case, the conduct or circumstances were not foreseen at the time of granting the award.

This provision reflects best practice and QBE's obligations under APRA's prudential standard CPS 510 to incorporate terms allowing for the adjustment of incentive awards to protect QBE's financial soundness and ability to respond to unforeseen significant issues.

### Treatment of conditional rights on a change in control of QBE

In accordance with the STI and LTI rules, a change in control is defined as either a scheme of arrangement that has been approved by QBE's shareholders or a bidder has at least 50% of the issued and to be issued QBE shares under an unconditional takeover offer made in accordance with the *Corporations Act 2001*.

Should a change in organisational control occur, the Remuneration Committee has discretion to determine how unvested conditional rights should be treated, having regard to factors such as the length of time elapsed in the performance period, the level of performance to date and the circumstances of the change of control.

### Trading policy

Trading in QBE ordinary shares is generally permitted outside of designated blackout periods. The QBE Share Trading Policy states that non-executive directors and executives should notify any intended share transaction to nominated people within the Group.

The policy prohibits the hedging of unvested equity entitlements by executives. The purpose of this prohibition is to ensure that, until equity has vested, there is an alignment between the interests of executives and shareholders, with the effect that share price movements (either positive or negative) will economically impact executive rewards. There is a further restriction on hedging vested equity entitlements if such entitlement counts towards the executive's minimum shareholding requirement.

The policy is enforced by requiring non-executive directors and executives to sign an annual declaration that confirms compliance with the restrictions on hedging. A copy of QBE's trading policy for dealing in securities is available from www.group.qbe.com/corporate-governance/background-documents.

### Dilution limits for share plans

Shares awarded under QBE's employee share plans may be purchased on market or issued subject to Board discretion and the requirements of the *Corporations Act 2001* and the ASX Listing Rules.

At 31 December 2016, the proportion of shares and unvested conditional rights and options held in the QBE Employee Share Plan is 2.43%. This is significantly less than the maximum of 10% over a 10 year period allowed under the plan rules.

## 5. REMUNERATION GOVERNANCE

QBE has a robust remuneration governance framework overseen by the QBE Group Board.

### QBE Group Board

- Overall responsibility for the remuneration strategy and outcomes for executives and non-executive directors.
- Reviews and, as appropriate, approves recommendations from the Remuneration Committee.

### Remuneration Committee

**Reviews and recommends for approval to the QBE Group Board**

- Remuneration strategy and framework for executives and non-executive directors.
- Contractual arrangements for the Group CEO and other executives.
- Fixed remuneration and at-risk reward for the Group CEO and other executives.
- Group remuneration policy.

**Reviews and approves**

- Executive termination payments.
- Reward structures and incentive schemes in line with APRA's prudential standard on governance.
- Major human resources policies relating to incentive schemes, equity schemes and superannuation plans.

**Oversees and monitors**

- The executive succession planning framework.
- Compliance with statutory remuneration reporting disclosures.
- Diversity and inclusion.
- The QBE Foundation.

### Group CEO

Makes recommendations to the Remuneration Committee on:

- Incentive targets and outcomes.
- Balanced scorecard measures and assessment for direct reports.
- Remuneration policy for all employees.
- Long-term incentive participation.
- Individual remuneration and contractual arrangements for executives.

### Divisional Remuneration Committees

Consisting of non-executive directors of QBE's divisional boards, provide input to the Remuneration Committee and the Group CEO on:

- Remuneration practices of the respective division.
- Ongoing compliance with regulatory remuneration requirements.
- Individual remuneration and contractual arrangements for senior employees reporting to the divisional CEO and any other employees specified by the relevant regulations.

### External advisors

Provide independent advice to the Remuneration Committee on:

- Management proposals.
- Benchmark data and market practice.

Further details on the role and scope of the Remuneration Committee are set out in the QBE Remuneration Committee charter (available from www.group.qbe.com/corporate-governance/background-documents).

# Remuneration Report CONTINUED

## 5.1 Use of remuneration consultants

Remuneration consultants provide guidance on remuneration for executives, facilitate discussion, review remuneration and at-risk reward benchmarking within industry peer groups and provide guidance on current trends in executive remuneration practices.

Any advice provided by remuneration consultants is used as a guide and is not a substitute for consideration of all the issues by each non-executive director on the Remuneration Committee.

The Remuneration Committee retained UK based firm FIT Remuneration Consultants LLP (FIT) to act as its independent remuneration adviser. Having received a declaration by FIT that they were not unduly influenced by QBE executives in regard to their remuneration recommendations, the Remuneration Committee and the Board are satisfied that the advice provided by FIT during 2016 was provided free from undue influence.

The cost of advice and assistance provided by FIT in 2016 was $157,000.

During 2016, management requested reports on market practice from PwC and other sources. No recommendations in relation to the remuneration of KMP were provided as part of these engagements.

## 5.2 Risk management

The Remuneration Committee works closely with Group Risk to ensure that any risk associated with remuneration arrangements is managed within the Group's risk management framework. Risk oversight policies exist within the remuneration governance framework to ensure executives cannot unduly influence a decision that could materially impact their own incentive outcome.

Global risk KPIs are included in executives balanced scorecards providing direct alignment between adherence to QBE's risk management process and incentives. In addition, the Group Chief Risk Officer attends the Remuneration Committee annually to report on executive risk behaviours.

The Group Board approves a comprehensive delegated authority for the Group CEO, which is an integral part of QBE's risk management process.

Executives are required to adhere to a range of Group-wide policies to ensure risk taking is well managed, strong governance structures are in place and high ethical standards are maintained. These policies are communicated to all employees throughout the Group.

# 6. REMUNERATION IN DETAIL

## 6.1 Statutory remuneration disclosures

### Overview

The following table provides details of the remuneration of QBE's executives as determined by reference to applicable Australian Accounting Standards (AASB) for the financial year ended 31 December 2016. Remuneration has been converted to US dollars using the average rate of exchange for the relevant year.

| | | SHORT-TERM EMPLOYMENT BENEFITS | | | POST EMPLOYMENT BENEFITS | OTHER LONG-TERM EMPLOYEE BENEFITS | SHARE-BASED PAYMENTS[1] | | |
|---|---|---|---|---|---|---|---|---|---|
| EXECUTIVES | YEAR | BASE SALARY US$000 | OTHER[2] US$000 | STI CASH[3] US$000 | SUPERANNUATION US$000 | LEAVE ACCRUALS[4] US$000 | CONDITIONAL RIGHTS[5] US$000 | TERMINATION BENEFITS US$000 | TOTAL US$000 |
| **Group head office** | | | | | | | | | |
| John Neal | **2016** | **1,635** | **113** | **821** | **–** | **(16)** | **1,975** | **–** | **4,528** |
| | 2015 | 1,631 | 79 | 330 | – | (13) | 1,232 | – | 3,259 |
| Jason Brown | **2016** | **506** | **2** | **347** | **15** | **25** | **377** | **–** | **1,272** |
| | 2015 | 501 | 39 | 310 | 14 | 26 | 377 | – | 1,267 |
| Colin Fagen[6] | **2016** | **956** | **22** | **–** | **15** | **87** | **748** | **–** | **1,828** |
| | 2015 | 844 | 40 | 465 | 14 | 57 | 708 | – | 2,128 |
| Margaret Murphy | **2016** | **127** | **80** | **92** | **12** | **7** | **17** | **–** | **335** |
| | 2015 | – | – | – | – | – | – | – | – |
| Patrick Regan | **2016** | **1,189** | **94** | **992** | **–** | **9** | **1,439** | **–** | **3,723** |
| | 2015 | 1,190 | 34 | 412 | – | (9) | 2,155 | – | 3,782 |
| **Divisional** | | | | | | | | | |
| David Fried | **2016** | **906** | **1,539** | **576** | **21** | **–** | **668** | **–** | **3,710** |
| | 2015 | 899 | 1,235 | 501 | 21 | – | 573 | – | 3,229 |
| Russell Johnston | **2016** | **571** | **11** | **429** | **21** | **–** | **367** | **–** | **1,399** |
| | 2015 | – | – | – | – | – | – | – | – |
| Richard Pryce | **2016** | **966** | **149** | **601** | **–** | **–** | **910** | **–** | **2,626** |
| | 2015 | 1,085 | 166 | 985 | – | – | 775 | – | 3,011 |
| **Former executives** | | | | | | | | | |
| David Duclos[7] | **2016** | **462** | **9** | **296** | **21** | **–** | **439** | **–** | **1,227** |
| | 2015 | 1,000 | 19 | 729 | 23 | – | 826 | – | 2,597 |
| Mike Emmett[8] | **2016** | **106** | **1** | **65** | **–** | **(12)** | **49** | **1,397** | **1,606** |
| | 2015 | 678 | 31 | 339 | 14 | 24 | 449 | – | 1,535 |
| Tim Plant[9] | **2016** | **428** | **5** | **149** | **15** | **25** | **241** | **832** | **1,695** |
| | 2015 | 270 | 20 | 140 | 9 | (10) | 318 | – | 747 |
| Jenni Smith[8] | **2016** | **448** | **18** | **303** | **15** | **39** | **199** | **813** | **1,835** |
| | 2015 | 556 | 23 | 279 | 14 | 28 | 224 | – | 1,124 |
| **Total 2016** | **2016** | **8,300** | **2,043** | **4,671** | **135** | **164** | **7,429** | **3,042** | **25,984** |
| **Total 2015** | 2015 | 8,654 | 1,686 | 4,490 | 109 | 103 | 7,637 | – | 22,679 |

1 The fair value at grant date of options and conditional rights is determined using appropriate models including Monte Carlo simulations, depending on the vesting conditions. The fair value of each conditional right is recognised evenly over the service period ending at vesting date. Details of grants of conditional rights are provided in section 6.4 of the Remuneration Report.

2 "Other" includes provision of motor vehicles, health insurance, spouse travel, staff insurance discount benefits received during the year, life assurance and personal accident insurance and the applicable taxes thereon. It also includes the deemed value of interest-free share loans, tax payments and other one-off expenses. For David Fried, this also includes expatriate benefits including a housing allowance, education assistance, a cost of living adjustment and associated taxes thereon. For Margaret Murphy, this includes cost of relocation.

3 Cash STI is payable in March 2017 for performance in 2016.

4 Includes the movement in annual leave and long service leave provisions during the year.

5 For Patrick Regan this includes the conditional rights granted on 20 August 2014. For further details, refer to section 6.4.3 of the Remuneration Report.

# Remuneration Report CONTINUED

6 At the time of publishing the Remuneration Report, the 2016 STI award to Colin Fagen has not been determined. The award will be determined in accordance with the STI Plan Rules.

7 David Duclos ceased being a KMP on 31 May 2016. He remains a QBE employee in an alternate position.

8 "Termination benefits" in respect of Mike Emmett, Tim Plant and Jenni Smith includes apportioned fixed remuneration paid for the balance of the notice period to the termination date, STI cash awards from the date of ceasing to be a KMP to the date of termination and the accelerated accounting charge or reversal of equity vesting or cancellation. For Mike Emmett this also includes a redundancy payment and a restraint payment. For further details, refer to section 6.2 of the Remuneration Report.

## 6.2 Former executives

The table below shows remuneration of executives who ceased employment during the financial year ended 31 December 2016, as determined under applicable Australian Accounting Standards.

| FORMER EXECUTIVES | APPORTIONED FIXED REMUNERATION TO TERMINATION DATE[1] US$000 | STI CASH[2] US$000 | STI DEFERRED[3] US$000 | OTHER TERMINATION PAYMENTS[4] US$000 | ACCELERATED ACCOUNTING CHARGE – CONDITIONAL RIGHTS[5] US$000 | TOTAL[6] US$000 |
|---|---|---|---|---|---|---|
| Mike Emmett | 239 | 374 | 204 | 289 | 291 | 1,397 |
| Tim Plant | 357 | - | 55 | 24 | 396 | 832 |
| Jenni Smith | 398 | 61 | 121 | 40 | 195 | 813 |

1 Apportioned fixed remuneration from the date of ceasing to be a KMP to the date of termination of employment.

2 Apportioned STI cash from the date of ceasing to be a KMP to the date of termination of employment.

3 Apportioned STI deferred from the date of ceasing to be a KMP to the date of termination of employment.

4 "Other termination payments" includes redundancy payments and movement in annual leave and long service leave provisions during the year.

5 Accounting charge accelerated or reversed due to termination.

6 Amounts have been converted to US dollars using the average rate of exchange for the 2016 year.

## 6.3 Equity-based remuneration

### Executive investment in QBE as at 31 January 2017

The table below shows the investment exposure of QBE's executives as at 31 January 2017. Amounts in the table include relevant interests but do not include interests attributable to personally related parties.

| EXECUTIVES | ORDINARY SHARES NUMBER | CONDITIONAL RIGHTS NUMBER | TOTAL POTENTIAL SHARES IN QBE AT 31 JAN 2017 NUMBER | VALUE OF POTENTIAL SHARES IN QBE AT 31 JAN 2017 US$000 | COST TO REPAY SHARE LOANS US$000 | NET INVESTMENT IN QBE AT 31 JAN 2017[1] US$000 |
|---|---|---|---|---|---|---|
| **Group head office** | | | | | | |
| John Neal | 292,178 | 1,399,612 | 1,691,790 | 16,002 | – | 16,002 |
| Jason Brown | 62,310 | 208,468 | 270,778 | 2,561 | (3) | 2,558 |
| Colin Fagen | 89,374 | 501,742 | 591,116 | 5,591 | (267) | 5,324 |
| Margaret Murphy | – | 25,720 | 25,720 | 243 | – | 243 |
| Patrick Regan | 552,214 | 903,008 | 1,455,222 | 13,765 | – | 13,765 |
| **Divisional** | | | | | | |
| David Fried | 41,999 | 398,142 | 440,141 | 4,163 | – | 4,163 |
| Russell Johnston | 30,000 | 158,792 | 188,792 | 1,786 | – | 1,786 |
| Richard Pryce | 76,899 | 558,241 | 635,140 | 6,008 | – | 6,008 |

1 The closing share price at 31 January 2017 was A$12.50 ($9.46 using the 31 January 2017 closing rate of exchange).

## 6.4 Conditional rights

### Overview

Equity awards at QBE are granted in the form of conditional rights. A conditional right is a promise by QBE to acquire one fully paid ordinary QBE Insurance Group Limited share where certain conditions are met.

### 6.4.1 Deferred equity awards

The table below details conditional rights provided under the terms of the STI Plan, QBE Incentive Scheme (QIS) (which ceased from 1 January 2014) and contractual arrangements. Further details are provided in sections 4.4 and 9.1 of the Remuneration Report.

| EXECUTIVES | CONDITIONAL RIGHTS GRANTED IN THE YEAR NUMBER | VALUE OF CONDITIONAL RIGHTS AT GRANT DATE US$000 | CONDITIONAL RIGHTS VESTED AND EXERCISED IN THE YEAR NUMBER | VALUE OF CONDITIONAL RIGHTS AT VESTING DATE US$000 | CONDITIONAL RIGHTS FORFEITED/ LAPSED IN THE YEAR NUMBER | VALUE OF CONDITIONAL RIGHTS AT FORFEITURE/ LAPSE DATE US$000 |
|---|---|---|---|---|---|---|
| **Group head office** | | | | | | |
| John Neal | 100,546 | 840 | 55,334 | 476 | – | – |
| Jason Brown | 18,607 | 155 | 14,192 | 122 | – | – |
| Colin Fagen | 27,913 | 233 | 52,337 | 451 | – | – |
| Margaret Murphy | – | – | – | – | – | – |
| Patrick Regan | 44,739 | 374 | 7,603 | 64 | – | – |
| **Divisional** | | | | | | |
| David Fried | 31,590 | 264 | 50,074 | 415 | – | – |
| Russell Johnston | – | – | – | – | – | – |
| Richard Pryce | 56,491 | 472 | 48,415 | 410 | – | – |
| **Former executives** | | | | | | |
| David Duclos | 46,000 | 384 | 44,814 | 387 | – | – |
| Mike Emmett | – | – | – | – | – | – |
| Tim Plant | 15,287 | 128 | 22,170 | 191 | – | – |
| Jenni Smith | 16,723 | 140 | 10,747 | 92 | – | – |

### 6.4.2 Long-term incentive plan

The table below details conditional rights provided under the terms of the LTI plan. LTI conditional rights are subject to future performance hurdles as detailed in section 4.5 of the Remuneration Report.

| EXECUTIVES | CONDITIONAL RIGHTS GRANTED IN THE YEAR NUMBER | VALUE OF CONDITIONAL RIGHTS AT GRANT DATE[1] US$000 | CONDITIONAL RIGHTS VESTED AND EXERCISED IN THE YEAR NUMBER | VALUE OF CONDITIONAL RIGHTS AT VESTING DATE US$000 | CONDITIONAL RIGHTS FORFEITED/ LAPSED IN THE YEAR NUMBER | VALUE OF CONDITIONAL RIGHTS AT FORFEITURE/ LAPSE DATE US$000 |
|---|---|---|---|---|---|---|
| **Group head office** | | | | | | |
| John Neal | 402,194 | 2,767 | – | – | – | – |
| Jason Brown | 47,989 | 313 | – | – | – | – |
| Colin Fagen | 148,537 | 970 | – | – | – | – |
| Margaret Murphy | 25,720 | 141 | – | – | – | – |
| Patrick Regan | 219,378 | 1,509 | – | – | – | – |
| **Divisional** | | | | | | |
| David Fried | 118,824 | 776 | – | – | – | – |
| Russell Johnston | 107,719 | 649 | – | – | – | – |
| Richard Pryce | 145,227 | 948 | – | – | – | – |
| **Former executives** | | | | | | |
| David Duclos | 196,222 | 1,281 | – | – | – | – |
| Mike Emmett | – | – | – | – | 29,964 | 258 |
| Tim Plant | 86,837 | 567 | – | – | 70,675 | 553 |
| Jenni Smith | 52,786 | 345 | – | – | 50,535 | 341 |

1 The value at grant date is calculated in accordance with AASB 2 *Share-based Payment*.

### 6.4.3 Future-performance conditional rights

The table below details conditional rights provided as remuneration to executives during 2016.

| EXECUTIVES | CONDITIONAL RIGHTS GRANTED IN THE YEAR NUMBER | VALUE OF CONDITIONAL RIGHTS AT GRANT DATE[1] US$000 | CONDITIONAL RIGHTS VESTED AND EXERCISED IN THE YEAR NUMBER | VALUE OF CONDITIONAL RIGHTS AT VESTING DATE US$000 | CONDITIONAL RIGHTS FORFEITED/ LAPSED IN THE YEAR NUMBER | VALUE OF CONDITIONAL RIGHTS AT FORFEITURE/ LAPSE DATE US$000 |
|---|---|---|---|---|---|---|
| **Group head office** | | | | | | |
| John Neal | 60,328 | 227 | – | – | – | – |
| Jason Brown | – | – | 5,960 | 50 | 2,555 | 22 |
| Patrick Regan | 40,672 | 153 | 135,008 | 1,110 | – | – |
| Russell Johnston | 50,000 | 428 | – | – | – | – |
| **Former executives** | | | | | | |
| Mike Emmett | – | – | – | – | 25,385 | 218 |

1 The value at grant date is calculated in accordance with AASB 2 *Share-based Payment*.

## 6.5 Employment agreements

The table below summarises the material terms of the employment agreements for the current executives which are subject to applicable laws. The terms and conditions of employment of each executive reflect market conditions at the time of their contract negotiation on appointment and thereafter.

| CONTRACTUAL TERM | EXECUTIVES AFFECTED | CONDITIONS |
|---|---|---|
| Duration of contract | All | Permanent full-time employment contract until notice given by either party. |
| Notice to be provided by executive or QBE | All | Notice period is 12 months for John Neal.<br>For Russell Johnston, notice required by QBE is 12 months, reducing to six months after 18 months of service.<br>Other executives' notice periods are six months.<br>QBE may elect to make a payment in lieu of notice. |
| Treatment of incentives on involuntary termination | All | **On termination with cause or for poor performance**<br>All unvested incentives are forfeited.<br>**On termination without cause**<br>For STI in the year of termination, the executive remains eligible to be considered for an award on a pro-rata basis with any award to be determined following the end of the performance year and subject to the standard deferral arrangements.<br>Unvested deferred STI conditional rights remain in the plan subject to the original vesting dates and malus provisions.<br>A pro-rata number of LTI conditional rights, reflecting the portion of the three year performance period the executive was in service, remain in the plan subject to the original performance and vesting conditions. Legacy LTI awards generally remain in the plan subject to the original performance and vesting conditions; however, the Remuneration Committee has discretion to vest these awards.<br>Legacy QIS-DEA awards generally remain in the plan subject to the original vesting conditions. |
| Treatment of incentives on voluntary termination | All | All unvested incentives are forfeited. |
| Deferred bonus | John Neal | Three weeks' fixed remuneration for each year of service capped at 12 months' fixed remuneration on termination if not due to resignation, termination without notice, poor performance or serious misconduct. |
| Post-employment restraints | John Neal | 12 month non-compete and non-solicitation. |
| | All others | Six month non-compete and non-solicitation. |

# 7. EXECUTIVE REMUNERATION CHANGES FOR 2017

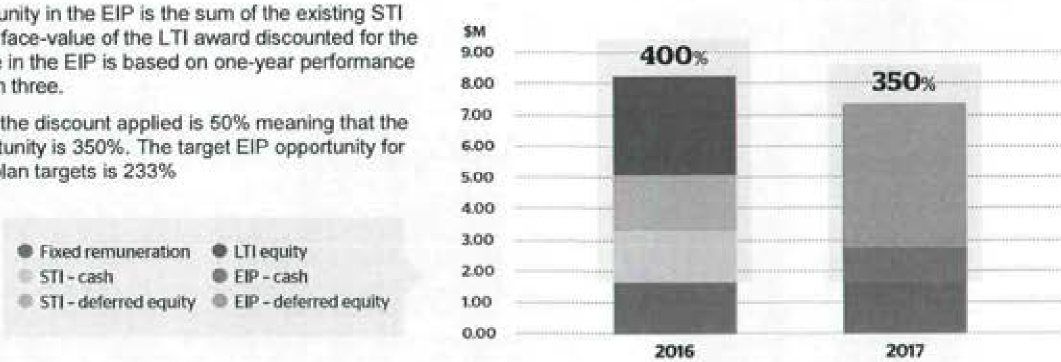
## 7.1 The Executive Incentive Plan

For 2017, we are introducing the EIP which effectively combines STI and LTI into a single, simpler incentive plan. The EIP balances both short and long-term performance through an annual award based on performance against a range of financial metrics that measure progress against longer-term strategy, with a significant portion of the award made in deferred equity. The diagram below illustrates the payment profile for the Group CEO of the revised remuneration framework to apply in 2017.

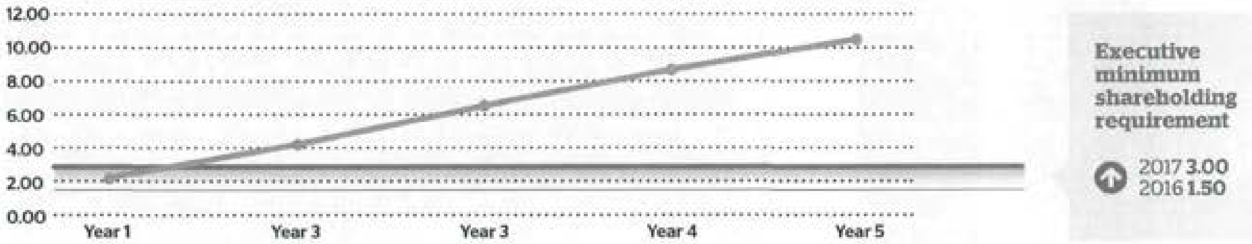
## 7.2 Group CEO incentive opportunity

The incentive opportunity in the EIP is the sum of the existing STI opportunity, plus the face-value of the LTI award discounted for the fact that the outcome in the EIP is based on one-year performance measures rather than three.

For the Group CEO, the discount applied is 50% meaning that the maximum EIP opportunity is 350%. The target EIP opportunity for achieving business plan targets is 233%




The EIP creates long-term shareholder alignment through the building of significant share ownership as deferred equity awards are earned. The diagram below illustrates how the Group CEO shareholding, as a multiple of fixed remuneration, would build up if annual business plans are met.



## 7.3 Performance measures

| Group<br>Cash ROE (25%) and COR (40%) | Group strategic priorities<br>(15%) | Balanced scorecard<br>(20%) |
|---|---|---|

### Group financial performance measures

For 2017, statutory ROE will be replaced with two Group measures, being cash ROE and COR. We believe this provides a better balance between alignment with shareholders and rewarding performance within the control of our people. The features of the Group financial performance measures are summarised in the table below.

| FEATURE | CASH ROE | COR |
|---|---|---|
| **Definition** | Net cash profit divided by average shareholders' funds. In accordance with existing policy and while we manage an unmatched asset-liability position with regards to duration, an adjustment for 50% of the impact of movements in risk-free discount rates will apply. | Net claims, commissions and expenses as a percentage of net earned premium (measured on an ex-discount rate basis). |
| **Rationale** | Cash ROE will generally be measured on the same basis as that used to determine shareholder dividends. As a principle, losses due to unbudgeted amortisation/ impairment of intangibles will, other than in exceptional circumstances, be added back to cash ROE so that executives remain accountable for the management of intangible assets. | COR has been introduced as it is the most relevant measure of the profitability of our insurance operations and therefore success. It is widely used externally for non-life insurance companies.<br>In the divisions, we will also use divisional COR, replacing RoAC. |
| **Adjustments** | Any other items (such as material acquisitions or divestments) not included in the business plan and deemed appropriate by the Remuneration Committee. For 2017, an adjustment will be made for the impact of changes, if any, to the Ogden tables in the UK beyond the provision included in the business plan.<br>The Board will retain an overarching discretion to adjust formulaic outcomes upwards or downwards to properly reflect performance. | |

### Strategic priorities

We have broadened our view of performance to include measures linked to annual milestones in achieving our three-year strategic priorities that in turn lead to value creation in future years. These measures account for 15% of the EIP outcome. The measures are expected to evolve over time as our strategy and focus evolves. As such, we will in future contemplate using human capital measures, such as employee engagement, that reflect our cultural objectives; however, measures will be quantifiable, typically be no more than three in number and will apply where relevant at a divisional level. For 2017 the strategic priorities will be:

1. **Operational efficiency**, measured by expense savings generated through operational excellence, automation and sourcing capability; and
2. **Claims excellence**, measured by savings generated through leveraging and improving our global claims capabilities and insights through data analytics.

### Balanced scorecard

The balanced scorecard will continue to comprise financial and non-financial KPIs that are relevant the executive's role and aligned to the QBE value creation model.

## 7.4 Summary of key features

The table below summarises the key features of the EIP changes.

| | 2016 INCENTIVE PLANS | | 2017 |
|---|---|---|---|
| FEATURE | STI | LTI | EIP |
| **Group CEO incentive components** | • STI cash (50%)<br>• STI deferred equity (50%) | • LTI equity (100%) | • EIP cash (20%)<br>• EIP deferred equity (80%) |
| **Group CEO maximum incentive opportunity** | • 200% | • 200% | • 350% |
| **Performance period** | • 1 year | • 3 years | • 1 year |
| **Equity deferral period** | • 1-2 years from end of performance period | • 3-5 years from start of performance period | • 1-4 years from end of performance period |
| **Performance measures** | • Group statutory ROE<br>• Divisional RoAC (for divisional CEOs)<br>• Balanced scorecard | • Group statutory ROE<br>• Relative TSR | • Group cash ROE<br>• Group COR<br>• Group/divisional strategic priorities<br>• Divisional COR (for divisional CEOs)<br>• Balanced scorecard |
| **Post-employment conditions (deferred equity)** | • Unvested awards remain in the plan subject to the original vesting conditions and dates<br>• On resignation or termination for cause, all awards are forfeited | • Unvested awards pro-rated for portion of performance period completed and award remains in the plan subject to the original vesting conditions and dates<br>• On resignation or termination for cause, all awards are forfeited | • Unvested awards remain in the plan subject to the original vesting conditions and dates<br>• On resignation or termination for cause, all awards are forfeited |
| **Malus** | • Subject to malus during the vesting period | • Subject to malus during the vesting period | • Subject to malus during the vesting period |
| **Executive minimum shareholding requirement** | • Group CEO: 1.5 times fixed remuneration<br>• Executives: 1.0 times fixed remuneration | | • Group CEO: 3.0 times fixed remuneration<br>• Executives: 1.5 times fixed remuneration |

## 8. NON-EXECUTIVE DIRECTOR REMUNERATION

### 8.1 Remuneration philosophy

Non-executive director remuneration reflects QBE's desire to attract, motivate and retain experienced independent directors and to ensure their active participation in the Group's affairs for the purposes of corporate governance, regulatory compliance and other matters. QBE aims to provide a level of remuneration for non-executive directors comparable with its peers, which include multinational financial institutions. The Board reviews surveys published by independent remuneration consultants and other public information to ensure that fee levels are appropriate. The remuneration arrangements of non-executive directors are distinct and separate from the executives. Non-executive directors do not have formal service agreements.

### 8.2 Fee structure and components

The aggregate amount approved by shareholders at the 2015 AGM was A$3,500,000 per annum.

Under the current fee framework, non-executive directors receive a base fee expressed in Australian dollars. In addition, a non-executive director (other than the Chairman) may receive further fees for chairmanship or membership of a board committee.

No change was made to non-executive remuneration during 2016.

Active committees in 2016 were as follows:

- Audit Committee
- Investment Committee
- Remuneration Committee
- Risk and Capital Committee
- Operations and Technology Committee (from 1 September 2016)

The non-executive director fee structure for 2016 and 2015 is shown in the table below.

| FEE FRAMEWORK | 2016 A$000 | 2015 A$000 |
|---|---|---|
| Chairman base fee | **663** | 663 |
| Deputy Chairman base fee | **229** | 229 |
| Non-executive director base fee | **208** | 208 |
| Committee chairman base fee | **50** | 50 |
| Committee membership fee | **27** | 27 |

### 8.3 Other benefits

Non-executive directors do not receive any performance-based remuneration such as cash incentives or equity awards. Under QBE's constitution, non-executive directors are entitled to be reimbursed for all travel and related expenses properly incurred in connection with the business of QBE. All non-executive directors receive an annual cash travel allowance of A$42,750 (A$64,000 for the Chairman) in addition to fees for the time involved in travelling to Board meetings and other Board commitments.

#### Superannuation

QBE pays superannuation to Australian-based non-executive directors in accordance with Australian superannuation guarantee legislation. Overseas-based non-executive directors receive the cash equivalent amount in addition to their fees.

# Remuneration Report CONTINUED

## 8.4 Minimum shareholding requirement

With effect from 1 April 2014, a non-executive director minimum shareholding requirement was introduced for the Group Board. Under this requirement, directors have five years to build a minimum shareholding equal to 100% of annual base fees.

To assist current and new non-executive directors in meeting the requirement, a Director Share Acquisition Plan (DSAP) was established with effect from 1 June 2014. The DSAP allows non-executive directors to sacrifice a portion of their pre-tax director fees to acquire QBE shares. Where the minimum shareholding requirement has not been met, directors are required to sacrifice a mandatory minimum amount of 20% of pre-tax fees into the DSAP until the minimum shareholding is met. Shares acquired in this way are not subject to performance targets, as they are acquired in place of cash payments.

Directors' shareholdings are shown in section 9.4 of the Remuneration Report.

## 8.5 Remuneration details for non-executive directors

The table below details the nature and amount of each component of the remuneration of QBE's current non-executive directors.

| | | SHORT-TERM EMPLOYMENT BENEFITS | | POST EMPLOYMENT BENEFITS | | |
|---|---|---|---|---|---|---|
| NON-EXECUTIVE DIRECTOR | YEAR | FEES [1] US$000 | OTHER US$000 | SUPERANNUATION – SGC [2] US$000 | SUPERANNUATION – OTHER US$000 | TOTAL [3] US$000 |
| Marty Becker | **2016** | **592** | – | – | – | **592** |
| | 2015 | 593 | – | – | – | 593 |
| Stephen Fitzgerald | **2016** | **272** | – | – | – | **272** |
| | 2015 | 258 | – | 5 | 7 | 269 |
| John M Green | **2016** | **292** | – | **14** | **13** | **319** |
| | 2015 | 272 | – | 14 | 12 | 298 |
| Margaret Leung | **2016** | **248** | – | – | – | **248** |
| | 2015 | 248 | – | – | – | 248 |
| Kathryn Lisson | **2016** | **89** | – | – | – | **89** |
| | 2015 | – | – | – | – | – |
| Sir Brian Pomeroy | **2016** | **267** | – | – | – | **267** |
| | 2015 | 267 | – | – | – | 267 |
| Jann Skinner | **2016** | **268** | – | **14** | **10** | **292** |
| | 2015 | 234 | – | 14 | 8 | 256 |
| Rolf Tolle | **2016** | **201** | – | – | – | **201** |
| | 2015 | – | – | – | – | – |
| Michael Wilkins | **2016** | **41** | – | **2** | **1** | **44** |
| | 2015 | – | – | – | – | – |
| **Total** | **2016** | **2,280** | – | **30** | **24** | **2,314** |
| | 2015 | 1,870 | – | 33 | 27 | 1,930[4] |

1 Travel allowances, additional fees in lieu of superannuation in Australia and amounts sacrificed in relation to the Director Share Acquisition Plan are included in directors' fees.

- Marty Becker, Stephen Fitzgerald, Margaret Leung, Kathryn Lisson, Sir Brian Pomeroy and Rolf Tolle receive additional fees of 9.5% in lieu of superannuation in Australia.
- Marty Becker, Stephen Fitzgerald, Margaret Leung, Kathryn Lisson, Sir Brian Pomeroy, Rolf Tolle and Michael Wilkins all participate in the Director Share Acquisition Plan.

2 John Green, Jann Skinner and Michael Wilkins are Australian residents. Superannuation is calculated as 9.5% of fees. Superannuation in excess of the statutory minimum may be taken as additional cash fees or in the form of superannuation contributions at the option of the director.

3 Remuneration has been converted to US dollars using the average rate of exchange for the relevant year.

4 Former non-executive director, John Graf, retired during 2015 therefore is excluded from the table above. Total non-executive director remuneration in 2015 was $2,219,000.

## 9. APPENDIX

### 9.1 Legacy equity schemes

The table below summarises QBE's legacy incentive plans.

| EQUITY SCHEME | DESCRIPTION |
|---|---|
| **Legacy Long-Term Incentive Plan (LTI)** | |
| **Until 31 December 2013** | The legacy LTI plan comprised an award of conditional rights to fully-paid shares without payment by the executive, subject to a five year tenure hurdle, with vesting contingent upon the achievement of two future performance hurdles as follows:<br>• 50% of the award granted will be contingent on QBE's diluted EPS increasing by a compound average of 7.5% per annum over the five year vesting period; and<br>• 50% of the award granted will be contingent on QBE's average statutory ROE and COR being in the top 10% of the top 50 largest global insurers and reinsurers as measured by net earned premium for the five year vesting period.<br>Conditional rights were granted as a maximum percentage of fixed remuneration ranging from 50% for the Group CEO, 25% for the Group CFO and 15% for Group and divisional executives. |
| **QBE Incentive Scheme (QIS)** | |
| **Until 31 December 2013** | The QBE Incentive Scheme (QIS) was a short-term, at-risk reward structure comprised cash and deferred equity awards (QIS-DEA). It came into effect from 1 January 2010 and was applicable to deferred equity awards made in March 2011 to March 2014.<br>Under the QIS, the directors could approve the issue of conditional rights to shares to executives who achieved predetermined performance targets. The maximum deferred equity award was based on an amount which was the lesser of 80% of the cash award earned or 100% of fixed remuneration at 31 December, in each case for the financial year immediately prior to the year in which the cash award was paid. The deferred equity award was used as the basis for calculating the number of conditional rights as follows:<br>• conditional rights to the value of 50% of the award converted to fully paid ordinary QBE shares after three years; and<br>• conditional rights to the value of 50% of the award converted to fully paid ordinary QBE shares after five years.<br>During the period from the date of the QIS grant to the vesting date of the conditional rights, further conditional rights are issued under the Bonus Share Plan to reflect dividends paid on ordinary shares of QBE.<br>The shares issued pursuant to the conditional rights are issued without payment being made by the recipient (i.e. at a nil exercise price).<br>The shares issued pursuant to the conditional rights vest only if the individual has remained in the Group's service throughout the vesting period. For awards made prior to 2012, the Remuneration Committee has the discretion to pay cash in lieu of shares in certain circumstances such as death, disability, redundancy or retirement if the individual is not subject to disciplinary proceedings or notice to terminate employment on that date. The extent of vesting of the conditional rights may be reduced (including to zero) for any material deterioration of the relevant entity's return on equity during the vesting period. |

# Remuneration Report CONTINUED

## 9.2 Valuation of conditional rights

The table below details the conditional rights issued affecting remuneration of KMP in the previous, current or future reporting periods.

| GRANT DATE | DATE EXERCISABLE | FAIR VALUE PER RIGHT AT GRANT DATE[1] |
|---|---|---|
| 7 March 2011 | 6 March 2016 | A$17.90 |
| 7 March 2012 | 6 March 2017 | A$11.78 |
| 1 September 2012 | 1 March 2016 | A$13.03 |
| 5 March 2013 | 4 March 2016 | A$13.18 |
| 5 March 2013 | 4 March 2018 | A$13.18 |
| 27 March 2013 | 26 March 2018 | A$13.02 |
| 2 April 2013 | 1 April 2016 | A$13.18 |
| 2 April 2013 | 1 April 2018 | A$13.18 |
| 8 April 2013 | 7 April 2016 | A$13.61 |
| 8 April 2013 | 7 April 2018 | A$13.61 |
| 4 March 2014 | 3 March 2017 | A$8.34 |
| 4 March 2014 | 3 March 2018 | A$8.34 |
| 4 March 2014 | 3 March 2019 | A$8.34 |
| 4 March 2014 | 3 March 2017 | A$8.60 |
| 4 March 2014 | 3 March 2018 | A$8.60 |
| 4 March 2014 | 3 March 2019 | A$8.60 |
| 4 March 2014 | 3 March 2017 | A$12.68 |
| 4 March 2014 | 3 March 2018 | A$12.68 |
| 4 March 2014 | 3 March 2019 | A$12.68 |
| 4 March 2014 | 3 March 2017 | A$12.75 |
| 4 March 2014 | 3 March 2018 | A$12.75 |
| 4 March 2014 | 3 March 2019 | A$12.75 |
| 20 August 2014 | 3 March 2017 | A$5.08 |
| 20 August 2014 | 3 March 2018 | A$5.08 |
| 20 August 2014 | 3 March 2019 | A$5.08 |
| 20 August 2014 | 3 March 2017 | A$10.70 |
| 20 August 2014 | 3 March 2018 | A$10.70 |
| 20 August 2014 | 3 March 2019 | A$10.70 |
| 20 August 2014 | 1 March 2015 | A$11.23 |
| 20 August 2014 | 1 March 2016 | A$11.23 |
| 20 August 2014 | 1 March 2017 | A$11.23 |
| 3 March 2015 | 2 March 2018 | A$9.15 |
| 3 March 2015 | 2 March 2019 | A$9.15 |
| 3 March 2015 | 2 March 2020 | A$9.15 |
| 3 March 2015 | 2 March 2018 | A$9.35 |
| 3 March 2015 | 2 March 2019 | A$9.35 |
| 3 March 2015 | 2 March 2020 | A$9.35 |
| 3 March 2015 | 2 March 2016 | A$11.63 |
| 3 March 2015 | 2 March 2017 | A$11.63 |
| 3 March 2015 | 2 March 2016 | A$12.63 |
| 3 March 2015 | 2 March 2017 | A$12.63 |
| 3 March 2015 | 2 March 2018 | A$12.63 |
| 3 March 2015 | 2 March 2019 | A$12.63 |
| 3 March 2015 | 2 March 2020 | A$12.63 |
| 3 March 2015 | 2 March 2016 | A$12.90 |
| 3 March 2015 | 2 March 2017 | A$12.90 |
| 3 March 2015 | 2 March 2018 | A$12.90 |
| 3 March 2015 | 2 March 2019 | A$12.90 |
| 3 March 2015 | 2 March 2020 | A$12.90 |
| 19 August 2015 | 2 March 2016 | A$14.06 |
| 19 August 2015 | 2 March 2017 | A$14.06 |
| 19 August 2015 | 2 March 2018 | A$14.06 |
| 1 March 2016 | 28 February 2019 | A$4.93 |
| 1 March 2016 | 28 February 2019 | A$6.16 |
| 1 March 2016 | 28 February 2020 | A$6.16 |
| 1 March 2016 | 28 February 2021 | A$6.16 |
| 1 March 2016 | 28 February 2019 | A$5.89 |
| 1 March 2016 | 28 February 2020 | A$5.89 |
| 1 March 2016 | 28 February 2021 | A$5.89 |

| GRANT DATE | DATE EXERCISABLE | FAIR VALUE PER RIGHT AT GRANT DATE[1] |
|---|---|---|
| 1 March 2016 | 28 February 2017 | A$10.94 |
| 1 March 2016 | 28 February 2018 | A$10.94 |
| 1 March 2016 | 28 February 2019 | A$10.94 |
| 1 March 2016 | 28 February 2020 | A$10.94 |
| 1 March 2016 | 28 February 2021 | A$10.94 |
| 1 March 2016 | 28 February 2019 | A$11.13 |
| 1 March 2016 | 28 February 2020 | A$11.13 |
| 1 March 2016 | 28 February 2021 | A$11.13 |
| 2 May 2016 | 15 March 2017 | A$11.21 |
| 2 May 2016 | 15 March 2018 | A$11.21 |
| 2 May 2016 | 15 March 2019 | A$11.21 |
| 31 August 2016 | 28 February 2019 | A$5.81 |
| 31 August 2016 | 28 February 2020 | A$5.81 |
| 31 August 2016 | 28 February 2021 | A$5.81 |
| 31 August 2016 | 28 February 2019 | A$9.97 |
| 31 August 2016 | 28 February 2020 | A$9.97 |
| 31 August 2016 | 28 February 2021 | A$9.97 |
| 10 October 2016 | 28 February 2019 | A$4.62 |
| 10 October 2016 | 28 February 2020 | A$4.62 |
| 10 October 2016 | 28 February 2021 | A$4.62 |
| 10 October 2016 | 28 February 2019 | A$9.72 |
| 10 October 2016 | 28 February 2020 | A$9.72 |
| 10 October 2016 | 28 February 2021 | A$9.72 |

1 The fair value of conditional rights at grant date is determined using appropriate models including Monte Carlo simulations, depending on the vesting conditions. The fair value of each conditional right is recognised evenly over the service period ending at vesting date. Details of grants of conditional rights are provided in section 6.4 of the Remuneration Report.

## 9.3 Equity instruments

### 9.3.1 QBE deferred equity plans – conditional rights

The table below details the movements in the number of conditional rights to ordinary shares in QBE provided as remuneration to the KMP and issued under the STI, QIS and DCP.

| 2016 | BALANCE AT 1 JAN 2016 NUMBER | GRANTED IN THE YEAR NUMBER | NOTIONAL DIVIDENDS ATTACHING IN THE YEAR NUMBER | VESTED AND TRANSFERRED IN THE YEAR NUMBER | FORFEITED/ LAPSED IN THE YEAR NUMBER | BALANCE AT 31 DEC 2016 NUMBER |
|---|---|---|---|---|---|---|
| **Executive directors** | | | | | | |
| John Neal | 82,032 | 100,546 | 6,359 | (55,334) | – | 133,603 |
| Patrick Regan | 15,206 | 44,739 | 2,616 | (7,603) | – | 54,958 |
| **Other key management personnel** | | | | | | |
| Jason Brown | 45,354 | 18,607 | 2,488 | (14,192) | – | 52,257 |
| Colin Fagen | 175,603 | 27,913 | 7,556 | (52,337) | – | 158,735 |
| David Fried | 118,109 | 31,590 | 6,231 | (50,074) | – | 105,856 |
| Russell Johnston | – | – | – | – | – | – |
| Margaret Murphy | – | – | – | – | – | – |
| Richard Pryce | 126,617 | 56,491 | 6,734 | (48,415) | – | 141,427 |
| **Former key management personnel** | | | | | | |
| David Duclos | 162,105 | 46,000 | 5,652 | (44,814) | – | 168,943 |
| Mike Emmett | 72,831 | – | – | – | – | 72,831 |
| Tim Plant | 67,521 | 15,287 | 1,694 | (22,170) | – | 62,332 |
| Jenni Smith | 15,550 | 16,723 | 1,076 | (10,747) | – | 22,602 |

# Remuneration Report CONTINUED

### 9.3.2 Long-term incentive plans – conditional rights

The table below details the movements in the number of conditional rights to ordinary shares in QBE provided as remuneration to the KMP and issued under the LTI plan and legacy LTI plan. No conditional rights to ordinary shares in QBE were provided to KMP under any legacy schemes.

| 2016 | BALANCE AT 1 JAN 2016 NUMBER | GRANTED IN THE YEAR NUMBER | NOTIONAL DIVIDENDS ATTACHING IN THE YEAR NUMBER | VESTED AND TRANSFERRED IN THE YEAR NUMBER | FORFEITED/ LAPSED IN THE YEAR NUMBER | BALANCE AT 31 DEC 2016 NUMBER |
|---|---|---|---|---|---|---|
| **Executive directors** | | | | | | |
| John Neal | 743,220 | 402,194 | 57,252 | – | – | 1,202,666 |
| Patrick Regan | 412,621 | 219,378 | 31,590 | – | – | 663,589 |
| **Other key management personnel** | | | | | | |
| Jason Brown | 83,494 | 47,989 | 6,576 | – | – | 138,059 |
| Colin Fagen | 178,140 | 148,537 | 16,330 | – | – | 343,007 |
| David Fried | 159,552 | 118,824 | 13,910 | – | – | 292,286 |
| Russell Johnston | – | 107,719 | – | – | – | 107,719 |
| Margaret Murphy | – | 25,720 | – | – | – | 25,720 |
| Richard Pryce | 251,747 | 145,227 | 19,840 | – | – | 416,814 |
| **Former key management personnel** | | | | | | |
| David Duclos | 310,810 | 196,222 | 14,164 | – | – | 521,196 |
| Mike Emmett | 92,588 | – | – | – | (29,964) | 62,624 |
| Tim Plant | 95,668 | 88,837 | 5,096 | – | (70,875) | 118,926 |
| Jenni Smith | 114,676 | 52,788 | 8,063 | – | (50,835) | 124,692 |

None of these conditional rights were vested or exercisable at 31 December 2016.

### 9.3.3 Other – conditional rights

The table below details the movements in the number of conditional rights to ordinary shares in QBE provided as remuneration to KMP.

| 2016 | BALANCE AT 1 JAN 2016 NUMBER | GRANTED IN THE YEAR NUMBER | NOTIONAL DIVIDENDS ATTACHING IN THE YEAR NUMBER | VESTED AND TRANSFERRED IN THE YEAR NUMBER | FORFEITED/ LAPSED IN THE YEAR NUMBER | BALANCE AT 31 DEC 2016 NUMBER |
|---|---|---|---|---|---|---|
| **Executive directors** | | | | | | |
| John Neal | – | 60,328 | 3,015 | – | – | 63,343 |
| Patrick Regan | 270,016 | 40,672 | 8,781 | (135,008) | – | 184,461 |
| **Other key management personnel** | | | | | | |
| Jason Brown | 25,803 | – | 864 | (5,960) | (2,555) | 18,152 |
| Russell Johnston | – | 50,000 | 1,073 | – | – | 51,073 |
| **Former key management personnel** | | | | | | |
| Mike Emmett | 25,385 | – | – | – | (25,385) | – |

## 9.4 Shareholdings

The table below details movements during the year in the number of ordinary shares in QBE held by KMP, including their personally related parties.

| 2016 | INTEREST IN SHARES AT 1 JAN 2016 NUMBER | CONDITIONAL RIGHTS VESTED NUMBER | NET OTHER CHANGES NUMBER [1] | DIVIDENDS REINVESTED IN THE YEAR NUMBER | INTEREST IN SHARES AT 31 DEC 2016 NUMBER | INTEREST IN SHARES AT 31 DEC 2016 SUBJECT TO NON-RECOURSE LOANS NUMBER |
|---|---|---|---|---|---|---|
| **Non-executive directors** | | | | | | |
| Marty Becker | 80,243 | – | 25,063 | – | 105,306 | – |
| Stephen Fitzgerald | 32,147 | – | 5,557 | – | 37,704 | – |
| John M Green | 37,258 | – | – | – | 37,258 | – |
| Margaret Leung | 6,464 | – | 14,879 | 571 | 21,914 | – |
| Kathryn Lisson | – | – | 1,485 | – | 1,485 | – |
| Sir Brian Pomeroy | 6,662 | – | 5,479 | – | 12,141 | – |
| Jann Skinner | 25,000 | – | 10,000 | – | 35,000 | – |
| Rolf Tolle | 15,000[2] | – | 3,991 | – | 18,991 | – |
| Michael Wilkins | – | – | 8,670 | – | 8,670 | – |
| **Executive directors** | | | | | | |
| John Neal | 234,998 | 55,334 | (12,400) | 14,248 | 292,178 | – |
| Patrick Regan | 388,979 | 142,611 | – | 20,624 | 552,214 | – |
| **Other key management personnel** | | | | | | |
| Jason Brown | 38,052 | 20,152 | 1,171 | 2,935 | 62,310 | 2,390 |
| Colin Fagen | 78,179 | 52,337 | (44,234) | 3,092 | 89,374 | 19,084 |
| David Fried | – | 50,074 | (8,829) | 754 | 41,999 | – |
| Russell Johnston | 30,000[3] | – | – | – | 30,000 | – |
| Margaret Murphy | – | – | – | – | – | – |
| Richard Pryce | 50,570 | 48,415 | (22,832) | 746 | 76,899 | – |
| David Duclos | – | 44,814 | (18,176) | 95 | 26,733 | – |
| Mike Emmett | – | – | – | – | – | – |
| Tim Plant | 5,922 | 22,170 | 49 | 757 | 28,898 | – |
| Jenni Smith | 30,762 | 10,747 | – | 1,161 | 42,670 | – |

1 Net other changes comprises acquisitions and disposals by the KMP and their related parties during the year.
2 Represents interest in shares on 11 March 2016, Rolf Tolle's date of appointment as a non-executive director.
3 Represents interest in shares on 2 May 2016, Russell Johnston's date of appointment as a KMP.

# Remuneration Report CONTINUED

The table below details the position of KMP against the minimum shareholding requirement.

| 2016 | MINIMUM SHAREHOLDING REQUIREMENT A$000 | INTEREST IN SHARES AT 31 MAR 2016 A$000 | UNVESTED CONDITIONAL RIGHTS WITHOUT PERFORMANCE CONDITIONS A$000 | VALUE OF EMPLOYEE LOAN SHARES[1] A$000 | TOTAL VALUE OF HOLDINGS A$000 | MINIMUM SHAREHOLDING REQUIREMENT STATUS[2] |
|---|---|---|---|---|---|---|
| **Non-executive directors** | | | | | | |
| Marty Becker | 663 | 1,011 | – | – | 1,011 | Met |
| Stephen Fitzgerald | 208 | 434 | – | – | 434 | Met |
| John M Green | 229 | 775 | – | – | 775 | Met |
| Margaret Leung | 208 | 123 | – | – | 123 | On track |
| Sir Brian Pomeroy | 208 | 100 | – | – | 100 | On track |
| Jann Skinner | 208 | 394 | – | – | 394 | Met |
| Rolf Tolle | 208 | 118 | – | – | 118 | On track |
| **Executive directors** | | | | | | |
| John Neal | 3,300 | 2,966 | 1,437 | – | 4,403 | Met |
| Patrick Regan | 1,600 | 5,672 | 2,030 | – | 7,702 | Met |
| **Other key management personnel** | | | | | | |
| Jason Brown | 700 | 599 | 601 | 25 | 1,225 | Met |
| Colin Fagen | 1,300 | 1,137 | 1,884 | (7) | 3,014 | Met |
| David Fried | 1,210 | 65 | 1,845 | – | 1,910 | Met |
| Richard Pryce | 1,523 | 813 | 1,617 | – | 2,430 | Met |
| **Former key management personnel** | | | | | | |
| David Duclos | 1,332 | 278 | 2,023 | – | 2,301 | Met |
| Tim Plant | 950 | 289 | 746 | – | 1,035 | Met |
| Jenni Smith | 770 | 443 | 244 | – | 687 | Not met |

1 Value at statement date less balance of loan owing.
2 This shows whether the MSR has been met as at 31 March 2016 using the closing share price on 1 April 2016 of A$10.67 or the value at purchase, if greater. Detailed information on the MSR is provided in sections 4.6 and 6.4 of the Remuneration Report.
3 Kathryn Lisson, Michael Wilkins, Russell Johnston, Margaret Murphy and Mike Emmett were not KMP at the 2016 test date (31 March 2016) and are therefore excluded from the table above.

## 9.5 Loans

This section details the loans made by the Group to KMP. All non-recourse loans are due to be paid within 10 days of ceasing employment.

### 9.5.1 Non-recourse share loans

Prior to 20 June 2005, non-recourse loans were provided by the Group to KMP for the purchase of shares in QBE. Under AASB 2 *Share-based Payment*, non-recourse loans and the related shares are derecognised and are instead treated as options.

| 2016 | BALANCE AT 1 JAN 2016 A$000 | LOANS MADE IN THE YEAR A$000 | REPAYMENTS A$000 | BALANCE AT 31 DEC 2016 A$000 | INTEREST NOT CHARGED A$000[1] | HIGHEST BALANCE IN THE PERIOD A$000 |
|---|---|---|---|---|---|---|
| **Key management personnel** | | | | | | |
| Jason Brown | 3 | – | – | 3 | – | 3 |
| Colin Fagen | 267 | – | – | 267 | 15 | 267 |

1 Deemed value of interest not charged for the period as KMP.

# Directors' Report CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2016

## Auditor

PricewaterhouseCoopers, Chartered Accountants, continue in office in accordance with section 327B of the *Corporations Act 2001.*

## Non-audit services

During the year, PricewaterhouseCoopers performed certain other services in addition to its statutory duties.

The Board, on the advice of the Audit Committee, has considered the position and is satisfied that the provision of non-audit services is compatible with the general standard of independence for auditors imposed by the *Corporations Act 2001*. The directors are also satisfied that the provision of non-audit services by the auditor, as set out in note 8.7 to the financial statements, did not compromise the auditor independence requirements of the *Corporations Act 2001*.

A copy of the auditor's independence declaration required under section 307C of the *Corporations Act 2001* is set out on page 104.

Details of amounts paid or payable to PricewaterhouseCoopers for audit and non-audit services are provided in note 8.7 to the financial statements.

## Rounding of amounts

The company is of a kind referred to in the *ASIC Corporations (Rounding in Financial/Directors' Reports) Instrument 2016/191.* Amounts have been rounded off in the Directors' Report to the nearest million dollars or, in certain cases, to the nearest thousand dollars in accordance with that instrument.

Signed in SYDNEY this 24th day of February 2017 in accordance with a resolution of the directors.

W. Marston Becker
**Director**

John Neal
**Director**

## Auditor's independence declaration for the year ended 31 December 2016

As lead auditor for the audit of QBE Insurance Group Limited for the year ended 31 December 2016, 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 Insurance Group Limited and the entities it controlled during the period.

RJ Clark
**Partner, PricewaterhouseCoopers**

Sydney
24 February 2017

# Financial Report contents



This Annual Report includes the consolidated financial statements for QBE Insurance Group Limited (the ultimate parent entity or the company) and its controlled entities (QBE or the Group). All amounts in this Financial Report are presented in US dollars unless otherwise stated. QBE Insurance Group Limited is a company limited by its shares, and incorporated and domiciled in Australia.
Its registered office is located at:

Level 27, 8 Chifley Square
Sydney NSW 2000
Australia

A description of the nature of the Group's operations and its principal activities is included on pages 4 to 49, none of which is part of this Financial Report. The Financial Report was authorised for issue by the directors on 24 February 2017. The directors have the power to amend and reissue the financial statements.

Through the use of the internet, we have ensured that our corporate reporting is timely, complete and available globally at minimum cost to the company. All material press releases, this Financial Report and other information are available at our QBE investor centre at our website: www.qbe.com.

# Consolidated statement of comprehensive income

FOR THE YEAR ENDED 31 DECEMBER 2016

| | NOTE | 2016 US$M | 2015 US$M |
|---|---|---|---|
| Gross written premium | | **14,395** | 15,092 |
| Unearned premium movement | | **(119)** | (170) |
| Gross earned premium revenue | 2.1 | **14,276** | 14,922 |
| Outward reinsurance premium | | **(2,653)** | (3,319) |
| Deferred reinsurance premium movement | | **(557)** | 711 |
| Outward reinsurance premium expense | | **(3,210)** | (2,608) |
| Net earned premium (a) | | **11,066** | 12,314 |
| Gross claims expense | 2.2 | **(9,042)** | (8,712) |
| Reinsurance and other recoveries revenue | 2.2 | **2,600** | 1,278 |
| Net claims expense (b) | 2.2 | **(6,442)** | (7,434) |
| Gross commission expense | | **(2,425)** | (2,488) |
| Reinsurance commission revenue | 2.1 | **391** | 374 |
| Net commission (c) | | **(2,034)** | (2,114) |
| Underwriting and other expenses (d) | | **(1,922)** | (2,137) |
| **Underwriting result (a)+(b)+(c)+(d)** | | **668** | 629 |
| Investment and other income – policyholders' funds | 3.1 | **422** | 418 |
| Investment expenses – policyholders' funds | 3.1 | **(15)** | (16) |
| **Insurance profit** | | **1,075** | 1,031 |
| Investment and other income – shareholders' funds | 3.1 | **348** | 273 |
| Investment expenses – shareholders' funds | 3.1 | **(9)** | (10) |
| Financing and other costs | 5.1.2 | **(294)** | (244) |
| Losses on sale of entities | 7.1 | **-** | (2) |
| Unrealised losses on assets held for sale | 7.1.2 | **(3)** | – |
| Amortisation and impairment of intangibles | 7.2 | **(45)** | (95) |
| Profit before income tax | | **1,072** | 953 |
| Income tax expense | 6.1 | **(228)** | (260) |
| Profit after income tax | | **844** | 693 |
| **Other comprehensive income** | | | |
| *Items that may be reclassified to profit or loss* | | | |
| Net movement in foreign currency translation reserve | 5.3.2 | **(474)** | 74 |
| Net movement in cash flow hedges | 5.3.2 | **–** | (1) |
| Income tax relating to these components of other comprehensive income | | **33** | 41 |
| *Items that will not be reclassified to profit or loss* | | | |
| (Losses) gains on remeasurement of defined benefit superannuation plans | | **(48)** | 17 |
| (Losses) gains on revaluation of owner occupied property | 5.3.2 | **(1)** | 1 |
| Income tax relating to these components of other comprehensive income | | **10** | (6) |
| Other comprehensive income after income tax | | **(480)** | 126 |
| Total comprehensive income after income tax | | **364** | 819 |
| **Profit after income tax attributable to:** | | | |
| Ordinary equity holders of the company | | **844** | 687 |
| Non-controlling interests | | **–** | 6 |
| | | **844** | 693 |
| **Total comprehensive income after income tax attributable to:** | | | |
| Ordinary equity holders of the company | | **364** | 813 |
| Non-controlling interests | | **–** | 6 |
| | | **364** | 819 |

| EARNINGS PER SHARE FOR PROFIT AFTER INCOME TAX ATTRIBUTABLE TO ORDINARY EQUITY HOLDERS OF THE COMPANY | NOTE | 2016 US CENTS | 2015 US CENTS |
|---|---|---|---|
| Basic earnings per share | 5.5 | **61.6** | 50.3 |
| Diluted earnings per share | 5.5 | **60.8** | 49.8 |

The consolidated statement of comprehensive income should be read in conjunction with the accompanying notes.

# Consolidated balance sheet

AS AT 31 DECEMBER 2016

| | NOTE | 2016 US$M | 2015 US$M |
|---|---|---|---|
| **Assets** | | | |
| Cash and cash equivalents | 5.2 | **847** | 662 |
| Investments | 3.2 | **24,374** | 26,032 |
| Derivative financial instruments | 5.6 | **181** | 33 |
| Trade and other receivables | 2.6 | **4,831** | 4,950 |
| Current tax assets | | **61** | 46 |
| Deferred insurance costs | 2.5 | **1,965** | 2,536 |
| Reinsurance and other recoveries on outstanding claims | 2.3 | **4,840** | 3,204 |
| Other assets | | **8** | 6 |
| Assets held for sale | 7.1.2 | **85** | – |
| Defined benefit plan surpluses | 8.6 | **27** | 44 |
| Property, plant and equipment | | **257** | 263 |
| Deferred tax assets | 6.2 | **778** | 767 |
| Investment properties | | **14** | 14 |
| Investment in associates | | **28** | 13 |
| Intangible assets | 7.2 | **3,627** | 3,604 |
| Total assets | | **41,583** | 42,176 |
| **Liabilities** | | | |
| Derivative financial instruments | 5.6 | **147** | 35 |
| Trade and other payables | 2.7 | **2,139** | 2,101 |
| Current tax liabilities | | **73** | 43 |
| Liabilities held for sale | 7.1.2 | **72** | – |
| Unearned premium | 2.5 | **6,763** | 7,006 |
| Outstanding claims | 2.3 | **18,321** | 18,583 |
| Provisions | | **69** | 76 |
| Defined benefit plan deficits | 8.6 | **86** | 67 |
| Deferred tax liabilities | 6.2 | **106** | 176 |
| Borrowings | 5.1 | **3,474** | 3,529 |
| Total liabilities | | **31,249** | 31,616 |
| Net assets | | **10,334** | 10,560 |
| **Equity** | | | |
| Share capital | 5.3.1 | **8,360** | 8,440 |
| Reserves | 5.3.2 | **(1,654)** | (1,248) |
| Retained profits | | **3,588** | 3,313 |
| Shareholders' funds | | **10,284** | 10,505 |
| Non-controlling interests | | **50** | 55 |
| Total equity | | **10,334** | 10,560 |

The consolidated balance sheet should be read in conjunction with the accompanying notes.

# Consolidated statement of changes in equity

FOR THE YEAR ENDED 31 DECEMBER 2016

| 2016 | SHARE CAPITAL US$M | TREASURY SHARES HELD IN TRUST US$M | RESERVES US$M | RETAINED PROFITS US$M | SHARE-HOLDERS' FUNDS US$M | NON-CONTROLLING INTERESTS US$M | TOTAL EQUITY US$M |
|---|---|---|---|---|---|---|---|
| As at 1 January | 8,440 | – | (1,248) | 3,313 | 10,505 | 55 | 10,560 |
| Profit after income tax | – | – | – | 844 | 844 | – | 844 |
| Other comprehensive income | – | – | (442) | (38) | (480) | – | (480) |
| Total comprehensive income | – | – | (442) | 806 | 364 | – | 364 |
| **Transactions with owners in their capacity as owners** | | | | | | | |
| Shares acquired and held in trust | – | (79) | – | – | (79) | – | (79) |
| Share-based payment expense | – | – | 58 | – | 58 | – | 58 |
| Shares vested and/or released | – | 79 | (38) | – | 41 | – | 41 |
| Contributions of equity, net of transaction costs and tax | 1 | – | – | – | 1 | – | 1 |
| Net changes in non-controlling interests | – | – | 25 | – | 25 | (5) | 20 |
| Reclassification on disposal of owner occupied property | – | – | (4) | 4 | – | – | – |
| Dividends paid on ordinary shares | – | – | – | (537) | (537) | – | (537) |
| Dividend reinvestment under Bonus Share Plan | – | – | – | 2 | 2 | – | 2 |
| Foreign exchange movement | (91) | – | (5) | – | (96) | – | (96) |
| As at 31 December | 8,350 | – | (1,654) | 3,588 | 10,284 | 50 | 10,334 |

| 2015 | SHARE CAPITAL US$M | TREASURY SHARES HELD IN TRUST US$M | RESERVES US$M | RETAINED PROFITS US$M | SHARE-HOLDERS' FUNDS US$M | NON-CONTROLLING INTERESTS US$M | TOTAL EQUITY US$M |
|---|---|---|---|---|---|---|---|
| As at 1 January | 9,391 | – | (1,405) | 3,044 | 11,030 | 52 | 11,082 |
| Profit after income tax | – | – | – | 687 | 687 | 6 | 693 |
| Other comprehensive income | – | – | 114 | 12 | 126 | – | 126 |
| Total comprehensive income | – | – | 114 | 699 | 813 | 6 | 819 |
| **Transactions with owners in their capacity as owners** | | | | | | | |
| Shares acquired and held in trust | – | (18) | – | – | (18) | – | (18) |
| Share-based payment expense | – | – | 59 | – | 59 | – | 59 |
| Shares vested and/or released to participants | – | 18 | (18) | – | – | – | – |
| Contributions of equity, net of transaction costs and tax | 59 | – | – | – | 59 | – | 59 |
| Reclassification on disposal of non-controlling interests | – | – | 15 | (15) | – | – | – |
| Dividends paid on ordinary shares | – | – | – | (421) | (421) | – | (421) |
| Dividend reinvestment under Bonus Share Plan | – | – | – | 6 | 6 | – | 6 |
| Foreign exchange movement | (1,010) | – | (13) | – | (1,023) | (3) | (1,026) |
| As at 31 December | 8,440 | – | (1,248) | 3,313 | 10,505 | 55 | 10,560 |

The consolidated statement of changes in equity should be read in conjunction with the accompanying notes.

# Consolidated statement of cash flows

FOR THE YEAR ENDED 31 DECEMBER 2016

| | NOTE | 2016 US$M | 2015 US$M |
|---|---|---|---|
| **Operating activities** | | | |
| Premium received | | 14,939 | 15,144 |
| Reinsurance and other recoveries received | | 1,568 | 1,563 |
| Outward reinsurance paid | | (2,798) | (2,664) |
| Claims paid | | (9,018) | (9,410) |
| Acquisition and other underwriting costs paid | | (4,000) | (4,430) |
| Interest received | | 450 | 483 |
| Dividends received | | 65 | 99 |
| Other operating income | | 13 | 46 |
| Other operating payments | | (184) | (253) |
| Interest paid | | (273) | (247) |
| Income taxes paid | | (203) | (347) |
| Net cash flows from operating activities | 8.3 | 559 | (16) |
| **Investing activities** | | | |
| Proceeds on sale of growth assets | | 3,258 | 692 |
| Payments for purchase of growth assets | | (2,755) | (1,289) |
| Payments for foreign exchange transactions | | (101) | (58) |
| Net proceeds on purchase and sale of interest bearing financial assets | | 35 | 534 |
| Payments for purchase of intangible assets | | (216) | (78) |
| Net proceeds on purchase and sale of non-controlling interests | | 16 | – |
| Proceeds on disposal of entities (net of cash disposed) | | – | 493 |
| Proceeds on sale of investment property | | 1 | 1 |
| Proceeds on sale of property, plant and equipment | | 14 | 13 |
| Payments for purchase of property, plant and equipment | | (78) | (55) |
| Payments for purchase of investment in associates | | (16) | – |
| Net cash flows from investing activities | | 158 | 253 |
| **Financing activities** | | | |
| Capital contribution from non-controlling interests | | – | 2 |
| Purchase of treasury shares | | (79) | (18) |
| Proceeds from settlement of staff share loans | | 1 | 4 |
| Proceeds from borrowings | | 38 | 640 |
| Repayment of borrowings | | (21) | (657) |
| Dividends paid | | (494) | (359) |
| Net cash flows from financing activities | | (555) | (388) |
| Net movement in cash and cash equivalents | | 162 | (151) |
| Cash and cash equivalents at the beginning of the year | | 662 | 852 |
| Effect of exchange rate changes | | 37 | (39) |
| Cash transferred to assets held for sale | | (14) | – |
| Cash and cash equivalents at the end of the year | 5.2 | 847 | 662 |

The consolidated statement of cash flows should be read in conjunction with the accompanying notes.

# Notes to the financial statements

FOR THE YEAR ENDED 31 DECEMBER 2016

## 1. OVERVIEW

### 1.1 About QBE

#### About QBE Insurance Group

QBE is one of the world's largest insurance and reinsurance companies, with operations in all the major insurance markets. Formed in Australia in 1886, QBE employs over 14,000 people in 37 countries, with significant operations in Australia, Europe, North America and across the emerging markets of Latin America and Asia Pacific. QBE's captive reinsurer, Equator Re, provides reinsurance protection to our divisions in conjunction with the Group's external reinsurance programs.

QBE is listed on the Australian Securities Exchange and is a for-profit entity.

#### About insurance

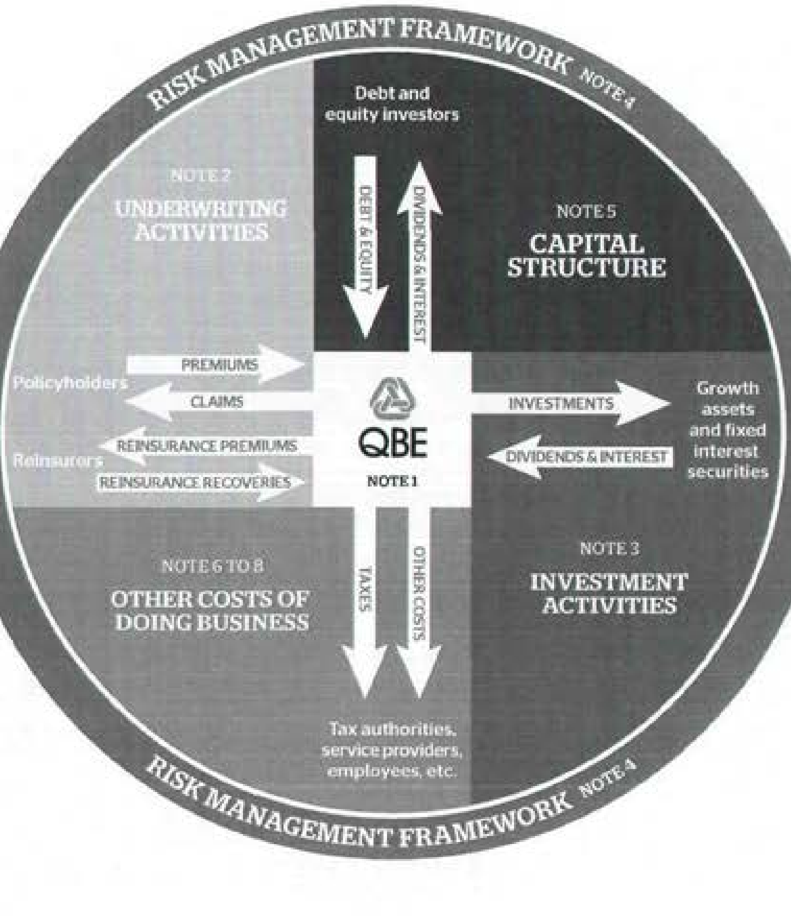
In simple terms, insurance and reinsurance companies help their customers (consumers, businesses and other insurance companies) to manage risk. More broadly put, an insurance company creates value by pooling and redistributing risk. This is done by collecting premium from those that it insures (i.e. policyholders), and then paying the claims of the few that call upon their insurance protection. The company may also choose to reduce some of its own accumulated risk through the use of outward reinsurance, which is insurance for insurance companies. As not all policyholders will actually experience a claims event, the effective pooling and redistribution of risk lowers the total cost of risk management, thereby making insurance protection more cost effective for all.

The operating model of insurance companies relies on profits being generated:

- by appropriately pricing risk and charging adequate premium to cover the expected payouts that will be incurred over the life of the insurance policy (both claims and operating expenses); and
- by earning a return on the collected premium and funds withheld to pay future claims through the adoption of an appropriate investment strategy.

Insurance therefore serves a critical function of providing customers with the confidence to achieve their business and personal goals through cost-effective risk management. This is achieved within a highly regulated environment, designed to ensure that insurance companies maintain adequate capital to protect the interests of policyholders.

The diagram below presents a simplified overview of the key components of this Financial Report.



# 1.

## 1.2 About this report

This Financial Report includes the consolidated financial statements of QBE Insurance Group Limited (the ultimate parent entity or the company) and its controlled entities (QBE or the Group).

The Financial Report includes the four primary statements, namely the statement of comprehensive income (which comprises profit or loss and other comprehensive income), balance sheet, statement of changes in equity and statement of cash flows as well as associated notes as required by Australian Accounting Standards. Disclosures have been grouped into the following categories in order to assist users in their understanding of the financial statements:

1. **Overview** contains information that impacts the Financial Report as a whole as well as segment reporting disclosures.
2. **Underwriting activities** brings together results and balance sheet disclosures relevant to the Group's insurance activities.
3. **Investment activities** includes results and balance sheet disclosures relevant to the Group's investments.
4. **Risk management** provides commentary on the Group's exposure to various financial and capital risks, explaining the potential impact on the results and balance sheet and how the Group manages these risks.
5. **Capital structure** provides information about the debt and equity components of the Group's capital.
6. **Tax** includes disclosures relating to the Group's tax balances.
7. **Group structure** provides a summary of the Group's controlled entities and includes disclosures in relation to transactions impacting the Group structure.
8. **Other** includes additional disclosures required in order to comply with Australian Accounting Standards.

Where applicable within each note, disclosures are further analysed as follows:

- **Overview** provides some context to assist users in understanding the disclosures.
- **Disclosures** (both numbers and commentary) provides analysis of balances as required by Australian Accounting Standards.
- **How we account for the numbers** summarises the accounting policies relevant to an understanding of the numbers.
- **Critical accounting judgements and estimates** explains the key estimates and judgements applied by QBE in determining the numbers.

The notes include information which the directors believe is required to understand the financial statements and is material and relevant to the operations, balance sheet and results of the Group. Information is considered material and relevant if:

- the amount in question is significant because of its size or nature;
- it is important to assist in understanding the results of the Group;
- it helps to explain the impact of significant changes in the Group's business – for example, significant acquisitions or disposals; or
- it relates to an aspect of the Group's operations that is important to its future performance.

### 1.2.1 Basis of preparation

This Financial Report is a general purpose financial report which:

- has been prepared in accordance with Australian Accounting Standards and Interpretations as issued by the Australian Accounting Standards Board (AASB), International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board and the *Corporations Act 2001*;
- has been prepared on a historical cost basis as modified by certain exceptions, the most significant of which are the measurement of investments and derivatives at fair value and the measurement of the net outstanding claims liability at present value;
- is presented in US dollars; and
- is presented with values rounded to the nearest million dollars or, in certain cases, to the nearest thousand dollars in accordance with *ASIC Corporations (Rounding in Financial/Directors' Reports) Instrument 2016/191*.

New and amended Accounting Standards and Interpretations issued by the AASB that are now effective are detailed in note 8.1.

The Group has not adopted any Accounting Standards and Interpretations that have been issued or amended but are not yet effective.

The consolidated financial statements incorporate the assets and liabilities of all entities controlled by the company as at 31 December 2016 and the results for the financial year then ended. A list of entities controlled by the company at year end is contained in note 7.3.

The financial statements of controlled entities are prepared for the same reporting period as the ultimate parent entity.

In preparing the consolidated financial statements, all transactions between controlled entities are eliminated in full. Where control of an entity commences or ceases during a financial year, the results are included for that part of the year during which control existed.

Lloyd's syndicates are accounted for on a proportional basis. The nature of Lloyd's syndicates is such that, even when one party provides the majority of capital, the syndicate as a whole is not controlled for accounting purposes.

# Notes to the financial statements

FOR THE YEAR ENDED 31 DECEMBER 2016

### 1.2.2 Critical accounting judgements and estimates

The preparation of the Group's consolidated financial statements requires management to make judgements and estimates that affect reported amounts. The diversity and complexity of the Group is evidenced by its worldwide operations and the broad product range as shown in the class of business analysis in note 4.2.

In view of its geographic and product diversity, the Group has developed a centralised risk management and policy framework designed to ensure consistency of approach across a number of operational activities, subject to the specific requirements of local markets, legislation and regulation. Such operational activities include underwriting, claims management, actuarial assessment of the outstanding claims liability and investment management.

Given the centralised approach to many of its activities and the product and geographic diversification, sensitivity analyses in respect of critical accounting estimates and judgements are presented at the consolidated Group level in order to provide information and analysis which is meaningful, relevant, reliable and comparable year on year. Sensitivity disclosure at business segment or product level would not provide a meaningful overview given the complex interrelationships between the variables underpinning the Group's operations.

The key areas in which critical estimates and judgements are applied are as follows:

- net outstanding claims liability (note 2.3);
- liability adequacy test (note 2.5.1);
- deferred income tax (note 6.2); and
- intangible assets (note 7.2).

### 1.2.3 Foreign currency

#### Translation of foreign currency transactions and balances

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

#### Translation of foreign operations

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

- income, expenses and other current period movements in comprehensive income are translated at average rates of exchange; and
- balance sheet items are translated at the closing balance date rates of exchange.

On consolidation, exchange differences arising from the translation of the net investment in foreign operations, and of financial liabilities and other instruments designated as hedges of foreign operations, are taken to shareholders' equity and recognised in other comprehensive income. When a foreign operation is sold in whole or part and capital is repatriated, exchange differences on translation from the entity's functional currency to the ultimate parent entity's functional currency of Australian dollars are reclassified out of other comprehensive income and recognised in profit or loss as part of the gain or loss on sale.

#### Derivatives and hedging transactions

Derivatives and borrowings which meet the specified criteria in AASB 139 *Financial Instruments: Recognition and Measurement* are accounted for as fair value hedges, cash flow hedges or hedges of a net investment in a foreign operation.

Hedges of net investments in foreign operations are accounted for in a manner similar to cash flow hedges. The gain or loss on the effective portion of the hedging instrument is recognised directly in other comprehensive income and the gain or loss on the ineffective portion is recognised immediately through profit or loss. The cumulative gain or loss previously recognised in equity is reclassified through profit or loss on the disposal or partial disposal of the foreign operation.

QBE does not ordinarily use derivatives to mitigate currency risk on translation to the ultimate parent's functional currency of Australian dollars; however, in periods of extraordinary volatility that are expected to persist for an extended period of time, QBE may elect to utilise derivatives to mitigate currency translation risk to preserve capital. The volatility created by the UK referendum decision to leave the European Union (Brexit) is an example of such volatility and, since 30 June 2016, the Group has elected to utilise derivatives to hedge its sterling net investment in foreign operations.

#### Exchange rates

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

| | 2016 | | 2015 | |
|---|---|---|---|---|
| | PROFIT OR LOSS | BALANCE SHEET | PROFIT OR LOSS | BALANCE SHEET |
| A$/US$ | 0.743 | 0.721 | 0.750 | 0.729 |
| £/US$ | 1.350 | 1.234 | 1.527 | 1.474 |
| €/US$ | 1.106 | 1.052 | 1.111 | 1.087 |

# 1.

## 1.3 Segment information

### Overview

The segment note provides information by operating division to assist the understanding of the Group's performance. The operating segments are consistent with the basis on which information is provided to the Group Executive for measuring performance and determining the allocation of capital, being the basis upon which the Group's underwriting products and services are managed within the various markets in which QBE operates.

**Operating segments**

The Group's operating segments are as follows:

- North American Operations writes general insurance and reinsurance business in the United States of America.
- European Operations writes general insurance business principally in the United Kingdom, Canada and throughout mainland Europe; both general insurance and reinsurance business through Lloyd's of London; and worldwide reinsurance business through offices in London, Ireland, Bermuda and mainland Europe.
- Australian & New Zealand Operations primarily underwrites general insurance risks throughout Australia and New Zealand, providing all major lines of insurance for personal and commercial risks.
- Emerging Markets writes general insurance business in North, Central and South America and provides personal, commercial and specialist general insurance covers throughout the Asia Pacific region.
- Equator Re is based in Bermuda and provides reinsurance protection to related entities. Inward premium received by Equator Re is principally derived from within the Group and is eliminated on consolidation.

Corporate and Other includes non-operating holding companies that do not form part of the Group's insurance operations; gains or losses on disposals, borrowings, financing costs and amortisation of any intangibles which are not allocated to a specific operating segment; and consolidation adjustments and internal reinsurance eliminations. Additional information in relation to the Group's intangibles, borrowings and gains or losses on disposals is disclosed in notes 7.2, 5.1 and 7.1 respectively.

Divisional management results are reported before corporate quota share reinsurances to Equator Re which exist to optimise capital management in the Group.

Intersegment transactions are priced on an arm's length basis and are eliminated on consolidation.

# Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2016

| 2016 | NORTH AMERICAN OPERATIONS US$M | EUROPEAN OPERATIONS US$M | AUSTRALIAN & NEW ZEALAND OPERATIONS US$M | EMERGING MARKETS US$M | EQUATOR RE US$M | TOTAL REPORTABLE SEGMENTS US$M | CORPORATE & OTHER US$M | TOTAL US$M |
|---|---|---|---|---|---|---|---|---|
| Gross written premium | 4,647 | 4,076 | 3,933 | 1,632 | 1,532 | 15,820 | (1,425) | 14,395 |
| Gross earned premium revenue – external | 4,532 | 3,840 | 3,913 | 1,588 | 1 | 13,874 | 402 | 14,276 |
| Gross earned premium revenue – internal | 125 | 38 | 11 | – | 1,428 | 1,602 | (1,602) | – |
| Outward reinsurance premium expense | (1,926) | (929) | (514) | (260) | (778) | (4,407) | 1,197 | (3,210) |
| Net earned premium | 2,731 | 2,949 | 3,410 | 1,328 | 651 | 11,069 | (3) | 11,066 |
| Net claims expense | (1,528) | (1,658) | (2,172) | (720) | (453) | (6,531) | 89 | (6,442) |
| Net commission | (564) | (574) | (511) | (313) | (50) | (2,012) | (22) | (2,034) |
| Underwriting and other expenses | (556) | (516) | (477) | (289) | (13) | (1,851) | (71) | (1,922) |
| Underwriting result | 83 | 201 | 250 | 6 | 135 | 675 | (7) | 668 |
| Net investment income on policyholders' funds | 83 | 115 | 168 | 67 | 27 | 460 | (53) | 407 |
| Insurance profit | 166 | 316 | 418 | 73 | 162 | 1,135 | (60) | 1,075 |
| Net investment income on shareholders' funds | 52 | 39 | 84 | 87 | 18 | 280 | 59 | 339 |
| Financing and other costs | – | – | – | – | – | – | (294) | (294) |
| Unrealised loss on assets held for sale | – | – | – | – | – | – | (3) | (3) |
| Amortisation and impairment of intangibles [1] | – | – | (6) | – | – | (6) | (39) | (45) |
| Profit (loss) before income tax | 218 | 355 | 496 | 160 | 180 | 1,409 | (337) | 1,072 |
| Income tax (expense) credit | (47) | (64) | (147) | (48) | (31) | (337) | 109 | (228) |
| Profit (loss) after income tax | 171 | 291 | 349 | 112 | 149 | 1,072 | (228) | 844 |
| Profit attributable to non-controlling interests | – | – | – | – | – | – | – | – |
| Net profit (loss) after income tax | 171 | 291 | 349 | 112 | 149 | 1,072 | (228) | 844 |

1 The amortisation and impairment of intangible assets acquired in 2016 (refer note 7.2) is now presented in segment profit or loss, consistent with information provided to the Group Executive.

# 1.

| 2015 | NORTH AMERICAN OPERATIONS US$M | EUROPEAN OPERATIONS US$M | AUSTRALIAN & NEW ZEALAND OPERATIONS US$M | EMERGING MARKETS US$M | EQUATOR RE US$M | TOTAL REPORTABLE SEGMENTS US$M | CORPORATE & OTHER US$M | TOTAL US$M |
|---|---|---|---|---|---|---|---|---|
| Gross written premium | 4,961 | 4,386 | 3,787 | 1,907 | 1,007 | 16,048 | (956) | 15,092 |
| Gross earned premium revenue – external | 4,930 | 4,338 | 3,753 | 1,865 | – | 14,886 | 36 | 14,922 |
| Gross earned premium revenue – internal | – | – | – | – | 994 | 994 | (994) | – |
| Outward reinsurance premium expense | (1,264) | (884) | (471) | (251) | (627) | (3,497) | 889 | (2,608) |
| Net earned premium | 3,666 | 3,454 | 3,282 | 1,614 | 367 | 12,383 | (69) | 12,314 |
| Net claims expense | (2,323) | (1,844) | (2,054) | (992) | (297) | (7,510) | 76 | (7,434) |
| Net commission | (635) | (634) | (481) | (345) | (17) | (2,112) | (2) | (2,114) |
| Underwriting and other expenses | (678) | (599) | (461) | (328) | (13) | (2,079) | (58) | (2,137) |
| Underwriting result | 30 | 377 | 286 | (51) | 40 | 682 | (53) | 629 |
| Net investment income on policyholders' funds | 63 | 87 | 181 | 123 | 63 | 517 | (115) | 402 |
| Insurance profit (loss) | 93 | 464 | 467 | 72 | 103 | 1,199 | (168) | 1,031 |
| Net investment income on shareholders' funds | 48 | 30 | 88 | 132 | 25 | 323 | (60) | 263 |
| Financing and other costs | – | – | – | – | – | – | (244) | (244) |
| Losses on sale of entities | – | – | – | – | – | – | (2) | (2) |
| Amortisation and impairment of intangibles | – | – | – | – | – | – | (95) | (95) |
| Profit (loss) before income tax | 141 | 494 | 555 | 204 | 128 | 1,522 | (569) | 953 |
| Income tax (expense) credit | (4) | (89) | (166) | (65) | (6) | (330) | 70 | (260) |
| Profit (loss) after income tax | 137 | 405 | 389 | 139 | 122 | 1,192 | (499) | 693 |
| Profit attributable to non-controlling interests | – | – | – | – | – | – | (6) | (6) |
| Net profit (loss) after income tax | 137 | 405 | 389 | 139 | 122 | 1,192 | (505) | 687 |

### Geographical analysis

All operating segments except for Emerging Markets are defined by reference to the geographical locations of each operating segment and, as such, satisfy the requirements of a geographical analysis as well as an operating segment analysis. No country within Emerging Markets is individually material.

Gross earned premium revenue – external for Australia, the parent entity's country of domicile, was $3,643 million (2015 $3,515 million).

### Product analysis

QBE does not collect Group-wide revenue information by product and the cost to develop this information would be excessive. Gross earned premium revenue by class of business is disclosed in note 4.2.

# Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2016

## 2. UNDERWRITING ACTIVITIES

### Overview

This section provides analysis and commentary on the Group's underwriting activities. Underwriting, in simple terms, is the agreement by the insurer to assume insurance risk in return for a premium paid by the insured. The underwriter assesses the quality of the risk and prices it accordingly.

### 2.1 Revenue

#### Overview

Revenue mainly comprises premiums charged for providing insurance coverage. Premiums are classified as either:

- direct, being those paid by the policyholder to the insurer;
- facultative, being reinsurance of an individual (usually significant) risk by a ceding insurer or reinsurer; or
- inward reinsurance premiums, being coverage provided to an insurer or reinsurer in relation to a specified grouping of policies or risks.

Other sources of revenue include amounts recovered from reinsurers under the terms of reinsurance contracts and commission income from reinsurers.

| | NOTE | 2016 US$M | 2015 US$M |
|---|---|---|---|
| **Gross earned premium revenue** | | | |
| Direct and facultative | | 13,298 | 13,967 |
| Inward reinsurance | | 978 | 955 |
| | | 14,276 | 14,922 |
| **Other revenue** | | | |
| Reinsurance and other recoveries revenue | 2.2 | 2,600 | 1,278 |
| Reinsurance commission revenue | | 391 | 374 |
| | | 17,267 | 16,574 |

#### How we account for the numbers

**Premium revenue**

Premium written comprises amounts charged to policyholders, excluding taxes collected on behalf of third parties. Premium is recognised as revenue in profit or loss based on the incidence of the pattern of risk associated with the insurance policy. The earned portion of premium on unclosed business, being business that is written at the balance date but for which detailed policy information is not yet booked, is also included in premium revenue.

**Reinsurance and other recoveries**

Reinsurance and other recoveries on paid claims, reported claims not yet paid, claims incurred but not reported (IBNR) and claims incurred but not enough reported (IBNER) are recognised as revenue. Recoveries are measured as the present value of the expected future receipts.

2.

## 2.2 Net claims expense

### Overview

The largest expense for an insurance company is net claims expense, which is the difference between the net outstanding claims liability (as described in note 2.3 below) at the beginning and the end of the financial year plus any claims incurred and settled during the financial year.

| | NOTE | 2016 US$M | 2015 US$M |
|---|---|---|---|
| **Gross claims and related expenses** | | | |
| Direct and facultative | | **8,525** | 8,367 |
| Inward reinsurance | | **517** | 345 |
| | | **9,042** | 8,712 |
| **Reinsurance and other recoveries revenue** | | | |
| Direct and facultative | | **2,568** | 1,210 |
| Inward reinsurance | | **32** | 68 |
| | 2.1 | **2,600** | 1,278 |
| Net claims expense | | **6,442** | 7,434 |
| **Analysed as follows:** | | | |
| Movement in net discounted central estimate | 2.4.2 | **6,574** | 7,453 |
| Movement in risk margin | 2.3.3 | **(132)** | (19) |
| Net claims expense | | **6,442** | 7,434 |

## 2.3 Net outstanding claims liability

### Overview

The net outstanding claims liability comprises the elements described below.

- The gross central estimate (note 2.3.1). This is the provision for expected future claims payments and includes claims reported but not yet paid, claims incurred but which have not yet been reported (IBNR), claims incurred but not enough reported (known as IBNER) and estimated claims handling costs.
- Less amounts recoverable from reinsurers (note 2.3.2). Insurance companies may elect to purchase reinsurance cover to manage their exposure to any one claim or series of claims. When an insurance company incurs a claim as a result of an insured loss, it may be able to recover some of that claim from reinsurance.
- Less an amount to reflect the discount to present value using risk-free rates of return. The net central estimate is discounted to present value recognising that the claim and/or recovery may not be settled for some time. The weighted average risk-free rate for each operating segment and for the consolidated Group are summarised in note 2.3.4.
- Plus a risk margin (note 2.3.3). A risk margin is added to reflect the inherent uncertainty in the net discounted central estimate of outstanding claims.

| | NOTE | 2016 US$M | 2015 US$M |
|---|---|---|---|
| Gross discounted central estimate | 2.3.1 | **17,233** | 17,323 |
| Risk margin | 2.3.3 | **1,088** | 1,260 |
| Gross outstanding claims liability | | **18,321** | 18,583 |
| Reinsurance and other recoveries on outstanding claims | 2.3.2 | **(4,540)** | (3,204) |
| Net outstanding claims liability | | **13,781** | 15,379 |

# Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2016

The table below analyses the movement in the net outstanding claims liability, showing separately the movement in gross claims liability and the impact of reinsurance.

| | 2016 | | | 2015 | | |
|---|---|---|---|---|---|---|
| | GROSS US$M | REINSURANCE US$M | NET US$M | GROSS US$M | REINSURANCE US$M | NET US$M |
| At 1 January | 18,583 | (3,204) | 15,379 | 20,412 | (3,464) | 16,948 |
| Claims expense – current accident year (note 2.4.2) | 9,168 | (1,894) | 7,274 | 8,743 | (1,394) | 7,349 |
| Claims expense – prior accident year (note 2.4.2) | 6 | (706) | (700) | (12) | 116 | 104 |
| Movement in risk margin (note 2.3.3) | (132) | – | (132) | (19) | – | (19) |
| Incurred claims recognised in profit or loss (note 2.2) | 9,042 | (2,600) | 6,442 | 8,712 | (1,278) | 7,434 |
| Transfers to liabilities held for sale / disposals | (33) | 6 | (27) | (135) | 5 | (130) |
| Claims payments | (8,623) | 1,172 | (7,451) | (9,259) | 1,402 | (7,857) |
| Foreign exchange | (648) | 86 | (562) | (1,147) | 131 | (1,016) |
| At 31 December | 18,321 | (4,540) | 13,781 | 18,583 | (3,204) | 15,379 |

## 2.3.1 Gross discounted central estimate

| | NOTE | 2016 US$M | 2015 US$M |
|---|---|---|---|
| Gross undiscounted central estimate excluding claims settlement costs | | 17,826 | 17,925 |
| Claims settlement costs | | 343 | 396 |
| Gross undiscounted central estimate | | 18,169 | 18,321 |
| Discount to present value | | (936) | (998) |
| Gross discounted central estimate | 2.3 | 17,233 | 17,323 |
| Payable within 12 months | | 7,053 | 6,040 |
| Payable in greater than 12 months | | 10,180 | 11,283 |
| Gross discounted central estimate | 2.3 | 17,233 | 17,323 |

### How we account for the numbers

The gross discounted central estimate is the present value of the expected future payments for claims incurred and includes reported but unpaid claims, IBNR, IBNER and claims handling costs. The central estimate is determined by the Group Chief Actuary, supported by a team of actuaries in each of the Group's businesses. The valuation process is performed quarterly and includes extensive consultation with claims and underwriting staff as well as senior management. The central estimate of outstanding claims is subject to a comprehensive independent review at least annually. The risk management procedures related to the actuarial function are explained in note 4.2.

2.

## Critical accounting judgements and estimates

The determination of the amounts that the Group will ultimately pay for claims arising under insurance and inward 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 for long tail insurance classes due to the longer period of time that can elapse before a claim is paid in full;
- the existence of complex underlying exposures;
- the incidence of catastrophic events close to the balance date;
- changes in the legal environment, including the interpretation of liability laws and the quantum of damages; and
- changing social, political and economic trends (e.g. price and wage inflation).

The estimation of IBNR and IBNER is generally subject to a greater degree of uncertainty than the estimation of the cost of settling claims that have been reported to the Group but not yet paid, for which more information about the claims is generally available. The notification and settlement of claims relating to liability and other long tail classes of business may not happen for many years after the event giving rise to the claim. As a consequence, liability and other long tail classes typically display greater variability between initial estimates and final settlement due to delays in reporting claims and uncertainty in respect of court awards and future claims inflation. Claims in respect of property and other short tail classes are typically reported and settled soon after the claim event, giving rise to more certainty.

Central estimates for each class of business are determined using a variety of estimation techniques, generally based on an analysis of historical experience and with reference to external benchmarks where relevant. The gross central estimate is discounted to present value using appropriate risk-free rates.

Central estimates are calculated gross of any reinsurance recoveries. A separate estimate is made of the amounts recoverable from reinsurers based on the gross central estimate (note 2.3.2).

### 2.3.2 Reinsurance and other recoveries on outstanding claims

| | NOTE | 2016 US$M | 2015 US$M |
|---|---|---|---|
| Reinsurance and other recoveries on outstanding claims – undiscounted [1] | | 4,816 | 3,426 |
| Discount to present value | | (276) | (222) |
| Reinsurance and other recoveries on outstanding claims | 2.3 | 4,540 | 3,204 |
| Receivable within 12 months | | 2,102 | 1,099 |
| Receivable in greater than 12 months | | 2,438 | 2,105 |
| Reinsurance and other recoveries on outstanding claims | 2.3 | 4,540 | 3,204 |

1 Net of a provision for impairment of $24 million (2015 $31 million).

## How we account for the numbers

The recoverability of amounts due from reinsurers is assessed at each balance date to ensure that the balances properly reflect the amounts ultimately expected to 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 4.3. Recoveries are discounted to present value using appropriate risk-free rates.

# Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2016

### 2.3.3 Risk margin

#### Overview

A risk margin is determined by the Group Board to reflect the inherent uncertainty in the net discounted central estimate.

The risk margin and the net discounted central estimate are key inputs in the determination of the probability of adequacy, which is a statistical measure of the relative adequacy of the outstanding claims liability to ultimately be able to pay claims. For example, a 90% probability of adequacy indicates that the net discounted central estimate is expected to be adequate nine years in 10.

| | | 2016 | 2015 |
|---|---|---|---|
| Risk margin | US$M | 1,088 | 1,260 |
| Risk margin as a percentage of the net discounted central estimate | % | 8.6 | 8.9 |
| Probability of adequacy | % | 89.5 | 89.0 |

The decrease in the risk margin of $172 million includes a foreign exchange movement of $39 million and a constant currency reduction of $132 million. The absolute level of risk margin has reduced due to a combination of reduced volatility in the net central estimate as a result of the reinsurance or termination of underperforming portfolios, the benefit of a further year of the Group's aggregate reinsurance covers and the impact of foreign exchange on both the risk margin and net central estimate. Partly offsetting these decreases, QBE has elected to increase the level of risk margin in response to the relatively increased uncertainty in the net discounted central estimate as a result of potential changes to statutory discount rates in relation to UK personal injury claims liabilities. Whilst the UK Ministry of Justice is expected to announce a change to the statutory rates (Ogden tables), no details of the change have been published as at the date of this report. The current allowance in the risk margin assumes a reduction in the statutory rate of around 1% (i.e. a proposed rate of 1.5% compared with the current legislated rate of 2.5%) which QBE estimates would increase the net central estimate by $33 million. If the statutory rate reduced by a further 0.5%, this would equate to an additional increase in the net central estimate of $20 million. Beyond this allowance, each further 0.5% reduction down to a zero statutory rate would increase the net central estimate by around $28 million, albeit that the impact is not linear.

The probability of adequacy is 89.5% at the balance date compared with 89.0% last year. Net profit after tax would have increased by $16 million if the probability of adequacy was maintained at 89.0%.

#### How we account for the numbers

AASB 1023 *General Insurance Contracts* requires an entity to adopt an appropriate risk margin. The resulting probability of adequacy is not of itself an accounting policy 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.

QBE reviews a number of factors when determining the appropriate risk margin, including any changes in the level of uncertainty in the net discounted central estimate, the resulting probability of adequacy and the risk margin as a percentage of the net discounted central estimate. The Group aims to maintain a probability of adequacy in the range of 87.5% to 92.5%.

## 2.

### Critical accounting judgements and estimates

The risk margin is determined by the Group Board and is held to mitigate the potential for uncertainty in the net discounted 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:

- mix of business, in particular the mix of short tail and long tail business and the overall weighted average term to settlement; and
- the level of uncertainty in the central estimate due to estimation error, data quality, variability of key inflation assumptions and possible economic and legislative changes.

The variability by class of business is measured using techniques that determine a range of possible outcomes of ultimate payments and assign a likelihood to outcomes at different levels. These techniques generally use standard statistical distributions, and the measure of variability is referred to as the coefficient of variation.

At a fixed probability of adequacy, the appropriate risk margin for two or more classes of business or for two or more geographic locations combined is likely to be less than the sum of the risk margins for the individual classes. This reflects the benefit of diversification in general insurance. The statistical measure used to determine diversification is called the correlation. The higher the correlation between two classes of business, the more likely it is that a negative outcome in one class will correspond to a negative outcome in the other class. For example, high correlation exists between classes of business affected by court cases involving bodily injury claims such as motor third party liability, workers' compensation and public liability, particularly in the same jurisdiction.

The probability of adequacy for the Group is determined by analysing the variability of each class of business and the correlation between classes of business and divisions. Correlations are determined for aggregations of classes of business, where appropriate, at the divisional level. The correlations adopted by the Group are generally derived from industry analysis, the Group's historical experience and the judgement of experienced and qualified actuaries.

### 2.3.4 Discount rate used to determine the outstanding claims liability

### Overview

Claims in relation to long tail classes of business (e.g. professional indemnity and workers' compensation) typically may not settle for many years. As such, the liability is discounted to reflect the time value of money. The table below summarises the weighted average discount rate for each operating segment and for the consolidated Group.

| | 2016 % | 2015 % |
|---|---|---|
| North American Operations | 2.11 | 1.85 |
| European Operations | 0.85 | 1.21 |
| Australian & New Zealand Operations | 2.24 | 2.36 |
| Emerging Markets [1] | 8.53 | 10.43 |
| Equator Re | 1.63 | 1.73 |
| Group [1] | 1.64 | 1.86 |

1 Emerging Markets and Group excluding the Argentine peso were 2.57% (2015 2.34%) and 1.33% (2015 1.62%) respectively.

### How we account for the numbers

AASB 1023 *General Insurance Contracts* requires that the net central estimate is discounted to reflect the time value of money using risk-free rates that are based on current observable, objective rates that reflect the nature, structure and terms of the future obligations.

# Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2016

### 2.3.5 Weighted average term to settlement

**Overview**

The weighted average term to settlement refers to the period from the balance date to the expected date of claims settlement. All other factors being equal, a longer weighted average term to settlement generally results in a larger impact on the central estimate from discounting.

| | 2016 YEARS | | | | | | 2015 YEARS | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | US$ | £ | A$ | € | OTHER | TOTAL | US$ | £ | A$ | € | OTHER | TOTAL |
| North American Operations | **2.9** | **–** | **–** | **–** | **–** | **2.9** | 2.8 | – | – | – | – | 2.8 |
| European Operations | **2.6** | **2.9** | **3.6** | **5.4** | **2.8** | **3.7** | 2.6 | 3.4 | 3.7 | 5.1 | 3.1 | 3.7 |
| Australian & New Zealand Operations | **–** | **–** | **2.2** | **–** | **1.8** | **2.1** | – | – | 2.2 | – | 1.4 | 2.2 |
| Emerging Markets | **0.8** | **–** | **–** | **–** | **1.6** | **1.6** | 0.9 | – | – | – | 1.5 | 1.5 |
| Equator Re | **2.1** | **3.5** | **2.8** | **3.6** | **1.8** | **2.4** | 2.9 | 3.5 | 2.9 | 3.5 | 2.3 | 2.9 |
| Group | **2.5** | **3.0** | **2.3** | **5.3** | **2.0** | **2.9** | 2.7 | 3.4 | 2.4 | 5.0 | 2.1 | 3.0 |

### 2.3.6 Net discounted central estimate maturity profile

**Overview**

The maturity profile is the Group's expectation of the period over which the net central estimate will be settled. The Group uses this information to ensure that it has adequate liquidity to pay claims as they are due to be settled and to inform the Group's investment strategy. The expected maturity profile of the Group's net discounted central estimate is analysed below.

| 2016 | LESS THAN ONE YEAR US$M | 13 TO 24 MONTHS US$M | 25 TO 36 MONTHS US$M | 37 TO 48 MONTHS US$M | 49 TO 60 MONTHS US$M | OVER 5 YEARS US$M | TOTAL US$M |
|---|---|---|---|---|---|---|---|
| North American Operations | **855** | **332** | **206** | **126** | **75** | **268** | **1,862** |
| European Operations | **1,448** | **936** | **677** | **484** | **348** | **1,211** | **5,103** |
| Australian & New Zealand Operations | **1,183** | **598** | **408** | **247** | **137** | **232** | **2,805** |
| Emerging Markets | **356** | **126** | **69** | **38** | **18** | **35** | **641** |
| Equator Re | **1,110** | **518** | **206** | **106** | **75** | **266** | **2,282** |
| | **4,951** | **2,510** | **1,566** | **1,001** | **653** | **2,012** | **12,693** |

| 2015 | LESS THAN ONE YEAR US$M | 13 TO 24 MONTHS US$M | 25 TO 36 MONTHS US$M | 37 TO 48 MONTHS US$M | 49 TO 60 MONTHS US$M | OVER 5 YEARS US$M | TOTAL US$M |
|---|---|---|---|---|---|---|---|
| North American Operations | 821 | 461 | 288 | 169 | 110 | 488 | 2,337 |
| European Operations | 1,622 | 1,086 | 716 | 521 | 373 | 1,277 | 5,595 |
| Australian & New Zealand Operations | 1,134 | 614 | 425 | 269 | 133 | 235 | 2,810 |
| Emerging Markets | 396 | 129 | 64 | 39 | 19 | 35 | 682 |
| Equator Re | 968 | 541 | 370 | 210 | 153 | 453 | 2,695 |
| | 4,941 | 2,831 | 1,863 | 1,208 | 788 | 2,488 | 14,119 |

2.

### 2.3.7 Impact of changes in key variables on the net outstanding claims liability

**Overview**

The impact of changes in key variables used in the calculation of the outstanding claims liability is summarised in the table below. Each change has been calculated in isolation from the other changes and shows the after tax impact on profit assuming that there is no change to any of the other variables. In practice, this is considered unlikely to occur as, for example, an increase in interest rates is normally associated with an increase in the rate of inflation. Over the medium to longer term, the impact of a change in discount rates is expected to be largely offset by the impact of a change in the rate of inflation.

The sensitivities below assume that all changes directly impact profit after tax. In practice, however, if the central estimate was to increase, at least part of the increase may result in an offsetting change in the level of risk margin rather than in a change to profit after tax, depending on the nature of the change in the central estimate. Likewise, if the coefficient of variation were to increase, 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.

| | SENSITIVITY % | PROFIT (LOSS)[1] 2016 US$M | 2015 US$M |
|---|---|---|---|
| Net discounted central estimate | +5 | **(444)** | (494) |
| | -5 | **444** | 494 |
| Risk margin | +5 | **(38)** | (44) |
| | -5 | **38** | 44 |
| Inflation rate | +0.5 | **(130)** | (145) |
| | -0.5 | **124** | 139 |
| Discount rate | +0.5 | **124** | 139 |
| | -0.5 | **(130)** | (145) |
| Coefficient of variation | +1 | **(114)** | (124) |
| | -1 | **114** | 124 |
| Probability of adequacy | +1 | **(37)** | (43) |
| | -1 | **35** | 40 |
| Weighted average term to settlement | +10 | **43** | 58 |
| | -10 | **(43)** | (59) |

1 Net of tax at the Group's prima facie income tax rate of 30%.

# Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2016

## 2.4 Claims development – net undiscounted central estimate

### Overview

The claims development table demonstrates the extent to which the original estimated ultimate claims payments in any one accident year (item (a) in the table below) has subsequently developed favourably (i.e. claims cost estimates have reduced) or unfavourably (i.e. further claims expense has been recognised in subsequent years). This table therefore illustrates the variability and inherent uncertainty in estimating the central estimate each year. The ultimate claims cost for any particular accident year is not known until all claims payments have been made which, for some long tail classes of business, could be many years into the future. The estimated ultimate claims payments at the end of each subsequent accident year demonstrates how the original estimate has been revised over time (b).

Cumulative actual net claims payments (d) are deducted from the expected ultimate claims payments in each accident year (c) at the current balance date, resulting in the undiscounted central estimate at a fixed rate of exchange (e). This is revalued to the balance date rate of exchange (f) to report the net undiscounted central estimate (g), which is reconciled to the discounted net central estimate (h). The treatment of foreign exchange in the claims development table is explained on the following page.

The net (increase) decrease in estimated ultimate claims payments (i) reflects the estimated ultimate net claims payments at the end of the current financial year (c) less the equivalent at the end of the previous financial year (b). This is further summarised in note 2.4.1.

The claims development table is presented net of reinsurance. With operations in 37 countries, hundreds of products, various reinsurance arrangements and with the Group's risk tolerance managed on a consolidated basis, it is considered neither meaningful nor practicable to provide this information other than on a consolidated Group basis.

| | 2006 & PRIOR US$M | 2007 US$M | 2008 US$M | 2009 US$M | 2010 US$M | 2011 US$M | 2012 US$M | 2013 US$M | 2014 US$M | 2015 US$M | 2016 US$M | TOTAL US$M |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Net ultimate claims payments** | | | | | | | | | | | | |
| (a) Original estimate of net ultimate claims payments | | 5,779 | 5,312 | 5,216 | 8,869 | 8,974 | 8,089 | 7,767 | 7,831 | 7,165 | 7,121 | |
| (b) One year later | | 5,561 | 5,468 | 5,246 | 7,039 | 9,229 | 8,217 | 7,793 | 7,930 | 7,168 | | |
| Two years later | | 5,669 | 5,437 | 5,194 | 7,110 | 9,260 | 8,239 | 7,791 | 7,783 | | | |
| Three years later | | 5,664 | 5,580 | 5,238 | 7,129 | 9,165 | 8,272 | 7,764 | | | | |
| Four years later | | 5,688 | 5,587 | 5,347 | 7,329 | 9,191 | 8,255 | | | | | |
| Five years later | | 5,689 | 5,719 | 5,370 | 7,358 | 9,144 | | | | | | |
| Six years later | | 5,725 | 5,704 | 5,335 | 7,273 | | | | | | | |
| Seven years later | | 5,730 | 5,707 | 5,297 | | | | | | | | |
| Eight years later | | 5,722 | 5,704 | | | | | | | | | |
| Nine years later | | 5,759 | | | | | | | | | | |
| (c) Current estimate of net ultimate claims payments | | 5,759 | 5,704 | 5,297 | 7,273 | 9,144 | 8,255 | 7,764 | 7,783 | 7,168 | 7,121 | |
| (d) Cumulative net payments to date | | (5,468) | (5,508) | (5,032) | (6,373) | (8,346) | (7,440) | (6,485) | (6,162) | (4,804) | (2,451) | |
| (e) Net undiscounted central estimate at fixed rate of exchange [1] | 885 | 291 | 196 | 265 | 900 | 798 | 815 | 1,279 | 1,621 | 2,364 | 4,670 | 14,084 |
| (f) Foreign exchange impact | | | | | | | | | | | | (490) |
| Reinsurance recoveries on closed portfolios | | | | | | | | | | | | (560) |
| Provision for impairment | | | | | | | | | | | | (24) |
| (g) Net undiscounted central estimate at 31 Dec 2016 | | | | | | | | | | | | 13,010 |
| Discount to present value | | | | | | | | | | | | (660) |
| Claims settlement costs | | | | | | | | | | | | 343 |
| Risk margin | | | | | | | | | | | | 1,088 |
| (h) Net outstanding claims liability at 31 Dec 2016 (note 2.3) | | | | | | | | | | | | 13,781 |
| (i) Movement in accident year net undiscounted central estimate (note 2.4.1) | (60) | 37 | (3) | (38) | (86) | (47) | (17) | (27) | (147) | 3 | 7,121 | 6,747 |

1 Excluding claims settlement costs.

## 2.

### How we account for the numbers

The estimate of net ultimate claims payments attributable to business acquired is generally included in the claims development table in the accident year in which the acquisition was made. The exception is increased participation in Lloyd's syndicates where the estimate of net ultimate claims payments is allocated to the original accident year(s) in which the underlying claim was incurred.

The Group writes business in currencies other than the US dollar. The translation of ultimate claims estimates denominated in foreign currencies gives rise to foreign exchange movements which have no direct bearing on the development of the underlying claims. To eliminate this distortion, amounts have been translated to the functional currencies of our controlled entities at constant rates of exchange. All estimates of ultimate claims payments for the 10 most recent accident years reported in functional currencies other than US dollars have been translated to US dollars using the 2016 average rates of exchange.

### 2.4.1 Reconciliation of claims development table to profit or loss

### Overview

The table below reconciles the net increase or decrease in estimated ultimate claims payments in the current financial year from the claims development table (item (i) in note 2.4) to the analysis of current and prior accident year central estimate development recognised in profit or loss (note 2.4.2).

| | 2016 | | | 2015 | | |
|---|---|---|---|---|---|---|
| | CURRENT ACCIDENT YEAR US$M | PRIOR ACCIDENT YEARS US$M | TOTAL US$M | CURRENT ACCIDENT YEAR US$M | PRIOR ACCIDENT YEARS US$M | TOTAL US$M |
| Net undiscounted central estimate movement (note 2.4) [1] | **7,121** | **(374)** | **6,747** | 7,473 | 77 | 7,550 |
| Discount reclassification [2] | **–** | **8** | **8** | – | (214) | (214) |
| Net undiscounted central estimate development | **7,121** | **(366)** | **6,755** | 7,473 | (137) | 7,336 |
| Reinsurance recoveries on closed portfolios | **–** | **(574)** | **(574)** | – | – | – |
| Movement in claims settlement costs | **341** | **(14)** | **327** | 373 | 21 | 394 |
| Movement in discount [2, 3] | **(209)** | **270** | **61** | (486) | 202 | (284) |
| Other movements | **21** | **(16)** | **5** | (11) | 18 | 7 |
| Movement in net discounted central estimate (note 2.4.2) | **7,274** | **(700)** | **6,574** | 7,349 | 104 | 7,453 |

1 Excluding claims settlement costs

2 Prior accident year central estimate release of $366 million includes an $8 million cost (2015 $214 million benefit) due to discount movement in relation to long tail classes where the level of assumed claims inflation is directly linked to movement in the discount rate.

3 Reflects the benefit of recoveries following the reinsurance of discontinued portfolios in the Group's North American and European Operations.

In 2016, prior accident year central estimate development was a net release of $366 million (2015 net release of $137 million). This reflects positive development in European Operations, Australian & New Zealand Operations and Equator Re, partly offset by adverse development in North American Operations.

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### 2.4.2 Net central estimate development

#### Overview

The table further analyses the current and prior accident year movement in the net discounted central estimate, separately identifying the gross and reinsurance components. Prior accident year claims are those claims that occurred in a previous year but for which a reassessment of the claims cost has impacted the result in the current period.

| | 2016 | | | 2015 | | |
|---|---|---|---|---|---|---|
| | CURRENT ACCIDENT YEAR US$M | PRIOR ACCIDENT YEARS US$M | TOTAL US$M | CURRENT ACCIDENT YEAR US$M | PRIOR ACCIDENT YEARS US$M | TOTAL US$M |
| **Gross central estimate development** | | | | | | |
| Undiscounted | 9,442 | (255) | 9,187 | 9,250 | 123 | 9,373 |
| Discount | (274) | 261 | (13) | (507) | (135) | (642) |
| | 9,168 | 6 | 9,174 | 8,743 | (12) | 8,731 |
| **Reinsurance and other recoveries** | | | | | | |
| Undiscounted | 1,959 | 723 | 2,682 | 1,415 | 7 | 1,422 |
| Discount | (65) | (17) | (82) | (21) | (123) | (144) |
| | 1,894 | 706 | 2,600 | 1,394 | (116) | 1,278 |
| **Net central estimate development** | | | | | | |
| Undiscounted | 7,483 | (978) | 6,505 | 7,835 | 116 | 7,951 |
| Discount | (209) | 278 | 69 | (486) | (12) | (498) |
| Net discounted central estimate development (note 2.4.1) | 7,274 | (700) | 6,574 | 7,349 | 104 | 7,453 |

### 2.5 Unearned premium and deferred insurance costs

#### Overview

**Unearned premium**

Gross written premium is earned in profit or loss in accordance with the pattern of incidence of risk of the related business. The unearned premium liability is that portion of gross written premium that QBE has not yet earned in profit or loss as it represents insurance coverage to be provided by QBE after the balance date.

**Deferred insurance costs**

Premium ceded to reinsurers by QBE in exchange for reinsurance protection is expensed in profit or loss in accordance with the reinsurance contract's expected pattern of incidence of risk. The deferred reinsurance premium asset is that portion of the reinsurance premium that QBE has not yet expensed in profit or loss as it represents reinsurance coverage to be received by QBE after the balance date.

Acquisition costs are the costs associated with obtaining and recording insurance business. Acquisition costs are similarly capitalised and amortised, consistent with the earning of the related premium for that business. Commissions are a type of acquisition cost but are disclosed separately.

## 2.

### Summary of unearned premium and deferred insurance costs balances

| | 2016 US$M | 2015 US$M |
|---|---|---|
| Unearned premium (a) | **6,763** | 7,006 |
| To be earned within 12 months | **6,175** | 6,356 |
| To be earned in greater than 12 months | **588** | 650 |
| Unearned premium | **6,763** | 7,006 |
| Deferred reinsurance premium | **585** | 1,160 |
| Deferred net commission | **990** | 995 |
| Deferred acquisition costs | **390** | 383 |
| Deferred insurance costs (b) | **1,965** | 2,538 |
| To be expensed within 12 months | **1,782** | 2,377 |
| To be expensed in greater than 12 months | **183** | 161 |
| Deferred insurance costs | **1,965** | 2,538 |
| Net premium liabilities (a) – (b) | **4,798** | 4,468 |

### Unearned premium movements

| | 2016 US$M | 2015 US$M |
|---|---|---|
| At 1 January | **7,006** | 7,366 |
| Deferral of unearned premium on contracts written in the financial year | **6,149** | 6,043 |
| Earning of premium written in previous financial years | **(6,030)** | (5,873) |
| Transfers to liabilities held for sale | **(27)** | – |
| Foreign exchange | **(335)** | (530) |
| At 31 December | **6,763** | 7,006 |

### Deferred insurance costs movements

| | DEFERRED REINSURANCE PREMIUM | | DEFERRED NET COMMISSION | | DEFERRED ACQUISITION COSTS | |
|---|---|---|---|---|---|---|
| | 2016 US$M | 2015 US$M | 2016 US$M | 2015 US$M | 2016 US$M | 2015 US$M |
| At 1 January | **1,160** | 502 | **995** | 1,019 | **383** | 510 |
| Costs deferred in financial year | **448** | 1,106 | **758** | 673 | **331** | 382 |
| Amortisation of costs deferred in previous financial years | **(1,005)** | (395) | **(690)** | (661) | **(322)** | (365) |
| Transfers to assets held for sale / disposals | **(2)** | – | **(3)** | – | **–** | (45) |
| Impairment | **–** | – | **–** | – | **–** | (41) |
| Foreign exchange | **(16)** | (53) | **(70)** | (36) | **(2)** | (58) |
| At 31 December | **585** | 1,160 | **990** | 995 | **390** | 383 |

## How we account for the numbers

### Unearned premium

Unearned premium is calculated based on the coverage period of the insurance or reinsurance contract and in accordance with the expected pattern of the incidence of risk, using either the daily pro-rata method or the 24ths method, adjusted where appropriate to reflect different risk patterns.

### Deferred insurance costs

Deferred reinsurance premium is calculated based on the period of indemnity provided to QBE by the reinsurance contract and in accordance with the related pattern of the incidence of risk.

Acquisition costs are capitalised when they relate to new business or the renewal of existing business and are amortised on the same basis as the earning pattern for that business. At the balance date, deferred acquisition costs represent the capitalised acquisition costs that relate to unearned premium and are carried forward to a subsequent accounting period in recognition of their future benefit. The carrying value of deferred acquisition costs is subject to impairment testing in the form of the liability adequacy test (note 2.5.1).

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### 2.5.1 Liability adequacy test

#### Overview

At each balance date, the Group is required to assess net premium liabilities (being unearned premium less deferred insurance costs) to determine whether the amount provided is sufficient to pay future claims.

If the present value of expected future claims exceeds the net premium liabilities, the net premium liability is deemed deficient. This deficiency is immediately recognised in profit or loss. In recognising the deficiency, an insurer must first write down any related intangible assets and then deferred acquisition costs before recognising an unexpired risk liability.

**Expected present value of future cash flows for future claims including risk margin**

| | 2016 US$M | 2015 US$M |
|---|---|---|
| Undiscounted net central estimate | 4,498 | 4,378 |
| Discount to present value | (171) | (240) |
| | 4,327 | 4,138 |
| Risk margin at the 75th percentile of insurance liabilities | 186 | 186 |
| Expected present value of future cash flows for future claims including risk margin | 4,513 | 4,324 |

The application of the liability adequacy test did not identify a deficiency at either 31 December 2016 or 2015.

#### How we account for the numbers

At each balance date, the adequacy of the unearned premium liability is assessed on a net of reinsurance basis against the present value of the expected future claims cash flows 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 operating segment level, being a portfolio of contracts subject to broadly similar risks and which are managed together as a single portfolio. The exception is the Emerging Markets segment where risks are considered to be broadly similar within each of the Latin American and Asia Pacific geographic regions but not across the operating segment as a whole.

#### Critical accounting judgements and estimates

In assessing the adequacy of net premium liabilities, AASB 1023 *General Insurance Contracts* requires the inclusion of a risk margin 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 liability, no such guidance exists in respect of the level of risk margin to be used in determining the adequacy of net premium liabilities.

The Group has adopted a risk margin of 4.3% (2015 4.5%) for the purpose 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. Without allowing for diversification benefits, the application of the 4.3% risk margin to the net premium liabilities is estimated to achieve a probability of adequacy of 70% (2015 71%) for net unearned premium liabilities on a standalone basis.

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# 2.

## 2.6 Trade and other receivables

### Overview

Trade and other receivables are principally amounts owed to QBE by policyholders or reinsurance counterparties. Unclosed premium receivables are estimated amounts due to QBE in relation to business for which the Group is on risk but where the policy is not billed to the counterparty at the balance date.

| | 2016 US$M | 2015 US$M |
|---|---|---|
| **Trade debtors** | | |
| Premium receivable [1] | **2,149** | 2,289 |
| Reinsurance and other recoveries [2] | **984** | 1,088 |
| Unclosed premium | **955** | 1,085 |
| Other trade debtors | **123** | 192 |
| | **4,211** | 4,654 |
| Other receivables | **620** | 296 |
| Trade and other receivables | **4,831** | 4,950 |
| Receivable within 12 months | **4,775** | 4,744 |
| Receivable in greater than 12 months | **56** | 206 |
| Trade and other receivables | **4,831** | 4,950 |

1 Net of a provision for impairment of $86 million (2015 $86 million).
2 Net of a provision for impairment of $53 million (2015 $61 million).

Due to the predominantly short-term nature of these receivables, the carrying value is assumed to approximate the fair value.

The maximum exposure to credit risk at the reporting date is the fair value of each class of receivables. No receivables are pledged by the Group as collateral for liabilities or contingent liabilities. Information on the ageing and credit rating of these balances is included in note 4.3.

### How we account for the numbers

Receivables are recognised at fair value and are subsequently measured at amortised cost less any impairment. A provision for impairment is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the receivable. Any increase or decrease in the provision for impairment is recognised in profit or loss within underwriting expenses.

# Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2016

## 2.7 Trade and other payables

### Overview

Trade payables primarily comprise amounts owed to reinsurance counterparties and cedants. Treasury and investment payables are amounts due to investment counterparties in settlement of transactions.

| | 2016 US$M | 2015 US$M |
|---|---|---|
| Trade payables | 1,172 | 1,261 |
| Other payables and accrued expenses | 612 | 678 |
| Treasury payables | 22 | 32 |
| Investment payables | 333 | 130 |
| Trade and other payables | 2,139 | 2,101 |
| Payable within 12 months | 2,017 | 2,056 |
| Payable in greater than 12 months | 122 | 45 |
| Trade and other payables | 2,139 | 2,101 |

### How we account for the numbers

Trade payables are recognised initially at their fair value and are subsequently measured at amortised cost using the effective interest method.

3.

## 3. INVESTMENTS ACTIVITIES

### Overview

Premiums collected from policyholders are invested to meet the Group's cash flow needs to pay claims and other expenses, as well as generating a return that contributes to the Group's profitability. A sound investment strategy is therefore integral to the success of the Group's operations.

The Group invests across a diversified range of instruments to achieve an appropriate balance between risk and return. Decisions on where to invest are dependent on expected returns, cash flow requirements of the Group, liquidity of the instrument, credit quality of the instrument and the overall risk appetite of the Group. Further details on the management of risk associated with investment assets can be found in note 4.

The Group's investment assets are categorised as either backing policyholders' or shareholders' funds, with the former being investment assets which back insurance liabilities whilst the latter comprises all other investment assets.

### 3.1 Investment income

| | 2016 US$M | 2015 US$M |
|---|---|---|
| Income on growth assets | **86** | 225 |
| Income on fixed interest securities, short-term money and cash | **561** | 489 |
| Gross investment income [1] | **647** | 714 |
| Investment expenses | **(24)** | (26) |
| Net investment income | **623** | 688 |
| Foreign exchange gain (loss) | **125** | (20) |
| Other income | **2** | 7 |
| Other expenses | **(4)** | (10) |
| Total investment income | **746** | 665 |
| Investment and other income – policyholders' funds | **422** | 418 |
| Investment expenses – policyholders' funds | **(15)** | (16) |
| Investment and other income – shareholders' funds | **348** | 273 |
| Investment expenses – shareholders' funds | **(9)** | (10) |
| Total investment income | **746** | 665 |

1 Includes net fair value gains of $109 million (2015 $128 million), interest income of $482 million (2015 $482 million) and dividend income of $56 million (2015 $104 million).

### How we account for the numbers

Interest income is recognised in the period in which it is earned. 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.

# Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2016

## 3.2 Investment assets

| | 2016 US$M | 2015 US$M |
|---|---|---|
| **Fixed income** | | |
| Short-term money | 3,964 | 5,924 |
| Government bonds | 5,996 | 4,158 |
| Corporate bonds | 11,339 | 12,385 |
| Infrastructure debt | 453 | 348 |
| Unit trusts | 31 | 64 |
| | 21,783 | 22,879 |
| **Growth assets** | | |
| Developed market equity | 579 | 683 |
| Emerging market equity | 34 | 254 |
| Emerging market debt | 305 | 318 |
| High yield debt | 202 | 458 |
| Unlisted property trusts | 1,028 | 1,043 |
| Alternatives | 443 | 397 |
| | 2,591 | 3,153 |
| Total investments | 24,374 | 26,032 |
| Amounts maturing within 12 months | 6,948 | 10,442 |
| Amounts maturing in greater than 12 months | 17,426 | 15,590 |
| Total investments | 24,374 | 26,032 |

### How we account for the numbers

Investments are designated as fair value through profit or loss on initial recognition, being the cost of acquisition excluding transaction costs, and are subsequently remeasured to fair value at each reporting date. The fair value hierarchy and the Group's approach to measuring the fair value of each investment instrument is disclosed in note 3.2.1.

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

# 3.

### 3.2.1 Fair value hierarchy

**Overview**

The Group Investments Valuation Committee is responsible for the governance and oversight of the investment valuation process and ensures that the determination of fair value is in accordance with the Group's investment valuation policy.

The investments of the Group are disclosed in the table below 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 for identical instruments in markets which are not active, quoted prices for similar instruments, or valuation techniques for which all significant inputs are based on observable market data, for example, consensus pricing using broker quotes or valuation models with observable inputs.

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

| | 2016 | | | | 2015 | | | |
|---|---|---|---|---|---|---|---|---|
| | LEVEL 1 US$M | LEVEL 2 US$M | LEVEL 3 US$M | TOTAL US$M | LEVEL 1 US$M | LEVEL 2 US$M | LEVEL 3 US$M | TOTAL US$M |
| **Fixed income** | | | | | | | | |
| Short-term money | 854 | 3,099 | 1 | 3,954 | 861 | 5,062 | 1 | 5,924 |
| Government bonds | 4,808 | 1,186 | 2 | 5,996 | 2,849 | 1,300 | 9 | 4,158 |
| Corporate bonds | – | 11,339 | – | 11,339 | – | 12,384 | 1 | 12,385 |
| Infrastructure debt | – | 170 | 293 | 463 | – | 139 | 209 | 348 |
| Unit trusts | – | 31 | – | 31 | – | 64 | – | 64 |
| | 5,662 | 15,825 | 296 | 21,783 | 3,710 | 18,949 | 220 | 22,879 |
| **Growth assets** | | | | | | | | |
| Developed market equity | 560 | – | 19 | 579 | 657 | – | 26 | 683 |
| Emerging market equity | – | 34 | – | 34 | – | 254 | – | 254 |
| Emerging market debt | – | 305 | – | 306 | – | 318 | – | 318 |
| High yield debt | – | 202 | – | 202 | – | 458 | – | 458 |
| Unlisted property trusts | – | 1,028 | – | 1,026 | – | 1,043 | – | 1,043 |
| Alternatives | – | 186 | 257 | 443 | – | 397 | – | 397 |
| | 560 | 1,755 | 276 | 2,591 | 657 | 2,470 | 26 | 3,153 |
| Total investments | 6,222 | 17,580 | 572 | 24,374 | 4,367 | 21,419 | 246 | 26,032 |

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

**Short-term money**

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

**Government bonds and corporate bonds**

Bonds which are traded in active markets and have quoted prices from external data providers are categorised as level 1 fair value measurements. 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.

**Infrastructure debt**

Infrastructure debt prices are sourced from the investment manager who may use a combination of observable market prices or comparable market prices where available and other valuation techniques.

**Developed market equity**

Listed equities traded in active markets are valued by reference to quoted bid prices. Unlisted equities are priced using QBE's share of the net assets of the entity.

**Emerging market equity, emerging market debt, high yield debt, unit trusts and unlisted property trusts**

These assets are valued using quoted bid prices in active markets or current unit prices as advised by the responsible entity, trustee or equivalent of the investment management scheme.

# Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2016

**Alternatives**

Alternatives comprise fund of funds vehicles. Fair value is based on the net asset value of the vehicle, and the responsibility for the valuation of the underlying securities lies with the external manager. In most cases, an independent administrator will be utilised by the external fund manager for pricing and valuation. A combination of observable market prices or comparable market prices (where available) and other valuation techniques may be used in the determination of fair value.

### Movements in level 3 investments

The following table provides an analysis of investments valued with reference to level 3 inputs.

| LEVEL 3 | 2016 US$M | 2015 US$M |
|---|---|---|
| At 1 January | 246 | 186 |
| Purchases | 393 | 105 |
| Disposals | (40) | (37) |
| Fair value (losses) gains recognised in profit or loss | (12) | 1 |
| Foreign exchange | (15) | (9) |
| At 31 December | 572 | 246 |

### 3.2.2 Charges over investments and restrictions on use

A controlled entity has given fixed and floating charges over certain of its investments and other assets in order to secure the obligations of the Group's corporate members at Lloyd's of London as described in note 8.2.

Included in investments are amounts totalling $3,043 million (2015 $3,346 million) which are held in Lloyd's syndicate trust funds. In order to conduct underwriting business within some territories, Lloyd's syndicates are required to lodge assets in locally regulated trust funds. Under Lloyd's byelaws, these amounts can only be used to pay claims and allowable expenses of the syndicate and cannot be withdrawn from the trust funds until allowed to be distributed as profit once annual solvency requirements are met. Included in this amount is $194 million (2015 $678 million) of short-term money.

3.

### 3.2.3 Derivatives over investment assets

#### Overview

In accordance with our investment management policies and procedures, derivatives may be used in the investment portfolio as both a hedging tool and to alter the risk profile of the portfolio. All long positions must be cash backed, all short positions must be covered by an underlying physical asset and no net short exposure to an asset class is permitted. Risk management policies over the use of derivatives are set out in note 4.

QBE may also have exposure to derivatives through investments in underlying pooled funds in accordance with the fund mandate. Those derivative exposures are not included in the table below.

The Group's notional exposure to investment derivatives at the balance date is set out in the table below.

| NOTIONAL EXPOSURE | 2016 US$M | 2015 US$M |
|---|---|---|
| **Fixed interest futures** | | |
| ASX 90 day bank bills | – | 760 |
| SFE Australian 3 year bond futures | – | 81 |
| 90 day sterling futures | – | (713) |
| **Equity futures** | | |
| ASX SPI 200 | – | 104 |
| S&P 500 E-mini | – | 191 |

#### How we account for the numbers

Derivatives over investment assets are initially recognised at fair value and are subsequently remeasured to 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. The mark to market value of futures positions are cash settled on a daily basis resulting in a fair value of nil at the balance date.

# Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2016

## 4. RISK MANAGEMENT

### Overview

QBE is in the business of managing risk. The Group's ability to satisfy customers' risk management needs is central to what we do. QBE aims to generate wealth and maximise returns for its shareholders by pursuing opportunities that involve risk. Our people are responsible for ensuring that QBE's risks are managed and controlled on a day to day basis. QBE aims to use its ability to properly manage risk to provide more certainty and improved outcomes for all stakeholders.

QBE applies a consistent and integrated approach to enterprise risk management (ERM); we refer to this as ONE ERM. QBE'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. QBE's risk management framework is articulated in the Risk Management Strategy (RMS) and Reinsurance Management Strategy (REMS), both of which are approved annually by the Group Board and lodged with APRA.

The framework consists of complementary elements that are embedded throughout the business management cycle and culture of the organisation. Key aspects include: risk appetite, governance, reporting, risk assessments, modelling and stress testing, management, and monitoring and risk culture.

Risk management is a continuous process and an integral part of robust business management. QBE's approach is to integrate risk management into the broader management processes of the organisation. It is QBE's philosophy to ensure that risk management remains 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.

QBE Group's strategy for managing risk is to:

- achieve competitive advantage by better understanding the risk environments in which we operate;
- operate within our stated risk appetite and more effectively allocate capital and resources by assessing the balance of risk and reward; and
- avoid unwelcome surprises to the achievement of business objectives by reducing uncertainty and volatility through the identification and management of risks.

The framework is supported by a suite of policies that detail QBE's approach to the key risk categories used by QBE to classify risk:

- Strategic risk (note 4.1)
- Insurance risk (note 4.2)
- Credit risk (note 4.3)
- Market risk (note 4.4)
- Liquidity risk (note 4.5)
- Operational risk (note 4.6)

# 4.

## 4.1 Strategic risk

### Overview

Strategic risk is the potential impact on earnings and/or capital as a result of strategic business decisions or lack of responsiveness to external change. QBE classifies strategic risk into five subcategories, as follows:

- business, product and market distribution;
- capital structure and management;
- acquisition, decision and negotiation;
- tax risk management; and
- investment strategy.

QBE's approach to managing strategic risk is underpinned by the Group strategic risk appetite statement as set by the Group Board and is summarised below.

### Business, product and market distribution

**Business:** The Group is a geographically diversified international general insurance and reinsurance group, underwriting most major commercial and personal lines classes of business through operations in 37 countries. The Group Board and the board of each division meet at least quarterly to review performance against business plans. Actual results are monitored and analysed regularly at various levels in the Group to identify adverse trends so that remedial action can be taken at an early stage. One of the key tools used to ensure achievement of business plans is to identify our 'manage to' likely scenarios impacting the plan year based on events that have occurred or risks identified since plans were set. We assess how these scenarios would impact return on equity (ROE) forecasts and develop and implement bridging actions to drive plan achievability.

**Product:** QBE reviews the structuring of its insurance products on an ongoing basis in line with market expectations and developments, legislation and claims trends.

**Market distribution approach:** QBE makes use of distributed networks of insurance agents and brokers to undertake sales and marketing of its insurance products. The Group also markets and distributes insurance products directly by phone and on the internet.

### Capital structure and management

QBE'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 Group's activities. In order to maintain or adjust the capital structure, the Group may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares or debt securities with capital characteristics, sell assets to reduce debt or adopt more conservative investment or reinsurance strategies.

QBE is subject to, and complies with, various externally imposed regulatory capital requirements, both through its wholly-owned insurance controlled entities and as a consolidated insurance group. These requirements are designed to ensure that a sufficient solvency margin is maintained in order to provide adequate protection for policyholders. In addition, the Group aims to maintain a strong credit and insurer financial strength rating along with robust capital ratios in order to support its business objectives and maximise shareholder wealth.

The Group uses an economic capital model (ECM) to assess the level of capital required for the underwriting, claims estimation, credit, market, liquidity and operational risk to which it is exposed. Economic capital is determined as the level of capital that the Group needs to ensure that it can, with a pre-specified probability, satisfy its ultimate policyholder obligations in relation to all insurance contracts issued on or before the end of the business plan year. The ECM is used by management to help in the determination of strategic capital allocation, business planning, underwriting performance, pricing, reinsurance arrangements and aggregate management. Capital is allocated to business units, divisions and ultimately to underwriting portfolios according to the associated risk. The business plans include net asset, dividend, issued share capital and solvency projections as well as the impact of potential acquisitions. In the event of a significant change in the Group's risk profile, the ECM will be recalculated and the results reported to the Group's Board.

The Group reviews its capital structure on an ongoing basis to optimise the allocation of capital whilst minimising the cost of capital. Active management of the business and its capital has enabled the Group to maintain its insurer financial strength and credit rating, and has afforded QBE good access to capital markets when needed.

Management has a particular focus on the following performance indicators:

- The Group actively manages the components of capital in order to maintain a level of eligible regulatory capital that exceeds APRA requirements. Having determined that the current Group risk appetite remains appropriate, the Board has set the target level of regulatory capital for 2017 at 1.6 – 1.8 times (2016 1.6 – 1.8 times) the Prescribed Capital Amount (PCA).
- All regulated wholly-owned entities are required to maintain a minimum level of capital to meet obligations to policyholders. It is the Group's policy that each regulated entity maintains a capital base appropriate to its size, business mix, complexity and risk profile which fully complies with and meets or exceeds local regulatory requirements.

# Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2016

- The Group aims to maintain the ratio of borrowings to shareholders' funds at 25% – 35% (2015 25% – 35%). The ratio of borrowings to shareholders' funds at 31 December 2016 was 33.8% (2015 33.6%).
- Insurer financial strength ratings provided by the major rating agencies demonstrate the Group's financial strength and claims paying ability.

In addition to the management reporting and planning processes, the Group has dedicated staff across its business units and divisions responsible for understanding the regulatory capital requirements of both the operating insurance entities and consolidated operations. The quality of QBE's assets (particularly investments and reinsurance recoveries) is continuously monitored to ensure any potential issues are identified and remedial action, where necessary, is taken to restore effective capital performance and levels.

### Acquisition, decision and negotiation

QBE's growth strategy is based on a combination of organic and inorganic growth. QBE's approach to inorganic growth/acquisitions is based on the principle that QBE will only acquire businesses that are aligned with our strategic intent and direction and which will contribute to the achievement of our corporate ambition. QBE's acquisition strategy supports QBE's value creation model by reinforcing leadership in core businesses and enabling profitable growth and diversification.

### Tax risk management

QBE's approach to managing taxation risk is underpinned by the QBE Group Tax Risk Management Framework, which is approved by the Group Board and aligns with QBE's business strategy.

### Investment strategy

QBE's approach to investment risk is underpinned by the Group's investment strategy, which is designed to achieve absolute return targets within pre-defined risk and capital constraints whilst meeting regulatory requirements in every jurisdiction. The strategy requires QBE to invest in a range of asset classes with portfolios consisting mainly of investment grade fixed income securities.

## 4.2 Insurance risk

### Overview

**Insurance risk is the risk of fluctuations in the timing, frequency and severity of insured events and claims settlements, relative to expectations. Key drivers of insurance risk include natural or man-made catastrophic events, pricing of individual insurance contracts, reserving and insurance claims.**

QBE classifies insurance risk into four subcategories, as follows:

- underwriting;
- insurance concentrations;
- reserving; and
- reinsurance.

QBE's approach to managing insurance risk is underpinned by the Group insurance risk appetite statement as set by the Group Board and is summarised below.

### Underwriting risk

QBE manages underwriting risk by appropriately setting and adjusting underwriting strategy, risk selection and pricing practices throughout the underwriting cycle.

QBE's underwriting strategy aims to diversify and limit the type of insurance risks accepted and reduce the variability of the expected outcome. The underwriting strategy is implemented through QBE's annual business planning process, supported by underwriting authorities. These authorities reflect the level of risk that the Group is prepared to take with respect to each permitted insurance class.

Pricing of risks is controlled by the use of in-house pricing models relevant to specific portfolios and the markets in which QBE operates. Underwriters and actuaries maintain pricing and claims analysis for each portfolio, combined with a knowledge of current developments in the respective markets and classes of business.

### Insurance concentration risk

QBE's exposure to concentrations of insurance risk is mitigated by maintaining a business portfolio that is diversified across countries and classes of business. Product diversification is pursued through a strategy of developing strong underwriting skills in a wide variety of classes of business.

4.

The table below demonstrates the diversity of QBE's operations.

| GROSS EARNED PREMIUM | 2016 US$M | 2015 US$M |
|---|---|---|
| Commercial & domestic property | 4,480 | 4,625 |
| Motor & motor casualty | 2,606 | 2,640 |
| Agriculture | 1,649 | 1,616 |
| Public/product liability | 1,442 | 1,592 |
| Workers' compensation | 1,062 | 1,240 |
| Marine energy & aviation | 904 | 976 |
| Professional indemnity | 898 | 840 |
| Accident & health | 852 | 592 |
| Financial & credit | 570 | 611 |
| Other | 113 | 190 |
| | 14,276 | 14,922 |

Concentration risk includes the risks from natural or man-made events that have the potential to produce claims from many of the Group's policyholders at the same time (e.g. catastrophes). QBE currently uses a variety of methodologies to monitor aggregates and manage catastrophe risk. These include the use of catastrophe models from third party vendors such as RMS and AIR, the Lloyd's realistic disaster scenarios (RDS) and group aggregate methodology. QBE sets the risk appetite relating to catastrophe risk with reference to the insurance concentration risk charge (ICRC). QBE's maximum risk tolerance for an individual natural catastrophe, measured using the ICRC methodology, is determined annually and is linked to budgeted net earned premium.

### Reserving risk

Reserving risk is managed through the quarterly actuarial valuation of insurance liabilities. The valuation of the net central estimate is performed by qualified and experienced actuaries, with reference to historical data and reasoned expectations of future events. The central estimate of outstanding claims is subject to a comprehensive independent review at least annually.

### Reinsurance risk

The Group limits its exposure to an individual catastrophe or an accumulation of claims by reinsuring a portion of risks underwritten. This allows the Group to control exposure to insurance losses, reduce volatility of reported results and protect capital.

## 4.3 Credit risk

### Overview

Credit risk is the risk of not recovering money owed to QBE by third parties as well as the loss of value of assets due to deterioration in credit quality. QBE's exposure to credit risk arises from financial transactions with securities issuers and/or a reduction or delay in repayments or interest payments from the default of counterparties such as debtors, brokers, policyholders, reinsurers and guarantors. QBE categorises credit risk into three sub-categories, as follows:

- reinsurance counterparty credit;
- investment counterparty credit; and
- premium and other counterparty credit.

QBE's approach to managing credit risk is underpinned by the Group credit risk appetite as set by the Group Board and summarised below.

### Reinsurance counterparty credit risk

The Group's objective is to maximise placement of reinsurance with highly rated counterparties. Concentration of risk with reinsurance counterparties is monitored strictly and regularly by the Group's Security Committee and is controlled by reference to the following protocols:

- treaty or facultative reinsurance is placed in accordance with the requirements of the Group REMS and Group Security Committee guidelines;
- reinsurance arrangements are regularly reassessed to determine their effectiveness based on current exposures, historical claims and potential future losses based on the Group's insurance concentrations; and
- exposure to reinsurance counterparties and the credit quality of those counterparties is actively monitored.

Credit risk exposures are calculated regularly and compared with authorised credit limits. In certain cases, the Group requires letters of credit or other collateral arrangements to be provided to guarantee the recoverability of the amount involved. The Group holds $1,055 million (2015 $894 million) in collateral to support reinsurance recoveries on outstanding claims. The credit rating analysis below includes the impact of such security arrangements. In some cases, further security has been obtained in the form of trust arrangements, reinsurer default protection and other potential offsets. This additional security has not been included in the credit rating analysis below.

# Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2016

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

| | CREDIT RATING | | | | | | |
|---|---|---|---|---|---|---|---|
| | AAA US$M | AA US$M | A US$M | BBB US$M | SPECULATIVE GRADE US$M | NOT RATED US$M | TOTAL US$M |
| **As at 31 December 2016** | | | | | | | |
| Reinsurance recoveries on outstanding claims [1,2] | **65** | **2,873** | **1,115** | **2** | **14** | **120** | **4,189** |
| Reinsurance recoveries on paid claims [1] | **2** | **847** | **116** | **3** | **4** | **12** | **984** |
| **As at 31 December 2015** | | | | | | | |
| Reinsurance recoveries on outstanding claims [1,2] | 51 | 1,572 | 1,099 | 7 | 12 | 123 | 2,864 |
| Reinsurance recoveries on paid claims [1] | 1 | 878 | 185 | 11 | 4 | 9 | 1,088 |

1 Net of a provision for impairment.

2 Excludes other recoveries of $351 million (2015 $340 million).

The following table provides further information regarding the ageing of reinsurance recoveries on paid claims at the balance date.

| | | | PAST DUE BUT NOT IMPAIRED | | | | |
|---|---|---|---|---|---|---|---|
| | YEAR | NEITHER PAST DUE NOR IMPAIRED US$M | 0 TO 3 MONTHS US$M | 4 TO 6 MONTHS US$M | 7 MONTHS TO 1 YEAR US$M | GREATER THAN 1 YEAR US$M | TOTAL US$M |
| Reinsurance recoveries on paid claims [1] | **2016** | **740** | **162** | **42** | **21** | **19** | **984** |
| | 2015 | 690 | 344 | 28 | 10 | 16 | 1,088 |

1 Net of a provision for impairment.

### Investment counterparty credit risk

The Group only transacts with investment counterparties within the limits outlined in the delegated authorities. Investment counterparty exposure limits are applied to individual counterparty exposures and to multiple exposures within a group of related companies in relation to investments, cash deposits and forward foreign exchange exposures. Counterparty exposure limit compliance is monitored daily.

The following table provides information regarding the Group's aggregate credit risk exposure at the balance 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 smaller credit risk items which generally cannot be rated and are not individually material. The analysis classifies the assets according to S&P counterparty credit ratings. AAA is the highest possible rating. Rated assets falling outside the range of AAA to BBB are classified as speculative grade.

| | CREDIT RATING | | | | | | |
|---|---|---|---|---|---|---|---|
| | AAA US$M | AA US$M | A US$M | BBB US$M | SPECULATIVE GRADE US$M | NOT RATED US$M | TOTAL US$M |
| **As at 31 December 2016** | | | | | | | |
| Cash and cash equivalents | **–** | **207** | **363** | **213** | **4** | **60** | **847** |
| Interest-bearing investments | **3,654** | **8,124** | **7,792** | **1,852** | **297** | **64** | **21,783** |
| Derivative financial instruments | **–** | **122** | **16** | **13** | **–** | **–** | **151** |
| **As at 31 December 2015** | | | | | | | |
| Cash and cash equivalents | 4 | 183 | 289 | 148 | 6 | 32 | 662 |
| Interest-bearing investments | 3,937 | 8,444 | 8,773 | 1,337 | 263 | 125 | 22,879 |
| Derivative financial instruments | – | 12 | 12 | 9 | – | – | 33 |

The carrying amount of the relevant asset classes in the balance sheet represents the maximum amount of credit exposure. The fair value of derivatives shown on the balance sheet represents the current risk exposure but not the maximum risk exposure that could arise in the future as a result of changing values.

4.

### Premium and other counterparty credit risk

The Group transacts with brokers that are reputable, suitable and approved in accordance with local broker policies. The continuous due diligence over brokers involves an assessment of the broker's reputation, regulatory standing and financial strength.

QBE regularly reviews the collectability of receivables and the adequacy of associated provisions for impairment. Concentration risk is also monitored for large brokers. Balances are monitored on the basis of uncollected debt and debt outstanding in excess of six months. Brokers are also subject to regular due diligence to ensure adherence to local broker policies and associated requirements.

The following table provides information regarding the ageing of the Group's financial assets that are past due but not impaired and which are largely unrated at the balance date.

| | NEITHER PAST DUE NOR IMPAIRED US$M | PAST DUE BUT NOT IMPAIRED 0 TO 3 MONTHS US$M | 4 TO 6 MONTHS US$M | 7 MONTHS TO 1 YEAR US$M | GREATER THAN 1 YEAR US$M | TOTAL US$M |
|---|---|---|---|---|---|---|
| **As at 31 December 2016** | | | | | | |
| Premium receivable [1] | **1,220** | **766** | **66** | **65** | **22** | **2,149** |
| Other trade debtors | **89** | **17** | **2** | **2** | **13** | **123** |
| Other receivables | **480** | **131** | **3** | **4** | **2** | **620** |
| **As at 31 December 2015** | | | | | | |
| Premium receivable [1] | 1,359 | 681 | 138 | 68 | 43 | 2,289 |
| Other trade debtors | 172 | 2 | 1 | 3 | 14 | 192 |
| Other receivables | 284 | 11 | – | – | 1 | 296 |

1 Net of a provision for impairment.

## 4.4 Market risk

### Overview

Market risk is the risk of variability in the value of investments due to:

- movement in market factors (including interest rates, credit spreads and equity prices); and
- movement in foreign exchange rates.

QBE's approach to managing market risk is underpinned by the Group market risk appetite as set by the Group Board and is summarised below.

QBE's approach to managing investment market movements is underpinned by the Group's investment strategy which outlines QBE's view of the markets and its corresponding investment approach. One of the key limits set by the strategy is the probability (as determined by the Economic Scenario Generator (ESG) Model) of earning negative returns on the investment portfolio. The ESG models asset class and portfolio returns using a stochastic process based on a range of economic and financial market scenarios.

Investment market risk is also managed through the application of exposure and asset limits. These limits are based on the market risk appetite as determined by the Group Board and apply to:

- initial losses generated on the investment portfolio under a market stress scenario. The scenario assumes adverse movements in credit spreads, equity markets and property markets and is designed to reflect a significant short-term market stress event. The loss generated by the stress scenario is partially offset by any gains from a downward shift in sovereign bond yields;
- interest rate risk, measured in terms of modified duration and spread duration; and
- total combined holdings in equity, investment property and other growth assets as a proportion of the Group's total investment portfolio.

# Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2016

### Interest rate risk

QBE is exposed to interest rate risk through its holdings in interest-bearing assets, emerging market debt and high yield debt investments. Financial instruments with a floating interest rate expose the Group to cash flow interest rate risk, whereas fixed interest rate instruments expose the Group to fair value interest rate risk. Interest-bearing borrowings issued by the Group are measured at amortised cost and therefore do not expose the Group result to fair value interest rate risk.

QBE'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 Group predominantly 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 net central estimate of outstanding claims is discounted to present value by reference to risk-free interest rates. The Group is therefore exposed to potential underwriting result volatility as a result of interest rate movements. In practice, over the longer term, an increase or decrease in interest rates is normally offset by a corresponding increase or decrease in inflation. Details are provided in note 2.3.7. QBE maintains a shorter asset duration relative to policyholders' funds, and has plans to move towards duration matching of assets and liabilities in 2018 or earlier. At 31 December 2016, the average modified duration of cash and fixed interest securities was 1.5 years (2015 0.9 years).

All investments are financial assets measured at fair value through profit or loss. Movements in interest rates impact the fair 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 Group at the balance date is shown in the table below.

| | SENSITIVITY % | PROFIT (LOSS)[1] 2016 US$M | 2015 US$M |
|---|---|---|---|
| Interest rate movement – interest-bearing financial assets | +0.5 | (118) | (71) |
| | -0.5 | 109 | 67 |
| Interest rate movement – high yield and emerging market debt | +0.5 | (9) | (13) |
| | -0.5 | 9 | 13 |

1 Net of tax at the Group's prima facie income tax rate of 30%.

### 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.

QBE is exposed to price risk on its investment in equities and may use derivative financial instruments to manage this exposure. The risk management processes over these derivative financial instruments are the same as those explained above in respect of interest rate derivative financial instruments. Exposure is also managed by diversification across worldwide markets and currencies.

At 31 December 2016, 2.3% (2015 3.8%) of the Group's investments and cash was held in listed equities (including derivatives), of which the majority was publicly traded in the major financial markets and 1.9% (2015 2.5%) of the Group's investments and cash was held in emerging market equity and alternatives.

All equities are measured at fair value through profit or loss. The impact of a 20% increase or decrease in the value of investments (including derivatives – refer to note 3.2.3) owned by the Group at the balance date on consolidated profit after tax is shown in the table below.

| | SENSITIVITY % | PROFIT (LOSS)[1] 2016 US$M | 2015 US$M |
|---|---|---|---|
| ASX 200 | +20 | 18 | 48 |
| | -20 | (18) | (48) |
| FTSE 100 | +20 | 15 | 8 |
| | -20 | (15) | (8) |
| EURO STOXX | +20 | 16 | 13 |
| | -20 | (16) | (13) |
| S&P 500 | +20 | 21 | 57 |
| | -20 | (21) | (57) |
| MSCI Emerging Markets Index | +20 | 6 | 36 |
| | -20 | (6) | (36) |
| Alternatives | +20 | 62 | 56 |
| | -20 | (62) | (56) |

1 Net of tax at the Group's prima facie income tax rate of 30%.

QBE is also exposed to price risk on its interest-bearing (fixed interest, high yield and emerging market debt) financial assets. All securities are measured at fair value through profit or loss. Movements in credit spreads impact the value of corporate interest-bearing securities, emerging market debt, alternatives and high yield debt and therefore impact reported profit after tax. This risk is managed by investing in high quality, liquid interest-bearing securities and by managing the credit spread duration of the corporate securities portfolio.

The impact of either a 0.5% increase or decrease in credit spreads on interest-bearing financial assets held by the Group at the balance date is shown in the table below.

| | SENSITIVITY % | PROFIT (LOSS)[1] 2016 US$M | 2015 US$M |
|---|---|---|---|
| Credit spread movement – corporate interest-bearing financial assets | +0.5 | (113) | (113) |
| | -0.5 | 98 | 106 |
| Credit spread movement – high yield and emerging market debt | +0.5 | (6) | (13) |
| | -0.5 | 6 | 13 |

1 Net of tax at the Group's prima facie income tax rate of 30%.

QBE is also exposed to price risk on its investment in unlisted property trusts. All unlisted property trust investments are measured at fair value through profit or loss. QBE manages this risk by investing in high quality, diversified unlisted property funds. Movements in unit prices impact the value of unlisted property trusts and therefore impact reported profit after tax. The impact of a 10% increase or decrease in unit prices on unlisted property trust securities owned by the Group at the balance date was $72 million (2015 $73 million) net of tax at the Group's prima facie income tax rate of 30%.

## Foreign exchange

QBE's approach to foreign exchange management is underpinned by the Group's foreign currency strategy. The Group's foreign exchange exposure generally arises as a result of either the translation of foreign currency amounts to the functional currency of a controlled entity (operational currency risk) or due to the translation of the Group's net investment in foreign operations to the functional currency of the parent entity of Australian dollars and to QBE's presentation currency of US dollars (currency translation risk).

*Operational currency risk*

Operational currency risk is managed as follows:

- each controlled entity manages the volatility arising from changes in foreign exchange rates by matching liabilities with assets of the same currency, as far as is practicable, thus ensuring that any exposures to foreign currencies are minimised; and
- forward foreign exchange contracts are used where possible to protect residual currency positions. These forward foreign exchange contracts are accounted for in accordance with the derivatives accounting policy set out in note 5.6.

Foreign exchange gains or losses arising from operational foreign currency exposures are reported in profit or loss consistent with the gains or losses from related forward foreign exchange contracts. The risk management process covering the use of forward foreign exchange contracts involves close senior management scrutiny. All forward foreign exchange contracts are subject to delegated authority levels provided to management and the levels of exposure are reviewed on an ongoing basis.

The Group's aim is to mitigate, where possible, its operational foreign currency exposures at a controlled entity level. From time to time, the company or controlled entities may maintain an operational foreign currency exposure to offset currency volatility arising from translation of foreign currency forecast profits, subject to senior management approval and adherence to Board approved limits.

The analysis below demonstrates the impact on profit after income tax of a 10% strengthening or weakening of the major currencies against the functional currencies of the underlying QBE Group entities. The exposures below reflect the aggregation of operational currency exposures of multiple entities with different functional currencies. The sensitivity is measured with reference to the Group's residual (or unmatched) operational foreign currency exposures at the balance date. Operational foreign exchange gains or losses are recognised in profit or loss in accordance with the policy set out in note 1.2.3. The sensitivities provided demonstrate the impact of a change in one key variable in isolation whilst other assumptions remain unchanged.

The sensitivities shown in the table below are relevant only at the balance sheet date, as any unmatched exposures are actively monitored by management and the exposure subsequently matched.

| | 2016 | | | 2015 | | |
|---|---|---|---|---|---|---|
| EXPOSURE CURRENCY | RESIDUAL EXPOSURE US$M | SENSITIVITY % | PROFIT (LOSS)[1] US$M | RESIDUAL EXPOSURE US$M | SENSITIVITY % | PROFIT (LOSS)[1] US$M |
| US dollar | 277 | +10 | 19 | (47) | +10 | (3) |
| | | -10 | (19) | | -10 | 3 |
| Euro | 20 | +10 | 1 | (41) | +10 | (3) |
| | | -10 | (1) | | -10 | 3 |
| Hong Kong dollar | 6 | +10 | – | 10 | +10 | 1 |
| | | -10 | – | | -10 | (1) |
| Canadian dollar | 5 | +10 | – | (6) | +10 | – |
| | | -10 | – | | -10 | – |
| Sterling | (1) | +10 | – | 12 | +10 | 1 |
| | | -10 | – | | -10 | (1) |
| Australian dollar | (13) | +10 | (1) | (32) | +10 | (2) |
| | | -10 | 1 | | -10 | 2 |
| New Zealand dollar | (123) | +10 | (9) | 7 | +10 | – |
| | | -10 | 9 | | -10 | – |

1 Net of tax at the Group's prima facie income tax rate of 30%.

# Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2016

*Currency risk in relation to translation of net investments in foreign operations*

QBE is exposed to currency risk in relation to:

- the translation of the ultimate parent entity's net investments in foreign operations to its functional currency of Australian dollars; and
- the translation of all foreign operations to the presentation currency of US dollars.

QBE does not ordinarily seek to use derivatives to mitigate currency translation risk on translation to the ultimate parent's functional currency of Australian dollars for the following reasons:

- currency translation gains and losses generally have no cash flow;
- currency translation gains and losses are accounted for in the foreign currency translation reserve (a component of equity) and therefore do not impact profit or loss unless the related foreign operation is disposed of; and
- management of translation risk needs to be balanced against the impact on capital requirements and liquidity risk.

In periods of extraordinary volatility that are expected to persist for an extended period of time, QBE may elect to utilise derivatives to mitigate currency translation risk to preserve capital. The volatility created by the UK referendum decision to leave the European Union (Brexit) is an example of such volatility and, since 30 June 2016, the Group has elected to utilise derivatives to hedge its sterling net investment in foreign operations.

Currency translation risks in QBE's investments in controlled entities are monitored on an ongoing basis and may be mitigated by designation of foreign currency borrowings as a hedge of this risk. Any debt security that qualifies as a hedging instrument may be designated as a hedge of the Australian dollar parent entity's net investment in foreign operations and any residual exposure to foreign operations in tradeable currencies may be hedged up to the limit specified in the Group risk appetite statement. The extent of hedging this exposure is carefully managed to ensure an appropriate balance between currency risk and associated risks such as liquidity risk and stability of capital adequacy levels.

Currency management processes are actively monitored by the Group Chief Financial Officer and involve close senior management scrutiny. All hedge transactions are subject to delegated authority levels provided to management, and the levels of exposure are reviewed on an ongoing basis. All instruments that are designated as hedges in accordance with AASB 139 are tested for effectiveness on both a prospective and a retrospective basis. These tests are performed at least quarterly.

At the balance date, derivatives with a net exposure of $945 million (2015 nil) and borrowings and accrued interest of $3,125 million (2015 $3,119 million) were designated as hedges of net investments in foreign operations.

Foreign exchange gains or losses arising on translation of the Group's foreign operations from the parent entity's functional currency of Australian dollars to the Group's US dollar presentation currency are recognised directly in equity in accordance with the policy set out in note 1.2.3. The Group cannot hedge this exposure.

The analysis below demonstrates the impact on equity of a 10% strengthening or weakening against the US dollar of the major currencies to which QBE is exposed through its net investment in foreign operations. The basis for the sensitivity calculation is the Group's actual residual exposure at the balance date.

| | 2016 | | | 2015 | | |
|---|---|---|---|---|---|---|
| EXPOSURE CURRENCY | RESIDUAL EXPOSURE US$M | SENSITIVITY % | EQUITY INCREASE (DECREASE) US$M | RESIDUAL EXPOSURE US$M | SENSITIVITY % | EQUITY INCREASE (DECREASE) US$M |
| Australian dollar | 6,064 | +10 | 606 | 5,559 | +10 | 556 |
| | | -10 | (606) | | -10 | (556) |
| Euro | 771 | +10 | 77 | 711 | +10 | 71 |
| | | -10 | (77) | | -10 | (71) |
| Sterling | 193 | +10 | 19 | 2,261 | +10 | 226 |
| | | -10 | (19) | | -10 | (226) |
| Hong Kong dollar | 158 | +10 | 16 | 159 | +10 | 16 |
| | | -10 | (16) | | -10 | (16) |
| New Zealand dollar | 157 | +10 | 16 | 142 | +10 | 14 |
| | | -10 | (16) | | -10 | (14) |
| Singapore dollar | 128 | +10 | 13 | 115 | +10 | 12 |
| | | -10 | (13) | | -10 | (12) |
| Argentinian peso | 119 | +10 | 12 | 143 | +10 | 14 |
| | | -10 | (12) | | -10 | (14) |
| Colombian peso | 42 | +10 | 4 | 40 | +10 | 4 |
| | | -10 | (4) | | -10 | (4) |

4.

## 4.5 Liquidity risk

### Overview

Liquidity risk is the risk of insufficient liquid assets to meet liabilities as they fall due or only being able to achieve the required level of liquidity at excessive cost. The Group's liquidity risk arises due to the nature of insurance activities where the timing and amount of cash outflows are uncertain.

QBE's approach to managing liquidity risk is underpinned by the Group liquidity risk appetite as set by the Group Board and is summarised below.

QBE manages liquidity risk using a number of tools, as follows:

- cash flow targeting;
- maintaining a proportion of liabilities in liquid assets;
- cash flow forecasting; and
- stress testing and contingency planning.

Liquidity is managed across the Group using a number of cash flow forecasting and targeting tools and techniques. Cash flow forecasting and targeting is conducted at a legal entity level and involves actively managing operational cash flow requirements.

To supplement the cash flow targeting and to ensure that there are sufficient liquid funds available to meet insurance and investment obligations, a minimum percentage of QBE's liabilities is held, at all times, in cash and liquid securities. QBE also maintains a defined proportion of the funds under management in liquid assets.

QBE actively forecasts cash flow requirements to identify future cash surpluses and shortages to optimise invested cash balances and limit unexpected calls from the investment pool. The Group limits the risk of liquidity shortfalls resulting from mismatches in the timing of claims payments and receipt of claims recoveries by negotiating cash call clauses in reinsurance contracts and seeking accelerated settlements for large reinsurance recoveries.

The following table summarises the maturity profile of the Group's financial liabilities based on the remaining contractual obligations. Borrowings and contractual undiscounted interest payments are disclosed by reference to the first call date of the borrowings, details of which are included in note 5.1.

| | LESS THAN ONE YEAR US$M | 13 TO 36 MONTHS US$M | 37 TO 60 MONTHS US$M | OVER 5 YEARS US$M | NO FIXED TERM US$M | TOTAL US$M |
|---|---|---|---|---|---|---|
| **As at 31 December 2016** | | | | | | |
| Forward foreign exchange contracts | **47** | **100** | **–** | **–** | **–** | **147** |
| Trade payables | **1,050** | **76** | **26** | **18** | **3** | **1,172** |
| Treasury payables | **22** | **–** | **–** | **–** | **–** | **22** |
| Investment payables | **333** | **–** | **–** | **–** | **–** | **333** |
| Borrowings [1] | **10** | **600** | **353** | **2,221** | **301** | **3,485** |
| Contractual undiscounted interest payments | **191** | **345** | **322** | **420** | **–** | **1,278** |
| **As at 31 December 2015** | | | | | | |
| Forward foreign exchange contracts | 35 | – | – | – | – | 35 |
| Trade payables | 1,160 | 60 | 2 | 4 | 35 | 1,261 |
| Treasury payables | 32 | – | – | – | – | 32 |
| Investment payables | 130 | – | – | – | – | 130 |
| Borrowings [1] | 11 | 901 | 146 | 2,479 | – | 3,537 |
| Contractual undiscounted interest payments | 219 | 394 | 364 | 317 | – | 1,294 |

1 Excludes capitalised finance costs of $11 million (2015 $8 million).

The maturity profile of the Group's net discounted central estimate is analysed in note 2.3.5.

# Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2016

The maturity of the Group's directly held interest-bearing financial assets is shown in the table below. Interest bearing assets held indirectly through collective investment schemes (such as high yield debt and emerging market debt) are excluded from the analysis.

| | | INTEREST-BEARING FINANCIAL ASSETS MATURING IN | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | | LESS THAN ONE YEAR | 13 TO 24 MONTHS | 25 TO 36 MONTHS | 37 TO 48 MONTHS | 49 TO 60 MONTHS | OVER 5 YEARS | TOTAL |
| **As at 31 December 2016** | | | | | | | | |
| Fixed rate | US$M | **5,916** | **1,648** | **1,770** | **1,622** | **2,226** | **1,554** | **14,736** |
| Weighted average interest rate | % | **1.7** | **2.2** | **1.8** | **2.1** | **2.0** | **1.9** | **1.9** |
| Floating rate | US$M | **1,879** | **1,214** | **916** | **1,281** | **685** | **1,919** | **7,894** |
| Weighted average interest rate | % | **1.4** | **1.9** | **2.0** | **1.6** | **2.4** | **2.9** | **2.0** |
| **As at 31 December 2015** | | | | | | | | |
| Fixed rate | US$M | 8,005 | 1,768 | 557 | 496 | 1,791 | 511 | 13,128 |
| Weighted average interest rate | % | 1.5 | 1.7 | 2.3 | 1.9 | 2.3 | 3.0 | 1.7 |
| Floating rate | US$M | 3,099 | 1,642 | 1,513 | 634 | 1,390 | 2,135 | 10,413 |
| Weighted average interest rate | % | 1.7 | 2.2 | 2.0 | 3.7 | 2.0 | 2.8 | 2.2 |

## 4.6 Operational risk

### Overview

**Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events (including legal risk).**

**Operational risk can materialise in a number of forms including fraud perpetrated by employees or by external parties (e.g. claims fraud or cyber attacks), employment practices (losses arising from breaches of employment, health or safety laws, breach of employment contracts, payment of personal injury claims or diversity and discrimination events), improper business practices (failure to meet professional obligations or issues with the nature or design of an insurance product), disasters and other events, technology and infrastructure failures, or business and transaction processing failures.**

QBE identifies and assesses operational risk through Risk and Control Assessment (RCA), Divisional Risk Assessment (DRA), top risks and emerging risks processes, and scenario analysis. The RCA process identifies and assesses the key risks to achieving business objectives and is conducted at the business unit level. The DRA process creates a single, divisional-level view of risk across all QBE risk categories. The top risks process involves the identification and assessment of the key risks relating to the Group and each division by their respective CEOs. The emerging risks process identifies and assesses new risks, which are characterised by incomplete but developing knowledge or existing risks that develop in new or surprising ways. The scenario analysis process assesses the impact of potentially extreme scenarios and the appropriateness of our contingency planning.

QBE manages operational risk through various systems, controls and processes, including effective segregation of duties, access controls, authorisations and reconciliation procedures, business continuity management, fraud management, information security and physical security. QBE monitors operational risk through control assurance, key risk indicators and internal loss events and issues and actions. Another key tool used by QBE is the targeted risk review process whereby reviews are conducted to identify whether there are any unmitigated risks or inadequacies in control design and provide recommendations to enhance the management of risk. The reviews are generally conducted by the Group's risk management and compliance function (the second line of defence) and involve various risk management techniques and approaches.

# 5. CAPITAL STRUCTURE

## Overview

QBE's objective in managing capital is to maintain an optimal balance between debt and equity in order to reduce the overall cost of capital whilst satisfying the capital adequacy requirements of regulators and rating agencies, providing financial security for our policyholders and continuing to provide an adequate return to shareholders.

QBE is listed on the ASX and its equity is denominated in Australian dollars. The Group also accesses international debt markets to diversify its funding base and maintain an appropriate amount of leverage. Debt is diversified across currencies, tenure and levels of seniority. The Group targets a benchmark debt to equity ratio of between 25% to 35%.

Details of the Group's approach to capital risk management are disclosed in note 4.1.

## 5.1 Borrowings

| FINAL MATURITY DATE | PRINCIPAL AMOUNT | 2016 US$M | 2015 US$M |
|---|---|---|---|
| **Bank loans** | | | |
| 29 March 2017 | $10 million | **10** | – |
| | | **10** | – |
| **Senior debt** | | | |
| 1 May 2018 | $600 million | **599** | 599 |
| | | **599** | 599 |
| **Subordinated debt** | | | |
| 29 September 2040 | A$200 million | **144** | 145 |
| 24 May 2041 | $167 million (2015 $1,000 million) | **167** | 1,000 |
| 24 May 2041 | £34 million (2015 £325 million) | **42** | 479 |
| 24 May 2042 | £327 million | **362** | – |
| 24 November 2043 | $400 million | **400** | – |
| 2 December 2044 | $700 million | **695** | 695 |
| 12 November 2045 | $300 million | **300** | 300 |
| 17 June 2046 | $524 million | **455** | – |
| | | **2,565** | 2,619 |
| **Capital securities** | | | |
| No fixed date | Nil (2015 £8 million) | – | 11 |
| No fixed date | $301 million | **300** | 300 |
| | | **300** | 311 |
| Total borrowings [1] | | **3,474** | 3,529 |
| Amounts maturing within 12 months | | **10** | 11 |
| Amounts maturing in greater than 12 months | | **3,464** | 3,518 |
| Total borrowings | | **3,474** | 3,529 |

1 Finance costs of $9 million (2015 $1 million) were capitalised in the year.

### Senior debt

***Senior notes due 2018***

On 1 May 2013, the company issued $600 million of senior notes maturing on 1 May 2018. The notes are unsecured and unsubordinated obligations of the company and will rank equally among themselves and, subject to certain exceptions in relation to ranking, with all other unsecured existing and future unsubordinated indebtedness of the company. Interest of 2.4% per annum is payable half yearly in arrears.

### Subordinated debt

***Subordinated debt due 2040***

On 29 September 2015, the company raised A$200 million through the issue of subordinated debt securities with a 25 year maturity. The securities entitle the holders to receive interest at the 90 day average mid-rate bank bill rate plus a margin of 4%. Interest is paid quarterly in arrears.

# Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2016

The securities are redeemable at the option of QBE, with the written approval of APRA, on 29 September 2020 and on each subsequent interest payment date during the 12 months following or at any time in the event of certain tax and regulatory events.

The securities must be converted into a variable number of QBE ordinary shares, or written off, if APRA determines QBE to be non-viable. The conversion rate is subject to a price floor of 20% of the volume-weighted average price (VWAP) of the shares in the five trading days before the date of issue of the securities.

*Subordinated debt due 2041*

On 24 May 2011, the Group raised $1,000 million and £325 million through the issue of subordinated debt securities with a 30 year maturity.

The securities entitle holders to receive interest at a fixed rate of 7.25% and 7.5% per annum respectively until 24 May 2021, at which time the rate will reset to a 10 year mid-market swap rate plus a margin of 4.05% and 4.0% per annum respectively. The rate will reset again, on the same basis, on 24 May 2031.

The securities are redeemable at the option of QBE, with the written approval of APRA, on 24 May 2021, 24 May 2031, 24 May 2041 or in the event of:

- certain tax and US investment company registration events, which allow a redemption at any time; or
- certain regulatory and rating agency equity credit events which allow redemption at any time after 24 May 2016.

During the year, QBE partially exchanged these securities for new subordinated debt securities, details which are set out below.

On 23 June 2016, QBE repurchased $5 million of these securities for cash.

*Subordinated debt due 2042*

On 19 May 2016, QBE exchanged £291 million of the subordinated debt securities due 2041 for £327 million of subordinated debt securities due 2042. The securities have a 26 year maturity and entitle holders to receive a fixed rate coupon of 6.115% per annum until 24 May 2022. The rate will reset in 2022, 2027, 2032 and 2037 to a rate calculated by reference to the then five year mid-market swap rate plus a margin of 5.0%. Interest is payable semi-annually in arrears.

The securities are redeemable at the option of QBE, with the written approval of APRA, on each interest reset date or at any time in the event of certain tax and regulatory events.

The securities must be converted into a variable number of QBE ordinary shares, or written off, if APRA determines QBE to be non-viable. The conversion rate is subject to a price floor of 20% of the VWAP of the shares in the five trading days before the date of issue of the securities.

*Subordinated debt due 2043*

On 17 November 2016, QBE exchanged $372 million of the subordinated debt securities due 2041 for $372 million of subordinated debt due 2043. On 28 November 2016, QBE raised an additional $28 million through the same subordinated debt issue. The securities have a 27 year maturity and entitle holders to receive a fixed rate coupon of 7.50% per annum until 24 November 2023. The rate will reset in 2023 and 2033 to a rate calculated by reference to the then 10 year US dollar swap rate plus a margin of 6.03%. Interest is payable semi-annually in arrears.

QBE has an option to defer payment of interest in certain circumstances and such deferral will not constitute an event of default. The securities are redeemable at the option of QBE, with the written approval of APRA, on each interest reset date or at any time in the event of certain tax and regulatory events.

The securities must be converted into a variable number of QBE ordinary shares, or written off, if APRA determines QBE to be non-viable. The conversion rate is subject to a price floor of 20% of the VWAP of the shares in the five trading days before the date of issue of the securities.

*Subordinated debt due 2044*

On 2 December 2014, the company raised $700 million through the issue of subordinated debt securities with a 30 year maturity. The securities entitle holders to receive interest at a fixed rate of 6.75% per annum until 2 December 2024, at which time the rate will reset to a 10 year mid-market swap rate plus a margin of 4.3%. The rate will reset again, on the same basis, on 2 December 2034. Interest is payable semi-annually in arrears.

The securities are redeemable at the option of QBE, with the written approval of APRA, on 2 December 2024, 2 December 2034 or at any time in the event of certain tax and regulatory events.

The securities must be converted into a variable number of QBE ordinary shares or written off if APRA determines QBE to be non-viable. The conversion rate is subject to a price floor of 20% of the VWAP of the shares in the five trading days before the date of issue of the securities.

*Subordinated debt due 2045*

On 12 November 2015, the company raised $300 million through the issue of subordinated debt securities with a 30 year maturity. The securities entitle holders to receive interest at a fixed rate of 6.1% per annum until 12 November 2025, at which time the rate will reset to a 10 year mid-market swap rate plus a margin of 3.993%. The rate will reset again, on the same basis, on 12 November 2035. Interest is payable semi-annually in arrears.

The securities are redeemable at the option of QBE, with the written approval of APRA, on 12 November 2025 and 12 November 2035 or at any time in the event of certain tax and regulatory events.

The securities must be converted into a variable number of QBE ordinary shares or written off if APRA determines QBE to be non-viable. The conversion rate is subject to a price floor of 20% of the VWAP of the shares in the five trading days before the date of issue of the securities.

*Subordinated debt due 2046*

On 17 June 2016, QBE exchanged $456 million of the $1,000 million of the subordinated debt securities due 2041 for $524 million of subordinated debt due 2046. The new subordinated debt securities have a 30 year maturity and entitle holders to receive a fixed rate coupon of 5.875% per annum until 17 June 2026. The rate will reset in 2026 and 2036 to a rate calculated by reference to the then 10 year mid-market swap rate plus a margin of 4.395%. Interest is payable semi-annually in arrears.

The securities are redeemable at the option of QBE, with the written approval of APRA, on each interest reset date or at any time in the event of certain tax and regulatory events.

The securities must be converted into a variable number of QBE ordinary shares, or written off, if APRA determines QBE to be non-viable. The conversion rate is subject to a price floor of 20% of the VWAP of the shares in the five trading days before the date of issue of the securities.

*Security arrangements*

The claims of bondholders pursuant to the subordinated debt will be subordinated in right of payment to the claims of all senior creditors.

### Capital securities

In 2006, a controlled entity issued £300 million of capital securities. Between 2008 and 2012, £292 million of capital securities were repurchased by the Group for cash at a discount, and were held on the balance sheets of Group entities as an investment asset. The assets and the corresponding liabilities were eliminated on consolidation in the Group's balance sheet and the interest income and expense was eliminated on consolidation in the profit or loss. On 18 July 2016, QBE repurchased the remaining sterling capital securities and subsequently cancelled them in full.

In 2007, a controlled entity issued $550 million of subordinated capital securities. The subordinated capital securities entitle holders to receive a fixed rate coupon of 6.797% per annum until 1 June 2017, at which time the rate will reset to floating three month US$ LIBOR plus a spread of 2.625%. Between 2008 and 2012, $249 million of capital securities were repurchased by the Group for cash at a discount, and were held on the balance sheets of Group entities as an investment asset. The assets and the corresponding liabilities are eliminated on consolidation in the Group's balance sheet and the interest income and expense is eliminated on consolidation in the profit or loss.

### 5.1.1 Fair value of borrowings

| | 2016 US$M | 2015 US$M |
|---|---|---|
| Bank loans | **10** | – |
| Senior debt | **601** | 601 |
| Subordinated debt | **2,833** | 2,813 |
| Capital securities | **304** | 322 |
| Total borrowings | **3,748** | 3,736 |

Consistent with other financial instruments, QBE is required to disclose the basis of valuation with reference to the fair value hierarchy which is explained in detail in note 3.2.1. The fair value of the Group's borrowings are categorised as level 2 fair value measurements. Fixed and floating rate securities are priced using broker quotes and comparable prices for similar instruments in active markets. Where no active market exists, floating rate resettable notes are priced using par plus accrued interest.

## How we account for the numbers

Borrowings are initially measured at fair value net of transaction costs directly attributable to the transaction and are subsequently measured at amortised cost. Any difference between the proceeds and the redemption amount is recognised through profit or loss over the period of the financial liability using the effective interest method.

# Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2016

### 5.1.2 Financing and other costs

| | 2016 US$M | 2015 US$M |
|---|---|---|
| Financing costs | 252 | 244 |
| Other costs [1] | 42 | – |
| Total financing and other costs | 294 | 244 |

1 Includes $12 million write down of contingent consideration recognised on the sale of Australian agencies in 2015 and a $30 million cost of discontinuing certain North American agency relationships.

## 5.2 Cash and cash equivalents

| | 2016 US$M | 2015 US$M |
|---|---|---|
| Fixed interest rate | 30 | 29 |
| Floating interest rate | 817 | 633 |
| | 847 | 662 |

**Restrictions on use**

Included in cash and cash equivalents are amounts totalling $78 million (2015 $63 million) which are held in Lloyd's syndicate trust funds. In order to conduct underwriting business within some territories, Lloyd's syndicates are required to lodge assets in locally regulated trust funds. Under Lloyd's byelaws, these amounts can only be used to pay claims and allowable expenses of the syndicates and cannot be withdrawn from the trust funds until allowed to be distributed as profit once annual solvency requirements are met.

QBE has operations in many countries which have foreign exchange controls and regulations. The nature of the controls and regulations is highly dependent on the relevant country's banking practices, and these practices can vary from simple reporting requirements to outright prohibition of movement of funds without explicit prior central bank approval. The impact of these controls and regulations may be the restriction of the Group's capacity to repatriate capital and/or profits. Whilst QBE's operations in these countries are generally small, foreign exchange controls and regulations may impact our ability to repatriate funds.

### How we account for the numbers

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

The reconciliation of profit after income tax to cash flows from operating activities is included in note 8.3.

# 5.

## 5.3 Equity and reserves

### Overview

Ordinary shares in the company rank after all creditors, 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.

### 5.3.1 Share capital

| | 2016 | | 2015 | |
|---|---|---|---|---|
| | NUMBER OF SHARES MILLIONS | US$M | NUMBER OF SHARES MILLIONS | US$M |
| Issued ordinary shares, fully paid at 1 January | **1,370** | **8,440** | 1,383 | 9,391 |
| Shares issued under the Employee Share and Option Plan | **–** | **1** | – | 3 |
| Shares issued under dividend reinvestment plans | **–** | **–** | 7 | 56 |
| Foreign exchange | **–** | **(91)** | – | (1,010) |
| Issued ordinary shares, fully paid at 31 December | **1,370** | **8,350** | 1,370 | 8,440 |
| Shares notified to the Australian Securities Exchange | **1,371** | **8,357** | 1,371 | 8,448 |
| Less: Plan shares subject to non-recourse loans, derecognised under IFRS | **(1)** | **(7)** | (1) | (8) |
| Issued ordinary shares, fully paid at 31 December | **1,370** | **8,350** | 1,370 | 8,440 |

# Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2016

### 5.3.2 Reserves

| | 2016 US$M | 2015 US$M |
|---|---|---|
| **Owner occupied property revaluation reserve** [1] | | |
| At 1 January | 9 | 10 |
| Valuation (decrease) increase | (1) | 1 |
| Reclassification on disposal of owner occupied property | (6) | – |
| Deferred taxation | 2 | – |
| Foreign exchange | 3 | (2) |
| At 31 December | 7 | 9 |
| **Cash flow hedges reserve** [2] | | |
| At 1 January | – | 1 |
| Transfers into reserve | – | (1) |
| At 31 December | – | – |
| **Foreign currency translation reserve** [3] | | |
| At 1 January | (1,426) | (1,541) |
| (Losses) gains on translation | (443) | 377 |
| Reclassification to profit or loss on disposal | – | 53 |
| Losses on hedging transactions | (31) | (356) |
| Taxation | 33 | 41 |
| At 31 December | (1,867) | (1,426) |
| **Share-based payment reserve** [4] | | |
| At 1 January | 208 | 185 |
| Options and conditional rights expense | 58 | 59 |
| Transfers from reserve on vesting of options and conditional rights | (38) | (18) |
| Foreign exchange | (8) | (18) |
| At 31 December | 220 | 208 |
| **Associates** [5] | | |
| At 1 January | 1 | 1 |
| Movement in the year | – | – |
| At 31 December | 1 | 1 |
| ***Premium on purchase of non-controlling interests*** [6] | | |
| At 1 January | (40) | (61) |
| Net changes in non-controlling interests | 25 | – |
| Reclassification to retained profits on disposal | – | 15 |
| Foreign exchange | – | 6 |
| At 31 December | (15) | (40) |
| Total reserves at 31 December | (1,654) | (1,248) |

1 Used to recognise fair value movements in the carrying value of owner occupied property.

2 Used to record gains or losses on cash flow hedges that are recognised directly in equity.

3 Exchange gains and losses arising on translation of a foreign controlled entity and related hedging instruments are taken to the foreign currency translation reserve. Refer to note 1.2.3. In the event of the disposal of a relevant net investment, the related movement in the reserve is reclassified to profit or loss.

4 Used to recognise the fair value of instruments issued as share-based payments.

5 Used to recognise the Group's share of other comprehensive income of associates.

6 Used to recognise movements in ownership interest that do not result in a change of control and represents the difference between the amount by which the non-controlling interest is adjusted and the fair value of the consideration paid or received.

## 5.4 Dividends

### Overview

The Group's dividend policy sets the dividend payout ratio at up to 65% of full year cash profit with a likely weighting of 40% for the interim dividend and 60% for the final.

| | 2016 | 2015 | |
|---|---|---|---|
| | INTERIM | FINAL | INTERIM |
| Dividend per share (Australian cents) | 21 | 30 | 20 |
| Franking percentage | 50% | 100% | 100% |
| Franked amount per share (Australian cents) | 10.5 | 30.0 | 20.0 |
| Dividend payout (A$M) | 288 | 411 | 274 |
| Payment date | 28 September 2016 | 14 April 2016 | 2 October 2015 |

On 24 February 2017, the directors announced a 50% franked final dividend of 33 Australian cents per share payable on 13 April 2017. The final dividend payout is A$453 million (2015 A$411 million).

| | 2016 US$M | 2015 US$M |
|---|---|---|
| Previous year final dividend on ordinary shares – fully franked | 317 | 228 |
| Interim dividend on ordinary shares – 50% franked (2015 fully franked) | 220 | 193 |
| Bonus Share Plan dividend forgone | (2) | (6) |
| Total dividend paid | 535 | 415 |

### Dividend Reinvestment and Bonus Share Plans

The company operates a Dividend Reinvestment Plan (DRP) and a Bonus Share Plan (BSP) which allow equity holders to receive their dividend entitlement in the form of QBE ordinary shares.

The last date of receipt of election notices to participate in the DRP or the BSP is 13 March 2017.

### Bonus Share Plan dividend forgone

The amount paid in dividends during the year has been reduced as a result of certain eligible shareholders participating in the BSP and forgoing all or part of their right to dividends. These shareholders were issued ordinary shares under the BSP. During the year 320,027 (2015 566,968) ordinary shares were issued under the BSP.

### Franking credits

The franking account balance on a tax paid basis at 31 December 2016 was a surplus of A$301 million (2015 A$391 million). After taking into account the impact of franking on the final dividend recommended by the Board since year end, but not recognised as a liability at year end, the franking account balance will have a surplus of A$113 million (2015 A$171 million).

The unfranked part of the dividend is declared to be conduit foreign income. For shareholders not resident in Australia, the dividend will not be subject to Australian withholding tax.

# Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2016

## 5.5 Earnings per share

### Overview

Earnings per share (EPS) is the amount of profit after tax attributable to each share. Diluted EPS adjusts the EPS for the impact of shares that are not yet issued but which may be in the future, such as shares potentially issuable from convertible notes, options and employee share-based payments plans.

| | 2016 US CENTS | 2015 US CENTS |
|---|---|---|
| Basic earnings per share | 61.6 | 50.3 |
| Diluted earnings per share | 60.8 | 49.8 |

### 5.5.1 Reconciliation of earnings used in calculating earnings per share

| | 2016 US$M | 2015 US$M |
|---|---|---|
| Net profit after income tax attributable to ordinary equity holders of the company used in calculating basic earnings per share | 844 | 687 |
| Add: finance costs of convertible securities | – | – |
| Earnings used in calculating diluted earnings per share | 844 | 687 |

### 5.5.2 Reconciliation of weighted average number of ordinary shares used in calculating earnings per share

| | 2016 NUMBER OF SHARES MILLIONS | 2015 NUMBER OF SHARES MILLIONS |
|---|---|---|
| Weighted average number of ordinary shares on issue | 1,371 | 1,368 |
| Weighted average number of non-recourse loan shares issued under the Employee Share and Option Plan (the Plan) | (1) | (1) |
| Weighted average number of ordinary shares used as the denominator in calculating basic earnings per share | 1,370 | 1,367 |
| Weighted average number of dilutive potential ordinary shares issued under the Plan | 19 | 13 |
| Weighted average number of ordinary shares used as the denominator in calculating diluted earnings per share | 1,389 | 1,380 |

### How we account for the numbers

**Basic earnings per share**

Basic earnings per share is calculated by dividing net profit after income tax attributable to members of the company, adjusted for the cost of servicing equity other than ordinary shares, by the weighted average number of ordinary shares outstanding during the financial year, adjusted for bonus elements in ordinary shares issued during the year.

**Diluted earnings per share**

Diluted earnings per share adjusts the earnings figure used in the determination of basic earnings per share to exclude the after income tax effect of interest and other financing costs associated with dilutive potential ordinary shares, and adjusts the weighted average number of shares assumed to have been issued for no consideration. It also adjusts the weighted average number of shares to include dilutive potential ordinary shares and instruments with a mandatory conversion feature.

## 5.6 Derivatives

### Overview

Derivatives may be used as a tool to hedge the Group's foreign exchange exposures. Each controlled entity manages operational foreign exchange volatility by matching liabilities with assets of the same currency, as far as practicable. Forward foreign exchange contracts are used to hedge residual currency exposures, with both the foreign exchange and derivatives impact reported through profit or loss. Forward foreign exchange contracts are also used to hedge the company's exposure to its net investments in foreign operations.

Interest rate swaps are used to hedge exposure to interest rate movements on the Group's borrowings.

Refer to note 4.4 for additional information relating to QBE's approach to managing interest rate risk and currency risk.

The Group's exposure to treasury derivatives at the balance date is set out in the table below:

| | 2016 | | | 2015 | | |
|---|---|---|---|---|---|---|
| | EXPOSURE US$M | FAIR VALUE ASSET US$M | FAIR VALUE LIABILITY US$M | EXPOSURE US$M | FAIR VALUE ASSET US$M | FAIR VALUE LIABILITY US$M |
| Forward foreign exchange contracts | 1,731 | 161 | 147 | 908 | 33 | 35 |
| Interest rate swaps | 144 | – | – | 145 | – | – |

### How we account for the numbers

Derivatives are initially recognised at fair value and are subsequently re-measured at fair value through profit or loss unless hedge accounting is applied. 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. The mark-to-market value of futures positions is cash settled on a daily basis.

In accordance with the criteria for hedge accounting, when a financial instrument is designated as being in a hedge relationship, the relevant controlled entity formally documents the relationship between the hedging instrument and hedged item, as well as its risk management objectives and its strategy for undertaking various hedging transactions. The relevant entity also documents its assessment, both at hedge inception and on an ongoing basis, of whether the hedging instruments are highly effective in offsetting changes in fair values, cash flows or net investments in foreign operations.

Hedge accounting is discontinued when:

- the hedge no longer meets the criteria for hedge accounting;
- the hedging instrument expires or is sold, terminated or exercised;
- the hedged item matures, is sold or repaid; or
- the entity revokes the designation.

For qualifying cash flow hedges and hedges of net investments in foreign operations, the gain or loss associated with the effective portion of the hedge is initially recognised directly in other comprehensive income. The gain or loss on any ineffective portion of the hedging instrument is recognised through profit or loss immediately. In a cash flow hedge, when a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is reclassified to profit or loss when the hedged item affects profit or loss. When a transaction is no longer expected to occur, the cumulative gain or loss that was recognised in equity is immediately reclassified to profit or loss. In hedges of net investments in foreign operations, the cumulative gain or loss is recycled to profit or loss on disposal.

# 6. TAX

## Overview

Income tax expense is the accounting tax charge for the period and is calculated as the tax payable on the current period 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 unused tax losses. The relationship between accounting profit and income tax expense is provided in the reconciliation of prima facie tax to income tax expense (note 6.1). Income tax expense does not equate to the amount of tax actually paid to tax authorities around the world, as it is based upon the accrual accounting concept.

Accounting income and expenses do not always have the same recognition pattern as taxable income and expenses, creating a timing difference as to when a tax expense or benefit can be recognised. These differences usually reverse over time but until they do, a deferred tax asset or liability is recognised on the balance sheet. Note 6.2 details the composition and movements in deferred tax balances and the key management assumptions applied in recognising tax losses.

The Group's approach to managing tax risk is disclosed in note 4.1.

Details of franking credits available to shareholders are disclosed in note 5.4.

## 6.1 Income tax

**Reconciliation of prima facie tax to income tax expense**

| | NOTE | 2016 US$M | 2015 US$M |
|---|---|---|---|
| Profit before income tax | | **1,072** | 953 |
| Prima facie tax expense at 30% | | **322** | 286 |
| Tax effect of non-temporary differences: | | | |
| Untaxed dividends | | **(6)** | (10) |
| Differences in tax rates | | **(58)** | (40) |
| Other, including non-allowable expenses and non-taxable income | | **10** | (5) |
| Prima facie tax adjusted for non-temporary differences | | **268** | 231 |
| Deferred tax assets (re-recognised) de-recognised | | **(51)** | 56 |
| Under (over) provision in prior years | | **11** | (27) |
| Income tax expense | | **228** | 260 |
| Analysed as follows: | | | |
| Current tax | | **269** | 287 |
| Deferred tax | | **(52)** | – |
| Under (over) provision in prior years | | **11** | (27) |
| | | **228** | 260 |
| Deferred tax (credit) expense comprises: [1] | | | |
| Deferred tax assets recognised in profit or loss | 6.2.1 | **(50)** | (38) |
| Deferred tax liabilities recognised in profit or loss | 6.2.2 | **(2)** | 38 |
| | | **(52)** | – |

1 Consolidated deferred tax expense includes $3 million charged (2015 $1 million credited) to profit as a result of changes in income tax rates.

6.

## How we account for the numbers

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 in which controlled entities 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 and establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Current tax assets and tax liabilities are offset where the entity has a legally enforceable right to offset and intends to either settle on a net basis or to realise the asset and settle the liability simultaneously. 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.

## 6.2 Deferred income tax

| | NOTE | 2016 US$M | 2015 US$M |
|---|---|---|---|
| Deferred tax assets | 6.2.1 | **778** | 767 |
| Deferred tax liabilities | 6.2.2 | **106** | 176 |

### 6.2.1 Deferred tax assets

The balance comprises temporary differences attributable to:

| | NOTE | 2016 US$M | 2015 US$M |
|---|---|---|---|
| **Amounts recognised in profit and loss** | | | |
| Financial assets – fair value movements | | **4** | 4 |
| Provision for impairment | | **20** | 20 |
| Employee benefits | | **83** | 77 |
| Intangible assets | | **219** | 177 |
| Insurance provisions | | **532** | 582 |
| Tax losses recognised | | **434** | 385 |
| Other | | **128** | 147 |
| | | **1,420** | 1,392 |
| **Amounts recognised in other comprehensive income and equity** | | | |
| Capitalised expenses | | **1** | 2 |
| Defined benefit plans | | **54** | 50 |
| Other | | **3** | 2 |
| | | **58** | 54 |
| **Deferred tax assets before set-off** | | **1,478** | 1,446 |
| Set-off of deferred tax liabilities | 6.2.2 | **(700)** | (679) |
| | 6.2 | **778** | 767 |
| **Deferred tax assets before set-off analysed as follows:** | | | |
| Recoverable within 12 months | | **74** | 64 |
| Recoverable in greater than 12 months | | **1,404** | 1,382 |
| | | **1,478** | 1,446 |

**Movements:**

| | NOTE | 2016 US$M | 2015 US$M |
|---|---|---|---|
| At 1 January | | **1,446** | 1,458 |
| Amounts recognised in profit or loss | 6.1 | **50** | 38 |
| Amounts recognised in other comprehensive income | | **4** | (7) |
| Foreign exchange | | **(22)** | (43) |
| At 31 December | | **1,478** | 1,446 |

# Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2016

### 6.2.2 Deferred tax liabilities

The balance comprises temporary differences attributable to:

| | NOTE | 2016 US$M | 2015 US$M |
|---|---|---|---|
| **Amounts recognised in profit and loss** | | | |
| Intangible assets | | 189 | 127 |
| Insurance provisions | | 481 | 565 |
| Financial assets – fair value movements | | 15 | 9 |
| Other provisions | | 37 | 37 |
| Other | | 82 | 107 |
| | | 804 | 845 |
| **Amounts recognised in other comprehensive income and equity** | | | |
| Owner occupied property | | 1 | 3 |
| Defined benefit plans | | 1 | 7 |
| | | 2 | 10 |
| **Deferred tax liabilities before set-off** | | 806 | 855 |
| Set-off of deferred tax assets | 6.2.1 | (700) | (679) |
| | 6.2 | 106 | 176 |
| **Deferred tax liabilities before set-off analysed as follows:** | | | |
| Recoverable within 12 months | | 20 | 21 |
| Recoverable in greater than 12 months | | 786 | 834 |
| | | 806 | 855 |

**Movements:**

| | NOTE | 2016 US$M | 2015 US$M |
|---|---|---|---|
| At 1 January | | 855 | 854 |
| Amounts recognised in profit or loss | 6.1 | (2) | 38 |
| Amounts recognised in other comprehensive income | | (8) | (1) |
| Foreign exchange | | (39) | (36) |
| At 31 December | | 806 | 855 |

## How we account for the numbers

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 consolidated financial statements. Deferred tax liabilities are not recognised if they arise from the initial recognition of goodwill or if they arise from the 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 substantively 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 in the consolidated financial statements 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.

### 6.2.3 Tax losses

The Group has not brought to account $182 million (2015 $225 million) of tax losses, which includes the benefit arising from tax losses in overseas countries. $118 million of tax losses not brought to account have a life of between 2 and 20 years with the majority expiring in 15 to 18 years, and $74 million have an indefinite life. This benefit will only be brought to account when the directors believe it is probable that it will be realised.

This benefit of tax losses will only be obtained if:

- the Group derives future assessable income of a nature and an amount sufficient to enable the benefit from the deductions for the losses to be realised;
- the Group continues to comply with the conditions for deductibility imposed by tax legislation; and
- no changes in tax legislation adversely affect the Group in realising the benefit from the deductions for the losses.

## Critical accounting judgements and estimates

**Recoverability of deferred tax assets**

QBE assesses the recoverability of deferred tax assets at each balance date. In making this assessment, QBE considers in particular the controlled entity's future business plans, history of generating taxable profits, whether the unused tax losses resulted from identifiable causes which are unlikely to recur and if any tax planning opportunities exist in the period in which the taxable losses can be utilised.

In North American Operations, a deferred tax asset of $573 million (2015 $573 million) continues to be recognised, comprising $388 million (2015 $333 million) of carry forward tax losses and $185 million (2015 $240 million) of deductible temporary differences, net of applicable offsetting deferred tax liabilities, as a result of insurance technical reserves and the tax deductibility of goodwill and other intangibles. Uncertainty continues to exist in relation to the utilisation of this asset which is subject to there being continued future taxable profits over the period of time in which the losses can be utilised. QBE has made a judgement that North American Operations will be able to generate sufficient taxable profits over the foreseeable future, based upon its future business plans. Key assumptions include a continuation of taxable profit driven by no material deterioration in the prior accident year central estimate, a sustained return of crop profitability to historical averages, benefits flowing from initiatives to reduce the cost base of the division and future increases in investment yields.

Losses expire over the next 20 years, with the majority expiring between 2030 and 2034. The uncertainty around the recognition of the deferred tax asset will be resolved in future years if taxable profits are generated. Recovery of the asset continues to be sensitive to changes in the combined operating ratio, premium growth and investment yield assumptions as these items are the key drivers of future taxable income.

There is prevailing uncertainty about potential changes to the North American corporate tax rate. If this was reduced by 5%, everything else being equal, the North American Operations deferred tax asset would be written down by $82 million.

### 6.2.4 Tax consolidation legislation

On adoption of the tax consolidation legislation, the company and its wholly-owned Australian controlled entities entered into a tax sharing and tax funding agreement that requires the Australian entities to fully compensate the company for current tax liabilities and to be fully compensated by the company for any current tax or deferred tax assets in respect of tax losses arising from external transactions occurring after the date of implementation of the tax consolidation legislation. The contributions are allocated by reference to the notional taxable income of each Australian entity. The head entity is QBE Insurance Group Limited.

# Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2016

## 7. GROUP STRUCTURE

### Overview

This section provides information to help users understand the QBE Group structure, including the impact of changes in the financial year. This includes acquisitions and disposals of businesses, intangible assets acquired or developed and the results of impairment reviews.

## 7.1 Acquisitions, disposals and assets held for sale

### 7.1.1 Acquisitions and disposals

There have been no significant acquisitions or disposals in the current financial year.

In 2015, the following non-core businesses were disposed of:

- North American agencies (Community Association Underwriters, Deep South and SIU) were sold on 2 February 2015.
- Australian agencies (CHU, Corporate Underwriting Agencies and Underwriting Agencies of Australia) were sold on 1 April 2015.
- Argentine workers' compensation business was sold on 10 August 2015.
- North American Mortgage & Lender Services business was sold on 1 October 2015.

A summary of the impact of each disposal on the financial statements is included in the table below.

| 2015 | AUSTRALIAN AGENCIES US$M | US AGENCIES US$M | ARGENTINE WORKERS' COMPENSATION US$M | MORTGAGE & LENDER SERVICES US$M | OTHER US$M | TOTAL US$M |
|---|---|---|---|---|---|---|
| Underwriting expenses | – | – | – | (41) | – | (41) |
| Gain (loss) on sale of entities | 130 | 12 | (56) | (92) | 6 | (2) |
| | 130 | 12 | (56) | (133) | 6 | (43) |

### 7.1.2 Assets held for sale

Controlled entities with net assets of $13 million (2015 nil) classified as held for sale at the balance date were QBE Chile Seguros Generales, QBE Life (Australia) Limited, Blue Ridge Indemnity Company and Southern Guaranty Insurance Company. On classification as held for sale, an unrealised impairment loss of $3 million (2015 nil) was recognised in profit or loss.

## 7.2 Intangible assets

### Overview

Intangible assets are assets with no physical substance. The most significant classes of intangible assets are detailed below:

**Lloyd's syndicate capacity**

The Lloyd's syndicate capacity intangible asset relates to the syndicate capacity acquired as part of the acquisition of QBE Underwriting Limited (formerly trading as Limit) in 2000 and costs incurred as a result of increasing capacity since that date. Syndicate capacity is the aggregate of the premium limits of each member of that syndicate at a point in time. An existing capital provider has the first right to participate on the next year of account, giving the indefinite right to participate on all future years of account. The Group has demonstrated a long-term commitment to developing its operations at Lloyd's. The value of this asset is in the access it gives to future underwriting profits at Lloyd's. For these reasons, Lloyd's syndicate capacity is deemed to have an indefinite useful life.

**Customer relationships**

Customer relationships comprise the capitalisation of future profits relating to insurance contracts acquired and the expected renewal of those contracts. It also includes the value of the distribution networks and agency relationships. Customer relationships are amortised over remaining lives of between five and 25 years depending on the classes of business to which the assets relate.

**Brand names**

These assets reflect the revenue generating ability of acquired brands. In some circumstances, brand names are considered to have an indefinite useful life due to the long-term nature of the asset. When there is a contractual limit on the use of the brand name, the asset is amortised over the remaining period, being in the range of five to 20 years.

**Insurance licences**

These assets give the Group the right to operate in certain geographic locations and to write certain classes of business with a potential to generate additional revenue. They are considered to have an indefinite useful life due to their long-term nature.

**Software**

This includes both acquired and internally developed software which is not integral or closely related to an item of hardware such as an underwriting system. Capitalised software is amortised over periods of up to seven years, reflecting the period during which the Group is expected to benefit from the use of the software.

**Goodwill**

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets acquired. Goodwill has an indefinite useful life and therefore is not subject to amortisation but is tested for impairment annually, or more often if there is an indication of impairment.

| | IDENTIFIABLE INTANGIBLES | | | | | | GOODWILL | TOTAL |
|---|---|---|---|---|---|---|---|---|
| 2016 | LLOYD'S SYNDICATE CAPACITY US$M | CUSTOMER RELATION-SHIPS US$M | BRAND NAMES US$M | INSURANCE LICENSES US$M | SOFTWARE US$M | OTHER US$M | US$M | US$M |
| **Cost** | | | | | | | | |
| At 1 January | 81 | 878 | 31 | 50 | 152 | 43 | 3,190 | 4,425 |
| Additions/reclassifications | – | 130 | – | – | 93 | – | – | 223 |
| Disposals/transfer to assets held for sale | – | (5) | – | (2) | – | – | (2) | (9) |
| Impairment | – | (1) | – | – | – | – | (2) | (3) |
| Foreign exchange | (13) | (13) | – | – | (33) | (1) | (94) | (154) |
| At 31 December | 68 | 989 | 31 | 48 | 212 | 42 | 3,092 | 4,482 |
| **Amortisation** | | | | | | | | |
| At 1 January | – | (692) | (22) | – | (73) | (34) | – | (821) |
| Disposals | – | 3 | – | – | – | – | – | 3 |
| Amortisation [1] | – | (40) | – | – | (29) | (2) | – | (71) |
| Foreign exchange | – | 13 | – | – | 21 | – | – | 34 |
| At 31 December | – | (716) | (22) | – | (81) | (36) | – | (855) |
| **Carrying amount** | | | | | | | | |
| At 31 December | 68 | 273 | 9 | 48 | 131 | 6 | 3,092 | 3,627 |

1 Amortisation of $29 million is included in underwriting expenses as it relates to intangible assets integral to the Group's underwriting activities.

# Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2016

| 2015 | IDENTIFIABLE INTANGIBLES<br>LLOYD'S SYNDICATE CAPACITY US$M | CUSTOMER RELATION-SHIPS US$M | BRAND NAMES US$M | INSURANCE LICENSES US$M | SOFTWARE US$M | OTHER US$M | GOODWILL<br>US$M | TOTAL<br>US$M |
|---|---|---|---|---|---|---|---|---|
| **Cost** | | | | | | | | |
| At 1 January | 85 | 938 | 38 | 50 | 59 | 35 | 3,408 | 4,613 |
| Additions/reclassifications | – | 23 | – | – | 106 | 9 | 6 | 144 |
| Disposals | – | (10) | (3) | – | (3) | – | (30) | (46) |
| Impairment | – | (44) | – | – | (2) | – | (1) | (47) |
| Foreign exchange | (4) | (29) | (4) | – | (8) | (1) | (193) | (239) |
| At 31 December | 81 | 878 | 31 | 50 | 152 | 43 | 3,190 | 4,425 |
| **Amortisation** | | | | | | | | |
| At 1 January | – | (667) | (24) | – | (58) | (33) | – | (782) |
| Amortisation [1] | – | (47) | – | – | (25) | (2) | – | (74) |
| Disposals | – | 8 | 1 | – | 3 | – | – | 12 |
| Foreign exchange | – | 14 | 1 | – | 7 | 1 | – | 23 |
| At 31 December | – | (692) | (22) | – | (73) | (34) | – | (821) |
| **Carrying amount** | | | | | | | | |
| At 31 December | 81 | 186 | 9 | 50 | 79 | 9 | 3,190 | 3,604 |

1 Amortisation of $26 million is included in underwriting expenses as it relates to intangible assets integral to the Group's underwriting activities.

## How we account for the numbers

Intangible assets are measured at cost less accumulated amortisation and impairment. Those with a finite useful life are amortised over their estimated useful life in accordance with the pattern of expected consumption of economic benefits, with amortisation expense reported in underwriting and other expenses or in amortisation and impairment of intangibles depending on the use of the asset. Intangible assets with an indefinite useful life are not subject to amortisation but are tested for impairment annually or more frequently if there are indicators of impairment. Intangible assets with a finite useful life are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

### 7.2.1 Impairment testing of intangible assets

## Overview

If there are indicators that an intangible asset's recoverable value has fallen below its carrying value (e.g. due to changing market conditions), an impairment test is performed and a loss is recognised for the amount by which the carrying value exceeds the asset's recoverable value. Intangible assets that have an indefinite useful life, such as goodwill, are tested annually for impairment or more frequently where there is an indication that the carrying amount may not be recoverable.

Goodwill is allocated to cash generating units, or groups of units, expected to benefit from synergies arising from the acquisition giving rise to the goodwill. Cash generating units or groups of cash generating units reflect the level at which goodwill is monitored for impairment by management. As the Group continues to acquire operations and reorganise the way that operations are managed, reporting structures may change, giving rise to a reassessment of cash generating units and/or the allocation of goodwill to those cash generating units.

The goodwill relating to certain acquisitions is denominated in currencies other than the US dollar and so is subject to foreign exchange movements.

7.

Goodwill is analysed by groups of cash generating units as follows:

| | 2016 US$M | 2015 US$M |
|---|---|---|
| North American Operations | 1,543 | 1,544 |
| Australian & New Zealand Operations | 1,128 | 1,133 |
| European Operations | 388 | 463 |
| Other[1] | 33 | 50 |
| | 3,092 | 3,190 |

1 None of these cash generating units is individually significant.

### Impairment losses

Intangible assets in Australian & New Zealand Operations of $3 million (2015 North American Operations and Emerging Markets of $47 million) were impaired following management's review of future cash flows attributable to these assets.

## How we account for the numbers

**Impairment testing of identifiable intangible assets**

The recoverable amount of each intangible asset with an indefinite useful life has been determined by reference to a value in use calculation based on the following key assumptions and estimates:

- cash flow forecasts relevant to the initial valuation of the identifiable intangible asset are reviewed and updated (if appropriate) by management. Cash flow forecasts are based on a combination of actual performance to date and management's expectations of future performance based on prevailing and anticipated market factors; and
- discount rates that include a beta and a market risk premium sourced from observable market information and a specific risk premium appropriate to reflect the nature of the risk associated with the intangible asset or the cash generating unit to which the asset is allocated.

**Impairment testing of goodwill**

The recoverable amount of each cash generating unit or group of cash generating units has been determined by reference to a value in use calculation based on the following key assumptions and estimates:

- cash flow forecasts, including investment returns, based on the latest three year business plan which has been approved by the Group Board. These forecasts are based on a combination of historical performance and management's expectations of future performance based on prevailing and anticipated market factors and the benefit of committed cost saving measures;
- terminal value is calculated using a perpetuity growth formula based on the cash flow forecast for year three. Growth rates reflect the long-term average of the countries relevant to the cash generating unit or group of cash generating units and are sourced from observable market information. The terminal growth rates used in management's impairment testing are: North American Operations 2.5% (2015 2.5%), Australian & New Zealand Operations 2.5% (2015 2.5%), European Operations 2.0% (2015 2.0%); and
- discount rates that reflect a beta and a market risk premium sourced from observable market information and a specific risk premium appropriate to reflect the nature of the business of each cash generating unit or group of cash generating units. The pre-tax discount rates used were: North American Operations 11.8% (2015 12.1%), Australian & New Zealand Operations 12.8% (2015 12.1%) and European Operations 9.6% (2015 9.8%). The post-tax discount rates used were: North American Operations 9.25% (2015 9.5%), Australian & New Zealand Operations 9.3% (2015 9.3%) and European Operations 8.0% (2015 8.1%).

## Critical accounting judgements and estimates

Uncertainty continues to exist in relation to the valuation of goodwill in QBE's North American Operations.

QBE has completed an impairment calculation and has determined that the recoverable amount exceeded the carrying value, albeit only by $98 million. The goodwill impairment valuation continues to be highly sensitive to a range of assumptions, in particular to increases in the forecast combined operating ratio used in the terminal value calculation and changes in discount rate and investment return assumptions.

If the terminal value combined operating ratio used was increased by 1.0% compared with QBE's estimate (94.2% to 95.2%), the impairment charge would be $244 million. If the post-tax discount rate was increased by 1.0% (9.25% to 10.25%), the impairment charge would be $456 million. If the long-term investment return was reduced by 1.0% (4.25% to 3.25%), the impairment charge would be $398 million.

# Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2016

## 7.3 Controlled entities

### Overview

This section lists all of the Group's controlled entities. The consolidated financial statements incorporate the assets and liabilities of all entities controlled by the company at 31 December 2016 and the results for the financial year then ended, or for the period during which control existed if the entity was acquired or disposed of during the financial year.

### 7.3.1 Controlled entities

| | COUNTRY OF INCORPORATION/ FORMATION | EQUITY HOLDING 2016 % | EQUITY HOLDING 2015 % |
|---|---|---|---|
| **Ultimate parent entity** | | | |
| QBE Insurance Group Limited | Australia | | |
| **Controlled entities** | | | |
| Anex Jenni & Partner SA | Switzerland | **100.00** | 100.00 |
| Austral Mercantile Collections Pty Limited | Australia | **100.00** | 100.00 |
| Australian Aviation Underwriting Pool Pty Limited | Australia | **100.00** | 100.00 |
| Aviation Insurance Direct Pty Limited | Australia | **100.00** | 100.00 |
| Aviation Underwriters of Asia Pacific Pty Limited | Australia | **100.00** | 100.00 |
| Blue Ridge Indemnity Company | US | **100.00** | 100.00 |
| Burnett & Company, Inc. | US | **100.00** | 100.00 |
| C&C Cornejo & Cornejo CIA LTDA | Ecuador | **99.50** | 99.50 |
| CHU Residentsline Limited (sold 31 March 2016)[1] | UK | **–** | 100.00 |
| CHU Underwriting Agencies (UK) Limited | UK | **100.00** | 100.00 |
| Colonial Insurance Agency Inc | Puerto Rico | **100.00** | 100.00 |
| Confoela SA (in liquidation) | Ecuador | **99.75** | 99.75 |
| Elders Insurance (Underwriting Agency) Pty Limited | Australia | **80.00** | 100.00 |
| Equator Reinsurances Limited | Bermuda | **100.00** | 100.00 |
| FAI Insurances (Fiji) Limited (dormant) | Fiji | **100.00** | 100.00 |
| General Casualty Company of Wisconsin | US | **100.00** | 100.00 |
| General Casualty Insurance Company | US | **100.00** | 100.00 |
| Greenhill BAIA Underwriting GmbH | Germany | **100.00** | 100.00 |
| Greenhill International Insurance Holdings Limited | UK | **100.00** | 100.00 |
| Greenhill Sturge Underwriting Limited | UK | **100.00** | 100.00 |
| Greenhill Underwriting Espana Limited | UK | **100.00** | 100.00 |
| Hoosier Insurance Company | US | **100.00** | 100.00 |
| Insurance Box Holdings Pty Limited | Australia | **83.98** | 78.19 |
| Insurance Box Pty Limited | Australia | **83.98** | 78.19 |
| Lantana Insurance Limited (dissolved 15 January 2016) | Bermuda | **–** | 100.00 |
| Lifeco Re Limited (dissolved 2 February 2016) | UK | **–** | 100.00 |
| Lifeco s.r.o.(dormant) | Czech Republic | **100.00** | 100.00 |
| MMWC Pty Limited | Australia | **100.00** | 100.00 |
| National Farmers Union Property and Casualty Company | US | **100.00** | 100.00 |
| NAU Country Insurance Company | US | **100.00** | 100.00 |
| New Century Finance Corporation | Puerto Rico | **100.00** | 100.00 |
| NIA Underwriting Agency Pty Limited (sold 30 June 2016)[1] | Australia | **–** | 78.19 |
| North Pointe Insurance Company | US | **100.00** | 100.00 |
| OLS S.A. Operador Logistico del Ecuador (in liquidation) | Ecuador | **99.98** | 99.98 |
| Praetorian Insurance Company | US | **100.00** | 100.00 |
| PT QBE General Insurance Indonesia (formerly PT Asuransi QBE Pool Indonesia) | Indonesia | **100.00** | 55.00 |
| QBE (Jersey) GP Limited (dissolved 5 December 2016) | Jersey | **–** | 100.00 |
| QBE (Jersey) GP II Limited | Jersey | **100.00** | 100.00 |
| QBE (PNG) Limited | PNG | **100.00** | 100.00 |
| QBE Administration Services, Inc. | US | **100.00** | 100.00 |
| QBE Agencies Australia Holdings Pty Limited | Australia | **100.00** | 100.00 |

| | COUNTRY OF INCORPORATION/ FORMATION | EQUITY HOLDING 2016 % | 2015 % |
|---|---|---|---|
| QBE Agencies Holdings Pty Limited | Australia | 100.00 | 100.00 |
| QBE Americas, Inc. | US | 100.00 | 100.00 |
| QBE Asegurando LTDA (in liquidation) | Colombia | 100.00 | 100.00 |
| QBE Asia Pacific Holdings Limited | Hong Kong | 100.00 | 100.00 |
| QBE Atlantic, LLC | US | 100.00 | 100.00 |
| QBE Atlasz Ingatlankezelo zrt (in liquidation) | Hungary | 100.00 | 100.00 |
| QBE Brazil Seguros SA | Brazil | 99.99 | 99.99 |
| QBE Capital Funding LP (dissolved on 9 November 2016)[2] | Jersey | – | – |
| QBE Capital Funding II LP[2] | Jersey | – | – |
| QBE Capital Funding III Limited | Jersey | 100.00 | 100.00 |
| QBE Capital Funding IV Limited | Jersey | 100.00 | 100.00 |
| QBE Chile Seguros Generales SA | Chile | 100.00 | 100.00 |
| QBE Compania Argentina de Reaseguros SA | Argentina | 100.00 | 100.00 |
| QBE Corporate Limited | UK | 100.00 | 100.00 |
| QBE de Mexico Compania de Seguros SA de CV | Mexico | 99.99 | 99.99 |
| QBE Denmark A/S | Denmark | 100.00 | 100.00 |
| QBE Emerging Markets Holdings Pty Limited | Australia | 100.00 | 100.00 |
| QBE Employee Share Trust[2] | Australia | – | – |
| QBE European Operations plc | UK | 100.00 | 100.00 |
| QBE European Services Limited | UK | 100.00 | 100.00 |
| QBE European Underwriting Services (Australia) Pty Limited | Australia | 100.00 | 100.00 |
| QBE Finance Holdings (EO) Limited | UK | 100.00 | 100.00 |
| QBE FIRST Enterprises, LLC | US | 100.00 | 100.00 |
| QBE FIRST Property Tax Solutions, LLC | US | 100.00 | 100.00 |
| QBE General Insurance (Hong Kong) Limited | Hong Kong | 100.00 | 100.00 |
| QBE Group Services Pty Ltd | Australia | 100.00 | 100.00 |
| QBE Group Shared Services Limited | UK | 100.00 | 100.00 |
| QBE Holdings (AAP) Pty Limited | Australia | 100.00 | 100.00 |
| QBE Holdings (EO) Limited | UK | 100.00 | 100.00 |
| QBE Holdings (Europe) Limited (in liquidation) | UK | 100.00 | 100.00 |
| QBE Holdings (LMI) Pty Limited (formerly QBE Holdings (LMI) Limited) | Australia | 100.00 | 100.00 |
| QBE Holdings (UK) Limited | UK | 100.00 | 100.00 |
| QBE Holdings, Inc. | US | 100.00 | 100.00 |
| QBE Hongkong & Shanghai Insurance Limited | Hong Kong | 74.47 | 74.47 |
| QBE Insurance (Australia) Limited | Australia | 100.00 | 100.00 |
| QBE Insurance (Europe) Limited | UK | 100.00 | 100.00 |
| QBE Insurance (Fiji) Limited | Fiji | 100.00 | 100.00 |
| QBE Insurance (International) Pty Limited (formerly QBE Insurance (International) Limited) | Australia | 100.00 | 100.00 |
| QBE Insurance (Malaysia) Berhad | Malaysia | 100.00 | 100.00 |
| QBE Insurance (PNG) Limited | PNG | 100.00 | 100.00 |
| QBE Insurance (Singapore) Pte Ltd | Singapore | 100.00 | 100.00 |
| QBE Insurance (Thailand) Public Company Limited[3] | Thailand | 47.48 | 47.47 |
| QBE Insurance (Vanuatu) Limited | Vanuatu | 100.00 | 100.00 |
| QBE Insurance (Vietnam) Company Limited | Vietnam | 100.00 | 100.00 |
| QBE Insurance Corporation | US | 100.00 | 100.00 |
| QBE Insurance Group of Puerto Rico Inc | Puerto Rico | 100.00 | 100.00 |
| QBE Insurance Holdings Pty Limited | Australia | 100.00 | 100.00 |
| QBE Insurance Services (Regional) Limited | UK | 100.00 | 100.00 |
| QBE Investments (Australia) Pty Limited | Australia | 100.00 | 100.00 |
| QBE Investments (North America), Inc. | US | 100.00 | 100.00 |
| QBE Irish Share Incentive Plan[2] | Ireland | – | – |
| QBE Jersey Finance Limited | Jersey | 100.00 | 100.00 |
| QBE Latin America Insurance Holdings Pty Ltd (formerly QBE Latin America Insurance Holdings SL) | Australia | 100.00 | 100.00 |
| QBE Lenders' Mortgage Insurance Limited | Australia | 100.00 | 100.00 |
| QBE Life (Australia) Limited | Australia | 100.00 | 100.00 |
| QBE Management (Ireland) Limited | Ireland | 100.00 | 100.00 |
| QBE Management, Inc. | US | 100.00 | 100.00 |

# Notes to the financial statements CONTINUED

*FOR THE YEAR ENDED 31 DECEMBER 2016*

| | COUNTRY OF INCORPORATION/ FORMATION | EQUITY HOLDING 2016 % | EQUITY HOLDING 2015 % |
|---|---|---|---|
| QBE Management Services (Philippines) Pty Limited | Australia | 100.00 | 100.00 |
| QBE Management Services (UK) Limited | UK | 100.00 | 100.00 |
| QBE Management Services Pty Limited | Australia | 100.00 | 100.00 |
| QBE Marine and Energy Services Pte Limited | Singapore | 100.00 | 100.00 |
| QBE Mortgage Insurance (Asia) Limited | Hong Kong | 100.00 | 100.00 |
| QBE Partner Services (Europe) LLP | UK | 100.00 | 100.00 |
| QBE Re (Europe) Limited | UK | 100.00 | 100.00 |
| QBE Re Services Pty Limited | Australia | 100.00 | 100.00 |
| QBE Regional Companies (N.A.), Inc. | US | 100.00 | 100.00 |
| QBE Reinsurance (Bermuda) Limited (dissolved 26 January 2016) | Bermuda | – | 100.00 |
| QBE Reinsurance Corporation | US | 100.00 | 100.00 |
| QBE Seaboard Insurance Philippines Inc. | Philippines | 59.50 | 59.50 |
| QBE Seguros | Puerto Rico | 100.00 | 100.00 |
| QBE Seguros Colonial SA | Ecuador | 100.00 | 100.00 |
| QBE Seguros La Buenos Aires SA | Argentina | 99.89 | 99.85 |
| QBE Seguros SA | Colombia | 98.85 | 98.79 |
| QBE Services (Europe) Limited | UK | 100.00 | 100.00 |
| QBE Services Inc | Canada | 100.00 | 100.00 |
| QBE SK s.r.o. | Slovakia | 100.00 | 100.00 |
| QBE Specialty Insurance Company | US | 100.00 | 100.00 |
| QBE s.r.o. | Czech Republic | 100.00 | 100.00 |
| QBE Stonington Insurance Holdings Inc | US | 100.00 | 100.00 |
| QBE Strategic Capital Company Pty Limited (formerly Pitt Nominees Pty Limited) | Australia | 100.00 | 100.00 |
| QBE UK Finance GP [2] | UK | – | – |
| QBE UK Finance III Limited (in solvent dissolution) | UK | 100.00 | 100.00 |
| QBE UK Finance IV Limited | UK | 100.00 | 100.00 |
| QBE UK Share Incentive Plan [2] | UK | – | – |
| QBE Underwriting Limited | UK | 100.00 | 100.00 |
| QBE Underwriting Services (Ireland) Limited | Ireland | 100.00 | 100.00 |
| QBE Underwriting Services (UK) Limited | UK | 100.00 | 100.00 |
| QBE Underwriting Services Limited | UK | 100.00 | 100.00 |
| QBE Workers Compensation (NSW) Limited | Australia | 100.00 | 100.00 |
| QBE Workers Compensation (SA) Limited | Australia | 100.00 | 100.00 |
| QBE Workers Compensation (VIC) Limited | Australia | 100.00 | 100.00 |
| Queensland Insurance (Investments) Limited | Fiji | 100.00 | 100.00 |
| Regent Insurance Company | US | 100.00 | 100.00 |
| Ridgwell Fox & Partners (Underwriting Management) Limited | UK | 100.00 | 100.00 |
| Sinkaonamahasarn Company Limited [4] | Thailand | 49.00 | 49.00 |
| Southern Fire & Casualty Company | US | 100.00 | 100.00 |
| Southern Guaranty Insurance Company | US | 100.00 | 100.00 |
| Southern National Risk Management Corporation | US | 100.00 | 100.00 |
| Southern Pilot Insurance Company | US | 100.00 | 100.00 |
| Standfast Corporate Underwriters Limited | UK | 100.00 | 100.00 |
| Stonington Insurance Company | US | 100.00 | 100.00 |
| Strakh-Consult (in liquidation) | Ukraine | 100.00 | 100.00 |
| Trade Credit Underwriting Agency NZ Limited | NZ | 100.00 | 100.00 |
| Trade Credit Underwriting Agency Pty Limited | Australia | 100.00 | 100.00 |
| Unigard Indemnity Company | US | 100.00 | 100.00 |
| Unigard Insurance Company | US | 100.00 | 100.00 |
| Westwood Insurance Agency | US | 100.00 | 100.00 |

1 The disposal of CHU Residentsline Limited and NIA Underwriting Agency Pty Limited during the year had an immaterial impact on the consolidated financial statements.

2 QBE Employee Share Trust, QBE Irish Share Incentive Plan, QBE UK Share Incentive Plan, QBE Capital Funding LP (dissolved on 9 November 2016), QBE Capital Funding II LP and QBE UK Finance GP have been included in the consolidated financial statements as these entities are special purpose entities that exist for the benefit of the Group.

3 For accounting purposes, QBE has management control of QBE Insurance (Thailand) Public Company Limited by reference to management agreements.

4 Although QBE has less than a 50% equity interest in Sinkaonamahasarn Company Limited, controlled entities have the right to acquire the remaining share capital.

All equity in controlled entities is held in the form of shares or through contractual arrangements.

## How we account for the numbers

**Controlled entities**

Control exists when the Group 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. 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, balance sheet and statement of changes in equity.

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 ownership of a controlled entity without the gain or loss of control is accounted for as an equity transaction.

# Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2016

## 8. OTHER

### Overview

This section includes other information that must be disclosed to comply with the Australian Accounting Standards or the *Corporations Act 2001*.

### 8.1 Other accounting policies

#### 8.1.1 New and amended standards adopted by the Group

The Group adopted the following new or revised accounting standards which became effective for the annual reporting period commencing on 1 January 2016.

| TITLE | |
|---|---|
| AASB 2015–1 | Annual improvements to Australian Accounting Standards 2012 – 2014 Cycle |
| AASB 2015–2 | Disclosure Initiative: Amendments to AASB 101 |
| AASB 2015–3 | Amendments to Australian Accounting Standards arising from the Withdrawal of AASB 1031 Materiality |
| AASB 2015–5 | Investment Entities: Applying the Consolidation Exception |
| AASB 2014–3 | Accounting for Acquisitions of Interests in Joint Operations |
| AASB 2014–4 | Clarification of Acceptable Methods of Depreciation and Amortisation |
| AASB 2014–9 | Equity Method in Separate Financial Statements |

The adoption of these new or revised standards did not materially affect the Group's accounting policies or financial statements.

#### 8.1.2 New accounting standards and amendments issued but not yet effective

| TITLE | | OPERATIVE DATE |
|---|---|---|
| AASB 2016–1 | Recognition of Deferred Tax Assets for Unrealised Losses | 1 January 2017 |
| AASB 2016–2 | Disclosure Initiative: Amendments to AASB 107 | 1 January 2017 |
| AASB 9 | Financial Instruments | 1 January 2018 |
| AASB 15 | Revenue from Contracts with Customers | 1 January 2018 |
| AASB 2014–10 | Sale or Contribution of Assets between an Investor and its Associates or Joint Venture | 1 January 2018 |
| AASB 2016–5 | Classification and Measurement of Share-based Payment Transactions | 1 January 2018 |
| AASB 2016–6 | Applying AASB 9 Financial Instruments with AASB 4 Insurance Contracts | 1 January 2018 |
| AASB 16 | Leases | 1 January 2019 |

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

The Group currently plans to 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 Group's financial statements.

AASB 9 was issued during 2014 and will replace existing accounting requirements for financial instruments. Currently, the Group's investments are designated as at fair value through profit or loss on initial recognition and are subsequently remeasured to fair value at each reporting date, reflecting the business model applied by the Group to manage and evaluate its investment portfolio. Under this business model, the adoption of AASB 9 is not expected to result in significant changes to accounting for investments, with the exception of certain equity investments which are held by the Group for strategic purposes. Any changes to the Group's investment business model prior to the adoption of AASB 9 will require the impact of adoption to be reassessed and could result in a different outcome when accounting for investments. Other changes to the accounting for the Group's financial instruments arising from the application of AASB 9 are currently expected to be minimal.

AASB 16 was issued during 2016 and will replace existing accounting requirements for leases. Under current requirements, leases are classified based on their nature as either finance leases, which are recognised on the balance sheet, or operating leases, which are not recognised on the balance sheet. The application of AASB 16 will result in the recognition of all leases on the balance sheet in the form of a right-of-use asset and a corresponding lease liability, except for leases of low value assets and leases with a term of 12 months or less. As a result, the new standard is expected to impact leases which are currently classified by the Group as operating leases; primarily, leases over offices, equipment, and motor vehicles.

## 8.2 Contingent liabilities

### Overview

Contingent liabilities are disclosed when the possibility of a future settlement of economic benefits is considered to be less than probable but more likely than remote. If the expected settlement of the liability becomes probable, a provision is recognised.

In the normal course of business, the Group is exposed to contingent liabilities in relation to claims litigation arising out of its insurance and reinsurance transactions and may be exposed to the possibility of contingent liabilities in relation to non-insurance litigation. Provisions are made for obligations that are probable and quantifiable. There are no individually significant amounts not provided for and such transactions are not considered likely to have a material impact on the net assets of the Group.

On 9 September 2015, QBE was served with a statement of claim alleging breaches of continuous disclosure and conduct obligations in relation to profit guidance issued for the year ended 31 December 2013. QBE rejects the allegations and is defending the claim. As at the date of this report, it is not possible to produce a reliable estimate of the potential financial effect arising from the claim, if any.

On 1 October 2015, QBE sold its Mortgage & Lender Services business in the US. Whilst the purchaser assumed responsibility for all potential future litigation in relation to this business, the sale contract specifically excludes liabilities associated with class action litigation and regulatory examinations underway at the time of the sale. This business is subject to litigation and regulatory examinations in the normal course of business. We do not believe that the outcome of class action litigation currently underway will be material. We do not have sufficiently reliable information to assess potential liability for current regulatory examinations.

QBE is required to support the underwriting activities of the Group's controlled entities which are corporate members at Lloyd's of London. Funds at Lloyd's are those funds of the Group which are subject to the terms of the Lloyd's Deposit Trust Deed and are required to support underwriting for the following year and the open years of account, determined by a formula prescribed by Lloyd's each year. Letters of credit of $1,624 million (2015 $1,463 million) were issued in support of the Group's participation in Lloyd's, along with cash and investments of $75 million (2015 $93 million). In addition, a controlled entity has entered into various trust and security deeds with Lloyd's in respect of assets lodged to support its underwriting activities. These deeds contain covenants that require the entity to meet financial obligations should they arise in relation to cash calls from syndicate participations. A cash call would be made first on the assets held in syndicate trust funds and would only call on funds at Lloyd's after syndicate resources were exhausted. Only if the level of these trust funds was not sufficient would a cash call result in a draw down on the letters of credit and other assets lodged with Lloyd's.

# Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2016

## 8.3 Reconciliation of profit after income tax to cash flows from operating activities

### Overview

AASB 1054 *Australian Additional Disclosures* requires a reconciliation of profit after income tax to cash flows from operating activities.

| | 2016 US$M | 2015 US$M |
|---|---|---|
| Profit after income tax | 844 | 683 |
| Depreciation/impairment of property, plant and equipment | 63 | 70 |
| Amortisation and impairment of intangibles | 74 | 121 |
| Losses on sale of entities | – | 2 |
| Losses on sale of plant and equipment | – | 15 |
| Net foreign exchange (gains) losses | (125) | 20 |
| Other gains on financial assets | (109) | (126) |
| Unrealised losses on assets held for sale | 3 | – |
| Decrease in net outstanding claims | (1,006) | (577) |
| Increase in unearned premium | 119 | 170 |
| Decrease (increase) in deferred insurance costs | 480 | (723) |
| Decrease in trade debtors | 455 | 315 |
| Increase in net operating assets | (13) | (187) |
| (Decrease) increase in trade payables | (250) | 252 |
| Decrease (increase) in net tax assets | 24 | (87) |
| Share-based payments expense | 58 | 59 |
| Decrease in net defined benefit obligation | (15) | (31) |
| Cash flows from operating activities | 559 | (16) |

## 8.4 Share-based payments

### Overview

Share-based payments are equity based compensation schemes provided to employees and executives. The company issues shares from time to time under an Employee Share and Option Plan (the Plan). Any full-time or part-time employee of the Group or any equally-owned joint venture who is offered shares or options is eligible to participate in the Plan.

### 8.4.1 Share schemes

A summary of the current deferred equity award plans together with the legacy deferred equity award plans is set out below.

**Current deferred equity plans**

| PLAN | AVAILABLE TO | NATURE OF AWARD | VESTING CONDITIONS |
|---|---|---|---|
| **Short-term incentive (STI) (2014-2016)** | Executives and other key senior employees | • 67% delivered in cash (50% in the case of the Group CEO).<br>• 33% deferred as conditional rights to fully paid ordinary QBE shares (50% in the case of the Group CEO). | The conditional rights are deferred in two equal tranches. The first tranche vests two years and the second tranche vests three years after the original grant date.<br>STI outcomes are subject to the achievement of:<br>• the Group's ROE target;<br>• individual performance ratings; and<br>• for divisional staff, divisional return on allocated capital targets. |
| **Long-term incentive (LTI) (2014-2016)** | Executives | Conditional rights to fully paid ordinary QBE shares. | The conditional rights are deferred in three equal tranches, vesting after three years (on achievement of performance conditions) and then one and two years after that date.<br>Vesting is subject to performance conditions as follows:<br>• 50% of each tranche is subject to the achievement of Group ROE performance targets over a three year performance period.<br>• 50% of each tranche is subject to the performance of the Group's relative total shareholder return over a three year performance period. |

Additionally, for current QBE deferred equity plans:

- Plan rules provide suitable discretion for the Remuneration Committee to adjust any formulaic outcome to ensure that awards made under the STI and LTI plans appropriately reflect performance.
- During the period from the grant date to the vesting date, further conditional rights are issued under the Bonus Share Plan to reflect dividends paid on ordinary shares of the company. These conditional rights are subject to the same vesting conditions as the original grant of conditional rights.
- Recipients must remain in the Group's service throughout the service period in order for the awards to vest, except in cases where good leaver provisions apply. Vesting is also subject to malus provisions.
- Good leaver provisions (e.g. retirement, redundancy, ill health, injury) apply and a pro-rata amount of conditional rights remain subject to the performance and vesting conditions.
- Once vested, conditional rights can be exercised for no consideration.

# Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2016

**Legacy deferred equity plans**

| PLAN | AVAILABLE TO | NATURE OF AWARD | VESTING CONDITIONS |
|---|---|---|---|
| **QBE Incentive Scheme (2010-2013)** | Executives and other key senior employees | Conditional rights to fully paid ordinary QBE shares.<br>The maximum deferred equity award was the lesser of 80% for executives and 66.67% for other key senior employees of the cash award earned or 100% of fixed remuneration for the financial year. | The conditional rights are deferred in two equal tranches, with the first tranche vesting over a three year service period from the grant date and the second over five years. |
| **Long-term incentive plan legacy scheme (2013)** | Executives | Conditional rights to fully paid ordinary shares. | Conditional rights vested over a five year service period.<br>Vesting is also subject to performance conditions as follows:<br>• 50% of the award is subject to the Group's average diluted EPS increasing by a compound average of 7.5% per annum over the five year period.<br>• 50% of the award is subject to the Group's average ROE and combined operating ratio being in the top 10% of the top 50 largest global insurers and reinsurers as measured by net earned premium over the five year period. |

Additionally, for legacy QBE deferred equity plans:

- The Remuneration Committee may exercise discretion when determining the vesting of awards.
- During the period from the grant date to the vesting date, further conditional rights are issued under the Bonus Share Plan to reflect dividends paid on ordinary shares of the company. These conditional rights are subject to the same vesting conditions as the original grant of conditional rights.
- Recipients must remain in the Group's service throughout the service period in order for the awards to vest. Vesting is also subject to malus provisions.
- Once vested, conditional rights can be exercised for no consideration.
- The Remuneration Committee has the discretion to pay cash in lieu of shares in certain circumstances such as death, disability, redundancy or retirement if the individual is not subject to disciplinary proceedings or notice to terminate employment on that date. In relation to the QBE Incentive Scheme, this only applies to awards made prior to 2012.

### 8.4.2 Conditional rights

Details of the number of employee entitlements to conditional rights to ordinary shares granted, vested and transferred to employees during the year are as follows:

| | 2016 NUMBER OF RIGHTS | 2015 NUMBER OF RIGHTS |
|---|---|---|
| At 1 January | **19,734,647** | 15,168,840 |
| Granted in the year | **10,646,139** | 7,327,623 |
| Dividends attaching in the year | **1,219,401** | 627,473 |
| Vested and transferred to employees in the year | **(4,693,348)** | (1,884,686) |
| Forfeited in the year | **(1,777,113)** | (1,504,603) |
| At 31 December | **25,129,726** | 19,734,647 |
| Weighted average share price at date of vesting of conditional rights during the year | **A$11.20** | A$13.13 |
| Weighted average fair value of conditional rights granted during the year | **A$9.80** | A$12.63 |

### 8.4.3 Fair value of conditional rights

The fair value of conditional rights is determined using appropriate models including Monte Carlo simulations, depending on the vesting conditions. For conditional rights granted during the year to 31 December 2016 and 31 December 2015, the following significant assumptions are used:

| | | 2016 | 2015 |
|---|---|---|---|
| Share price at grant date | A$ | **9.33 – 12.44** | 10.35 – 14.44 |
| Fair value of instrument at grant date | A$ | **4.60 – 12.34** | 10.38 – 14.60 |
| Expected life of instrument | Years | **0.1 – 5.0** | 0.1 – 5.0 |

Some of the assumptions are based on historical data which is not necessarily indicative of future trends. Reasonable changes in these assumptions would not have a material impact on the amounts recognised in the financial statements.

### 8.4.4 Employee options

The market value of all shares underlying the options at the balance date is A$0.2 million (2015 A$0.2 million). During 2016, no options were cancelled or forfeited. At 31 December 2016, 17,000 remained (excluding notional dividends). The options were issued to employees in 2004 in lieu of shares under the Plan. The options vested immediately and are exercisable until March 2024.

### 8.4.5 Share-based payment expense

Total expenses arising from share-based payment awards under the Plan amounted to $58 million (2015 $59 million). These amounts are included in underwriting and other expenses.

## How we account for the numbers

The fair value of the employee services received in exchange for the grant of equity settled instruments is recognised as an expense. The total amount to be expensed over the vesting period is determined by reference to the fair value of the instruments granted, excluding the impact of any non-market vesting conditions. Non-market vesting conditions are included in assumptions about the number of instruments that are expected to become exercisable.

The fair value of each instrument is recognised evenly over the service period ending at the vesting date; however, at each balance date, the Group revises its estimates of the number of instruments that are expected to become exercisable due to the achievement of non-market vesting conditions. The Group recognises the impact of the revision of original estimates, if any, in profit or loss with a corresponding adjustment to equity.

# Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2016

## 8.5 Key management personnel

### Overview

AASB 124 *Related Party Disclosures* requires disclosure of the compensation of directors (executive and non-executive) and those persons having authority and responsibility for planning, directing and controlling the activities of the Group, either directly or indirectly. This group is collectively defined as key management personnel. Additional details in respect of key management personnel and their remuneration are shown in the Remuneration Report.

| | 2016 US$000 | 2015 US$000 |
|---|---|---|
| Short-term employee benefits | **17,474** | 16,985 |
| Post-employment benefits | **189** | 173 |
| Other long-term employment benefits | **164** | 103 |
| Share-based payments | **7,429** | 7,637 |
| Termination benefits | **3,042** | – |
| | **28,298** | 24,898 |

### How we account for the numbers

**Short-term employee benefits – profit sharing and bonus plans**

A provision is recognised for profit sharing and bonus plans where there is a contractual obligation or where past practice has created a constructive obligation at the end of each reporting period. Bonus or profit sharing obligations are settled within 12 months from the balance date.

**Post-employment benefits – defined contribution plans**

Defined contribution plans are post-employment benefit plans under which an entity pays a fixed contribution into a fund during the course of employment and has no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods. Contributions to defined contribution plans are expensed as incurred.

**Other long-term employee benefit obligations**

The liabilities for long service leave and annual leave are recognised in the provision for employee benefits and measured as the present value of expected future payments to be made in respect of services provided by employees up to the end of the reporting period using the projected unit credit method. Consideration is given to expected future wage and salary levels, experience of employee departures and periods of service. Expected future payments are discounted using high quality corporate bond yields with terms and currencies that match, as closely as possible, the estimated future cash outflows. Remeasurements as a result of experience adjustments and changes in actuarial assumptions are recognised in profit or loss.

**Termination benefits**

Termination benefits are payable when employment is terminated before the normal retirement date or when an employee accepts voluntary redundancy in exchange for these benefits. The Group recognises termination benefits at the earlier of the date:

- when the Group can no longer withdraw the offer of those benefits; and
- when the Group recognises costs for a restructuring that is within the scope of AASB 137 *Provisions, Contingent Liabilities and Contingent Assets* and involves the payment of termination benefits.

In the case of an offer made to encourage voluntary redundancy, the termination benefits are measured based on the number of employees expected to accept the offer. Benefits falling due more than 12 months after the end of the reporting period are discounted to present value.

### 8.6 Defined benefit plans

#### Overview

Defined benefit plans are post-employment plans which provide benefits to employees on retirement, disability or death. The benefits are based on years of service and an average salary calculation. Contributions are made to cover the current cash outflows from the plans and a liability is recorded to recognise the estimated accrued but not yet funded obligations.

| | DATE OF LAST ACTUARIAL ASSESSMENT | FAIR VALUE OF PLAN ASSETS 2016 US$M | FAIR VALUE OF PLAN ASSETS 2015 US$M | PRESENT VALUE OF PLAN OBLIGATIONS 2016 US$M | PRESENT VALUE OF PLAN OBLIGATIONS 2015 US$M | NET RECOGNISED SURPLUSES (DEFICITS) 2016 US$M | NET RECOGNISED SURPLUSES (DEFICITS) 2015 US$M |
|---|---|---|---|---|---|---|---|
| **Defined benefit plan surpluses** | | | | | | | |
| Iron Trades Insurance staff trust | 31 Dec 16 | **304** | 308 | **(277)** | (264) | **27** | 44 |
| **Defined benefit plan deficits** [1] | | | | | | | |
| Janson Green final salary superannuation scheme | 31 Dec 16 | **171** | 193 | **(194)** | (196) | **(23)** | (3) |
| QBE the Americas plan | 31 Dec 16 | **228** | 217 | **(264)** | (258) | **(36)** | (41) |
| Other plans [2] | 31 Dec 16 | **37** | 37 | **(63)** | (60) | **(26)** | (23) |
| | | **436** | 447 | **(521)** | (514) | **(85)** | (67) |

1 Defined benefit plan obligations are funded.

2 Other plans includes $10 million (2015 $10 million) of defined benefit post-employment healthcare plan obligations that are not funded.

The measurement of assets and liabilities in defined benefit plans makes it necessary to use assumptions about discount rates, expected future salary increases, investment returns, inflation and life expectancy. If actuarial assumptions differ materially from actual outcomes, this could result in a significant change in employee benefit expense recognised in profit or loss or in actuarial remeasurements recognised in other comprehensive income, together with the defined benefit assets and liabilities recognised in the balance sheet.

The Group does not control the investment strategies of defined benefit plans; they are managed by independent trustees. Nonetheless, the Group has agreed, as part of ongoing funding arrangements, that the trustees should manage their strategic asset allocation in order to minimise the risk of material adverse impact. In particular, the Group has agreed with the trustee to reduce the level of investment risk by investing in assets that match, where possible, the profile of the liabilities. This involves holding a mixture of government and corporate bonds. The Group believes that due to the long-term nature of the plan liabilities, a level of continuing equity investment is also appropriate.

The charge recognised in profit or loss in the year of $2 million (2015 $5 million) is included in underwriting expenses. Total employer contributions expected to be paid to the various plans in 2017 amount to $16 million.

#### How we account for the numbers

The surplus or deficit recognised in the balance sheet in respect of defined benefit superannuation plans is the present value of the defined benefit obligation at the balance date less the fair value of plan assets. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high quality corporate or government bonds that are denominated in the currency in which the benefits will be paid, and that have a term to maturity approximating the term of the related superannuation liability. Remeasurement gains and losses arising from experience adjustments and changes in actuarial assumptions are recognised in the period in which they occur, and are shown in other comprehensive income. Past service costs are recognised immediately in profit or loss.

# Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2016

## 8.7 Remuneration of auditors

### Overview

QBE may engage the external auditor for non-audit services other than 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. The Board believes some non-audit services are appropriate given the external auditor's knowledge of the Group. External tax services are generally provided by an accounting firm other than the external auditor. Consistent with prior periods, the external auditor cannot provide the excluded services of preparing accounting records or financial reports or acting in a management capacity.

| | 2016 US$000 | 2015 US$000 |
|---|---|---|
| **PricewaterhouseCoopers (PwC) Australian firm** | | |
| Audit or review of financial reports of the ultimate parent entity | 1,435 | 1,244 |
| Audit of financial reports of controlled entities | 2,525 | 2,119 |
| Audit of statutory returns | 596 | 589 |
| Other assurance services | 900 | 305 |
| Taxation services | 295 | 190 |
| Advisory services | 1,713 | 2,365 |
| | 7,464 | 6,792 |
| **Related practices of PwC Australian firm (including overseas PwC firms)** | | |
| Audit of financial reports of controlled entities | 9,772 | 9,826 |
| Audit of statutory returns | 2,270 | 2,328 |
| Other assurance services | 129 | 200 |
| Taxation services | 420 | 1,881 |
| Advisory services | 908 | 705 |
| | 13,499 | 14,940 |
| | 20,963 | 21,732 |
| Audit and assurance services | 17,627 | 16,591 |
| Other services | 3,336 | 5,141 |
| | 20,963 | 21,732 |
| **Other auditors** | | |
| Audit of financial reports of controlled entities | 167 | 238 |
| Other services | 5 | – |
| | 172 | 238 |

## 8.8 Ultimate parent entity information

### Overview

The *Corporations Act 2001* requires the disclosure of summarised financial information for the ultimate parent entity, QBE Insurance Group Limited.

### 8.8.1 Summarised financial data of QBE Insurance Group Limited (the company)

| | 2016 US$M | 2015 US$M |
|---|---|---|
| Profit after income tax for the year | **943** | 738 |
| Other comprehensive income for the year | **12** | 45 |
| Total comprehensive income | **955** | 783 |
| Assets due within 12 months [1] | **2,822** | 1,297 |
| Shares in controlled entities | **13,035** | 13,521 |
| Total assets | **15,857** | 14,818 |
| Liabilities payable within 12 months [2] | **1,700** | 2,291 |
| Borrowings | **3,061** | 1,739 |
| Total liabilities | **4,761** | 4,030 |
| Net assets | **11,096** | 10,788 |
| Share capital | **8,350** | 8,440 |
| Share-based payment reserve | **169** | 159 |
| Foreign currency translation reserve | **87** | 105 |
| Retained profits | **2,490** | 2,084 |
| Total equity | **11,096** | 10,788 |

1 Includes amounts due from QBE Group companies of $551 million (2015 $349 million).
2 Includes amounts due to QBE Group companies of $1,575 million (2015 $2,192 million).

### 8.8.2 Guarantees and contingent liabilities

| | COMPANY | |
|---|---|---|
| | 2016 US$M | 2015 US$M |
| Letters of credit issued in support of the Group's participation in Lloyd's of London | **1,624** | 1,463 |
| Letters of credit issued in support of insurance provisions of controlled entities | **716** | 1,088 |
| Guarantees to investors in capital securities [1] | **364** | 757 |
| Guarantees to investors in subordinated debt [1] | **329** | 1,479 |
| Guarantees in relation to bank loans of controlled entities | **10** | – |

1 Excludes capital securities and subordinated debts owned by the ultimate parent entity.

Details of the guarantees to investors in capital securities and security arrangements in respect of borrowings are provided in note 5.1.

On 9 September 2015, QBE was served with a statement of claim alleging breaches of continuous disclosure and conduct obligations in relation to profit guidance issued for the year ended 31 December 2013. QBE rejects the allegations and is defending the claim. As at the date of this report, it is not possible to produce a reliable estimate of the potential financial effect arising from the claim, if any.

### 8.8.3 Tax consolidation legislation

The accounting policy in relation to the legislation is set out in note 6.2.4. On adoption of the tax consolidation legislation, the directors of the company and its wholly-owned Australian controlled entities entered into a tax sharing and tax funding agreement that requires the Australian entities to fully compensate the company for current tax liabilities and to be fully compensated by the company for any current tax or deferred tax assets in respect of tax losses arising from external transactions occurring after the date of implementation of the tax consolidation legislation. The contributions are allocated by reference to the notional taxable income of each Australian entity.

Details of franking credits available to shareholders are shown in note 5.4

## How we account for the numbers

The financial information of the ultimate parent entity of the Group has been prepared on the same basis as the consolidated financial report except for shares in controlled entities which are recorded at cost less any provision for impairment in the ultimate parent entity balance sheet.

# Directors' declaration

In the directors' opinion:

(a) the financial statements and notes set out on pages 106 to 177 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 Group's financial position as at 31 December 2016 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 1.2.1 confirms that the financial statements comply with International Financial Reporting Standards as issued by the International Accounting Standards Board.

The directors have been given the declarations by the Group Chief Executive Officer and Group Chief Financial Officer required by section 295A of the *Corporations Act 2001* and as recommended under the ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations*.

Signed in SYDNEY this 24th day of February 2017 in accordance with a resolution of the directors.

W. Marston Becker
**Director**

John Neal
**Director**

# Independent auditor's report

TO THE SHAREHOLDERS OF QBE INSURANCE GROUP LIMITED

pwc

## Report on the audit of the Financial Report

### Our opinion

In our opinion:

The accompanying Financial Report of QBE Insurance Group Limited (the company) and its controlled entities (together, the Group) is in accordance with the *Corporations Act 2001*, including:

a) giving a true and fair view of the Group's financial position as at 31 December 2016 and of its financial performance for the year then ended; and

b) complying with Australian Accounting Standards and the *Corporations Regulations 2001*.

***What we have audited***

The Financial Report comprises:

- the consolidated balance sheet as at 31 December 2016;
- the consolidated statement of comprehensive income for the year then ended;
- the consolidated statement of changes in equity for the year then ended;
- the consolidated statement of cash flows for the year then ended;
- the notes to the consolidated financial statements, which include summaries of the significant accounting policies; and
- the directors' declaration.

### Basis for opinion

We conducted our audit in accordance with Australian Auditing Standards. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the Financial Report section of our report.

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

***Independence***

We are independent of the Group in accordance with the auditor independence requirements of the *Corporations Act 2001* and the ethical requirements of the Accounting Professional and Ethical Standards Board's APES 110 *Code of Ethics for Professional Accountants* (the Code) that are relevant to our audit of the Financial Report in Australia. We have also fulfilled our other ethical responsibilities in accordance with the Code.

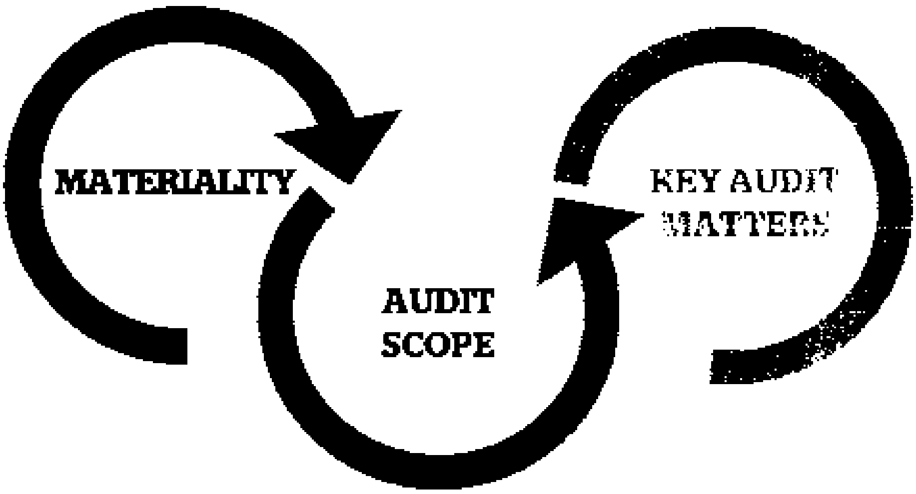
# Independent auditor's report

TO THE SHAREHOLDERS OF QBE INSURANCE GROUP LIMITED

**Our audit approach**

An audit is designed to provide reasonable assurance about whether the Financial Report is free from material misstatement. Misstatements may arise due to fraud or error. They are considered material if individually or in aggregate they could reasonably be expected to influence the economic decisions of users taken on the basis of the Financial Report.

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the Financial Report as a whole, taking into account the geographic and management structure of the Group, its accounting processes and controls and the industry in which it operates.




## MATERIALITY

- For the purpose of our audit we used overall Group materiality of $61 million, which represents approximately 0.5% of the Group's net earned premium.
- We applied this threshold, together with qualitative considerations, to determine the scope of our audit and the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements on the Financial Report as a whole.
- We chose net earned premium as the benchmark because, in our view, it is a key financial statement metric used in assessing the performance of the Group and is not as volatile as other profit and loss measures. We selected 0.5% based on our professional judgement, noting that it is also within the range of commonly accepted revenue-related benchmarks.

## AUDIT SCOPE

- Our audit focused on where the directors made subjective judgements; for example, significant accounting estimates involving assumptions and inherently uncertain future events.
- We ensured that the audit teams at both Group and operational levels possessed the appropriate skills and competencies needed for the audit of a complex global insurer. This included industry expertise in insurance, as well as IT specialists, actuarial, tax, treasury and valuation professionals.
- We conducted an audit of the most financially significant operations being the North American Operations, European Operations, Australian & New Zealand Operations and Equator Re (the "Operations"). In addition, we performed specified risk focused audit procedures on certain account balances for other Corporate and Emerging Market entities within the Group.
- For the work performed by auditors within PwC Australia or from other PwC network firms operating under our instructions, we determined the level of involvement we needed to have in their audit work to be satisfied that sufficient audit evidence had been obtained for the purposes of our opinion.
- We kept in regular communication with audit teams throughout the year with phone calls, discussions and written instructions, where appropriate. Further, we visited the significant operations on a rotational basis and met with management and local audit teams in New York, London, Hong Kong, Singapore and Sydney.
- We performed further audit procedures at a Group level over the remaining balances and the consolidation of the Group's reporting units.
- The work carried out in the Operations, together with these additional procedures performed at the Group level, provided us with sufficient evidence to express an opinion on the Group Financial Report as a whole.

# Independent auditor's report

TO THE SHAREHOLDERS OF QBE INSURANCE GROUP LIMITED

**Key audit matters**

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the Financial Report for the current period. The key audit matters were addressed in the context of our audit of the Financial Report as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. Further, any commentary on the outcome of a particular audit procedure is made in that context.

| KEY AUDIT MATTER | How our audit addressed the key audit matter |
|---|---|

***Valuation of net outstanding claims***
*Refer to Note 2.3 – $13,781 million*

We focused on this net outstanding claims balance because of the complexity involved in the estimation process and the significant judgements that management and the directors make in determining the balance.

Note 2.3 to the financial statements describes the elements that make up the balance. We comment on the most judgemental aspects of these elements below.

***(a) Gross discounted central estimate***
*Refer to Note 2.3.1 – $17,233 million*

The estimation of outstanding claims involves significant judgement given the size of the liability and inherent uncertainty in estimating the expected future payments for claims incurred.

In particular, judgement arises over the estimation of payments for claims that have been incurred at the reporting date but have not yet been reported to the Group as there is generally less information available in relation to these claims. Classes of business where there is a greater length of time between the initial claim event and settlement (such as workers' compensation, professional indemnity and other liability classes) also tend to display greater variability between initial estimates and final settlement.

The valuation of outstanding claims relies on the quality of the underlying data. It involves complex and subjective judgements about future events, both internal and external to the business, for which small changes in assumptions can result in material impacts on the estimate.

The estimate of expected future payments is discounted to present value using a risk-free rate of return in order to reflect the time value of money. Judgement is involved in estimating the period over which claims are expected to settle.

Our audit procedures included evaluating the design effectiveness and implementation of key actuarial controls, including key data reconciliations and the Group's review of the estimates.

Historical claims data is a key input to the actuarial estimates. Accordingly, we tested controls and performed detailed testing over a sample of claims case estimates and settlements. No material issues arose and so, in the context of our audit materiality, we were satisfied with the adequacy of the data used in the actuarial estimates in our sample.

We determined those classes of business where claims reserve estimates present a higher risk and focused on classes which inherently involve greater levels of judgement and have historically shown greater year on year variation over previous estimates. In the current year such portfolios included CTP in Australia and certain liability portfolios in North America and Europe.

In order to challenge management's methodologies and assumptions, with particular focus on the higher risk areas, we:

- Evaluated whether the Group's actuarial methodologies were consistent with those used in the industry and with prior periods. We sought sufficient justification for any significant differences.
- Assessed key actuarial assumptions including claims ratios, and expected frequency and severity of claims. We challenged these assumptions by comparing them with our expectations based on the Group's experience, current trends and our own industry knowledge. For some classes of business, we also performed our own independent actuarial projections and compared the results with management's estimates. Based on this work, we concluded that the methodologies and assumptions tested were materially consistent with our independent expectations and analysis.
- Tested the discount applied for classes of business where there is a greater length of time between the initial claim event and settlement by territory and line of business.

We were assisted by our own actuarial experts to understand and evaluate the Group's actuarial practices and the Group's gross discounted central estimate. We also considered the work and findings of external actuarial experts engaged by management.

| KEY AUDIT MATTER | How our audit addressed the key audit matter |
|---|---|

### *(b) Reinsurance and other recoveries*
*Refer to Note 2.3.2 – $4,540 million*

The valuation of reinsurance assets requires a significant level of judgement, given its inherent dependence on underlying estimates of gross outstanding claims.

In addition, significant management judgement may be required to ensure contractual terms on the most material contracts are correctly accounted for (such as the Group's aggregate large risk and catastrophe reinsurance program (GLRC)).

We obtained audit evidence in relation to the data and actuarial processes for estimating reinsurance recoveries on outstanding claims by performing the same audit procedures as those outlined above for gross claims estimates.

With regards to the GLRC contract, we gave particular focus to assessing and challenging management's estimate of claims that will be subject to recovery under the contract. We inspected the work of management's actuarial experts, as well as directly testing a sample of relevant claims.

We tested individually material new reinsurance arrangements including the program run off reinsurance in North America. Our work focused on reviewing all relevant contracts to ensure that the key terms contained therein had been appropriately reflected in the financial statements.

### *(c) Risk margins and Probability of Adequacy (PoA)*
*Refer to Note 2.3.3 – $1,088 million*

The net outstanding claims provision includes, in addition to the central estimate of the present value of the expected future payments, a risk margin which relates to the inherent uncertainty in that estimate. In determining the risk margin, management must make judgements about the variability of each class of business underwritten and the extent of correlation within each division and between different geographical locations.

PoA is a measure of the estimated overall sufficiency of reserves including a risk margin in light of that variability.

We assessed the Board's approach to setting the risk margin in accordance with the requirements of AASB 1023, with a particular focus on the assessed level of uncertainty in the net central estimate leading to a change in the margin year on year. We challenged these factors by considering the findings from our work performed on the net central estimate.

We tested the Group's actuarial calculation of the Probability of Adequacy (PoA) for reasonableness and consistency with previous valuations. This included developing an understanding of and testing the actuarial techniques applied by management, and comparing the results with industry benchmarks. We found the variability assumptions to be aligned with industry benchmarks and prior year.

# Independent auditor's report

TO THE SHAREHOLDERS OF QBE INSURANCE GROUP LIMITED

| KEY AUDIT MATTER | How our audit addressed the key audit matter |
|---|---|
| ***Valuation of goodwill in North America***<br>*Refer to Note 7.2.1 – $1,543 million* | |
| We focused on goodwill in North America because the level of headroom between management's valuation and the balance sheet carrying value remains limited following impairment in 2013. The carrying value is material, and the impairment test remains sensitive to reasonably possible changes in assumptions.<br><br>The valuation is based on the Board approved business plan for North America. The most significant judgements relate to the discount rate applied together with the assumptions supporting the underlying forecast cash flows, in particular the terminal growth rate and the forecast combined operating ratios in the projection period and investment return assumptions. | We have evaluated management's identification of the North American cash generating unit, and evaluated the process by which the relevant cash flow forecasts were developed. We compared these forecasts with Board approved business plans and also compared previous forecasts to actual results to assess the performance of the business and the historical accuracy of forecasting.<br><br>We were satisfied that the three year forecast used in management's valuation model was consistent with the Board approved North America business plan, and that the key assumptions were subject to oversight from the directors.<br><br>We tested the assumptions and methodologies used in the model, in particular those relating to the discount rate and growth rates. To do this:<br>• Our valuation experts evaluated these assumptions with reference to valuations of similar companies.<br>• We compared the key assumptions to externally derived data where possible, including market expectations of investment return, projected economic growth and interest rates.<br>• We applied sensitivities in evaluating the directors' assessment of the planned growth rate in cash flows, including forecast premium growth and combined operating ratios.<br><br>We were satisfied that the growth rate assumptions were reasonable given the economic outlook and industry forecasts. Further, the discount rate used by management was consistent with market data and industry research available to us.<br><br>In testing the valuation model:<br>• We checked the calculations for mathematical accuracy, noting no exceptions.<br>• We considered the sensitivity of the calculation by varying the assumptions and applying other values within a reasonably possible range for North America.<br><br>We also considered the work and findings of external valuation experts engaged by management.<br><br>The impairment assessment remains sensitive to a range of assumptions, in particular to changes in the discount rate and achievement of forecast improvements in investment returns and combined operating ratios. Accordingly relevant disclosures have been made in note 7.2.1. |

| KEY AUDIT MATTER | How our audit addressed the key audit matter |
|---|---|

***Recoverability of deferred tax assets in North America***
*Refer to Note 6.2.3 – $573 million*

We focused on this balance because there has been a history of tax losses in North America, and as such, the recoverability of the deferred tax asset in North America is particularly sensitive to expectations about the future profitability of this business. This in turn depends on the achievement of underlying business plans.

Significant judgement is required over the recoverability of deferred tax assets arising from past tax losses because the realisation of tax benefits is dependent on future taxable profits and there are inherent uncertainties involved in forecasting such profits.

The ultimate recoverability of the deferred tax asset depends upon both continued improvement in the profitability of the North American business, and the period over which tax losses will be available for recovery.

We focused on whether sufficient evidence was available with regard to these two elements, as follows:

- Evaluated the progress made by management in improving the profitability of the business in recent periods, which includes the remediation of the causes of past losses through, amongst other things, run off reinsurance arrangements, implementation of a revised capital structure to reduce funding costs, business disposals, and other expense reduction initiatives. We noted that progress has been made in relation to each of these.
- Assessed the credibility of the business plans used in the deferred tax asset recoverability assessment. These were based on the same three year forecast used in the goodwill valuation model, and were therefore assessed as part of our goodwill testing as outlined above.
- Used our tax experts, who considered that the tax losses are legally available for the forecast recoupment period.

***Valuation of investments***
*Refer to Note 3.2 – $24,374 million*

This is the largest asset on the balance sheet, representing approximately 59% of total assets. Our audit effort has increased in this area as the Group's investment portfolio has become more diversified in recent years.

In particular, there is significant focus on considering whether the underlying investments are valued appropriately.

The valuation of financial investments held at fair value is based on a range of inputs. Many of the inputs required can be obtained from readily available liquid market prices and rates. Where observable market data is not available, for example, when determining the valuation of certain infrastructure debt, estimates must be developed based on the most appropriate source data and are subject to a higher level of judgement.

We performed the following audit procedures over the valuation of investments held by the Group:

- Assessed the design and performed tests of the implementation and operating effectiveness of the key controls over the investment function carried out by Group Investments, which is responsible for managing the majority of investments for the Group.
- Assessed the Group's valuation of individual investment holdings. Where readily observable data was available, we sourced that independently and compared it to the company's valuation. For investments where there was less or little observable market data, including level 3 holdings as disclosed in note 3.2.1, we obtained and assessed other relevant valuation data or carried out our own independent valuations. We did not identify any material differences from the company's valuations from performing this work.

# Independent auditor's report

TO THE SHAREHOLDERS OF QBE INSURANCE GROUP LIMITED

### Other Information

The directors are responsible for the other information. The other information comprises the Performance overview, Business review, Governance, Directors' Report, and Other information included in the Group's Annual Report for the year ended 31 December 2016 but does not include the Financial Report and our auditor's report thereon.

Our opinion on the Financial Report does not cover the other information and accordingly we do not express any form of assurance conclusion thereon.

In connection with our audit of the Financial Report, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the Financial Report or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

### Responsibilities of the directors 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 gives a true and fair view and is free from material misstatement, whether due to fraud or error.

In preparing the Financial Report, the directors are responsible for assessing the ability of the Group to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or to cease operations, or have no realistic alternative but to do so.

### Auditor's responsibilities for the audit of the Financial Report

Our objectives are to obtain reasonable assurance about whether the Financial Report as a whole is free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the Australian Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the Financial Report.

A further description of our responsibilities for the audit of the Financial Report is located at the Auditing and Assurance Standards Board website at:

http://www.auasb.gov.au/auditors_files/ar2.pdf. This description forms part of our auditor's report.

## Report on the Remuneration Report

***Our opinion on the Remuneration Report***

We have audited the Remuneration Report included in pages 68 to 102 of the Directors' Report for the year ended 31 December 2016.

In our opinion, the Remuneration Report of QBE Insurance Group Limited for the year ended 31 December 2016 complies with section 300A of the *Corporations Act 2001*.

***Responsibilities***

The directors of the company are responsible for the preparation and presentation of the Remuneration Report in accordance with section 300A of the *Corporations Act 2001*. Our responsibility is to express an opinion on the Remuneration Report, based on our audit conducted in accordance with Australian Auditing Standards.

PricewaterhouseCoopers

PricewaterhouseCoopers

Rory Clark

SJ Hadfield

**RJ Clark**
Partner

**SJ Hadfield**
Partner

Sydney
24 February 2017

# Shareholder information

QBE is incorporated in Australia, is listed on the Australian Securities Exchange (ASX) and trades under the code "QBE".

## Registered office

**QBE Insurance Group Limited**
Level 27, 8 Chifley Square
Sydney NSW 2000 Australia

Telephone: +61 2 9375 4444
Facsimile: +61 2 9231 6104

Website: www.qbe.com

## QBE website

QBE's website provides investors with information about QBE including annual reports, corporate governance statements, annual reviews, sustainability reviews, half yearly reports and announcements to the ASX. The website also offers regular QBE share price updates, a calendar of events, a history of QBE's dividend and online access to your shareholding details via the share registry.

## Shareholder information and enquiries

Enquiries and correspondence regarding shareholdings can be directed to QBE's share registry:

**Computershare Investor Services Pty Limited (Computershare)**
GPO Box 2975
Melbourne VIC 3001 Australia

452 Johnston Street
Abbotsford VIC 3067 Australia

Telephone: 1300 723 487 (Australia)
Telephone: +61 3 9415 4840 (International)

Web: www.computershare.com.au
Email: qbe.queries@computershare.com.au

For security purposes, you will need to quote your Securityholder Reference Number (SRN) or Holder Identification Number (HIN).

If you are broker (CHESS) sponsored, queries relating to incorrect registrations and changes to name and/or address can only be processed by your stockbroker. Please contact your stockbroker. Computershare cannot assist you with these changes.

## Shareholding details online

Manage your shareholding online by visiting QBE's share registry, Computershare. Log onto www.investorcentre.com.au to view your holding balance and dividend statements, to update your address (if you are registered with an SRN) or direct credit instructions, provide DRP or BSP instructions or change/add your TFN/ABN details.

You may also register to receive shareholder documentation electronically including dividend statements, notices of meetings, annual reports and major company announcements.

## Privacy legislation

Chapter 2C of the *Corporations Act 2001* requires information about you as a security holder (including your name, address and details of the securities you hold) to be included in QBE's share register. These details must continue to be included in the public register even if you cease to be a security holder. A copy of the privacy policy is available on Computershare's website.

## Relevant interests register

Nasdaq OMX Pty Ltd of Level 8, 155 George Street, Sydney NSW 2000 Australia maintains QBE's register of information about relevant interests. Shareholders and other parties can telephone Nasdaq OMX on +61 2 8076 2600 or facsimile on +61 2 8076 2601 if they wish to inspect this register.

## Dividends

QBE pays cash dividends to shareholders resident in Australia and New Zealand by direct credit. Shareholders in the UK and the US also have the option to receive their cash dividends by direct credit, although it is not mandatory. The benefit to shareholders of the direct credit facility is access to cleared funds quickly and securely – reducing the risk of cheques being lost or stolen. Shareholders in other countries will receive cheque payments in Australian dollars if they have not elected to receive their payment by direct credit. Shareholders receive a dividend statement for tax records, either by post or by email depending on the selected communications option.

Eligible shareholders can participate in QBE's Dividend Reinvestment Plan (DRP) and Bonus Share Plan (BSP) when the plans are active. The DRP enables you to subscribe for additional shares. The BSP is a bonus share plan whereby the dividend entitlement is forgone for bonus shares in lieu of the dividend. In order to participate in either the DRP or BSP, you must have a minimum shareholding of 100 shares and have a registered address in Australia or New Zealand.

Participants may change their election to participate in the DRP and BSP at any time. DRP/BSP election cut-off dates and application forms are available from QBE's website.

## Tax File Number (TFN), Australian Business Number (ABN) or exemption – Australian residents

You can confirm whether you have lodged your TFN, ABN or exemption by visiting Computershare's Investor Centre. If you choose not to lodge these details, QBE is obliged to deduct tax at the highest marginal rate (plus the Medicare levy) from the unfranked portion of dividends paid. Australian shareholders living abroad should advise Computershare of their resident status.

## Conduit foreign income (CFI)

Shareholders will receive CFI credits in respect of the whole unfranked portion of QBE dividends. These credits exempt non-resident shareholders from Australian withholding tax.

## Unpresented cheques/unclaimed money

Under the *Unclaimed Moneys Act* unclaimed dividends six or more years old must be given to the ACT Public Trustee. It is very important that shareholders bank outstanding dividend cheques promptly and advise Computershare immediately of changes of address or bank account details.

## Recent QBE dividends

| DATE PAID | TYPE | RECORD DATE | AUSTRALIAN CENTS PER SHARE | FRANKING % |
|---|---|---|---|---|
| 28 March 2013 | Final | 8 March 2013 | 10 | 100 |
| 23 September 2013 | Interim | 2 September 2013 | 20 | 100 |
| 31 March 2014 | Final | 13 March 2014 | 12 | 100 |
| 23 September 2014 | Interim | 29 August 2014 | 15 | 100 |
| 13 April 2015 | Final | 6 March 2015 | 22 | 100 |
| 2 October 2015 | Interim | 28 August 2015 | 20 | 100 |
| 14 April 2016 | Final | 11 March 2016 | 30 | 100 |
| 28 September 2016 | Interim | 26 August 2016 | 21 | 50 |
| 13 April 2017 | Final | 10 March 2017 | 33 | 50 |

## Annual General Meeting

The Annual General Meeting of QBE Insurance Group Limited will be held at 10.00am on Wednesday, 3 May 2017 in the Ballroom 3 and 4, The Westin Sydney, No 1 Martin Place, Sydney, NSW 2000.

The Annual General Meeting will be webcast at www.group.qbe.com/investor-centre/annual-general-meeting and an archive copy uploaded for later viewing.

## Voting rights of ordinary shares

The constitution provides for votes to be cast:

- on a show of hands, one vote for each shareholder; and
- on a poll, one vote for each fully paid ordinary share.

## Annual Report mailing list

Amendments to the *Corporations Act 2001* have removed the obligation for companies to mail an annual report to shareholders. To improve efficiency, save costs and reduce our impact on the environment by minimising unnecessary use of paper and printing resources, the Annual Report is published on our website at www.qbe.com.

If you wish to receive a hard copy of the Annual Report, please update your communication preferences by logging into your shareholding at www.investorcentre.com.

QBE does not produce a concise financial report.

# Shareholder information CONTINUED

## Top 20 shareholders as at 31 January 2017

| NAME | NUMBER OF SHARES | % OF TOTAL[1] |
|---|---|---|
| HSBC Custody Nominees (Australia) Limited | 495,660,616 | 36.14 |
| JP Morgan Nominees Australia Limited | 221,764,388 | 16.17 |
| Citicorp Nominees Pty Limited | 122,691,632 | 8.95 |
| National Nominees Limited | 88,811,252 | 6.48 |
| BNP Paribas Nominees Pty Ltd (Agency Lending DRP A/C) | 38,977,021 | 2.84 |
| BNP Paribas Nominees Pty Ltd (DRP) | 20,148,757 | 1.47 |
| Citicorp Nominees Pty Limited (Colonial First State Investment A/C) | 14,414,060 | 1.05 |
| AMP Life Limited | 10,543,027 | 0.77 |
| RBC Investor Services Australia Nominees Pty Limited (PI Pooled A/C) | 9,815,272 | 0.72 |
| HSBC Custody Nominees (Australia) Limited (NT Commonwealth Super Corp A/C) | 7,615,608 | 0.56 |
| Australian Foundation Investment Company Limited | 6,331,575 | 0.46 |
| Argo Investments Limited | 5,920,491 | 0.43 |
| RBC Investor Services Australia Nominees Pty Limited (MBA A/C) | 2,703,062 | 0.20 |
| Milton Corporation Limited | 2,618,375 | 0.19 |
| CPU Share Plans Pty Ltd (QBE Employees Vested Control A/C) | 2,569,006 | 0.19 |
| Navigator Australia Ltd (MLC Investment Settlement A/C) | 2,333,522 | 0.17 |
| National Nominees Limited (N A/C) | 2,029,723 | 0.15 |
| Nulis Nominees (Australia) Limited (Navigator Master Plan Settlement A/C) | 1,987,448 | 0.14 |
| HSBC Custody Nominees (Australia) Limited | 1,939,029 | 0.14 |
| National Nominees Limited (DB A/C) | 1,716,001 | 0.13 |
| | 1,060,589,865 | 77.35 |

1 Percentage of total at date of notice.

## QBE substantial shareholders as at 31 January 2017

At 31 January 2017, QBE Insurance Group Limited had no substantial shareholders.

## Distribution of shareholders and shareholdings as at 31 January 2017

| SIZE OF HOLDING | NUMBER OF SHAREHOLDERS | % | NUMBER OF SHARES | % |
|---|---|---|---|---|
| 1 to 1,000 | 67,480 | 53.45 | 29,702,541 | 2.17 |
| 1,001 to 5,000 | 48,242 | 38.21 | 106,756,003 | 7.78 |
| 5,001 to 10,000 | 6,730 | 5.33 | 47,017,487 | 3.43 |
| 10,001 to 100,000 | 3,636 | 2.88 | 74,781,229 | 5.45 |
| 100,001 and over | 157 | 0.12 | 1,113,333,038 | 81.17 |
| Total | 126,245 | 100.00 | 1,371,590,368 | 100.00 |

## Shareholdings of less than a marketable parcel as at 31 January 2017

| | SHAREHOLDERS | | SHARES | |
|---|---|---|---|---|
| | NUMBER | % OF TOTAL | NUMBER | % OF TOTAL |
| Holdings of 40 or fewer shares | 4,124 | 3.27% | 70,248 | 0.01% |

# Financial calendar

| YEAR | MONTH | DAY | ANNOUNCEMENT |
|---|---|---|---|
| 2017 | February | 27 | Results and dividend announcement for the year ended 31 December 2016 |
| | March | 9 | Shares begin trading ex dividend |
| | | 10 | Record date for determining shareholders' entitlement to 2016 final dividend |
| | | 13 | DRP/BSP election close date – last day to nominate to participate in the Dividend Reinvestment Plan or the Bonus Share Plan |
| | April | 13 | Payment date for the 2016 final dividend |
| | May | 3 | 2017 Annual General Meeting |
| | June | 30 | Half year end |
| | August | 17[1] | Results and dividend announcement for the half year ended 30 June 2017 |
| | | 24[1] | Shares begin trading ex dividend |
| | | 25[1] | Record date for determining shareholders' entitlement to 2017 interim dividend |
| | | 28[1] | DRP/BSP election close date – last day to nominate to participate in the Dividend Reinvestment Plan or the Bonus Share Plan |
| | September | 29[1] | Payment date for the 2017 interim dividend |
| | December | 31 | Full year end |

1 Dates shown may be subject to change.

# 10 year history

FOR THE YEAR ENDED 31 DECEMBER

| | | 2016 | 2015 | 2014 | 2013 | 2012 | 2011 | 2010 | 2009 | 2008 | 2007 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Gross written premium | US$M | **14,395** | 15,092 | 16,332 | 17,975 | 18,434 | 18,291 | 13,629 | 11,239 | 11,015 | 10,391 |
| Gross earned premium | US$M | **14,276** | 14,922 | 16,521 | 17,889 | 18,341 | 17,840 | 13,432 | 10,943 | 10,773 | 10,353 |
| **Net earned premium** | US$M | **11,086** | 12,314 | 14,084 | 15,396 | 15,798 | 15,359 | 11,362 | 9,446 | 9,293 | 8,552 |
| Claims ratio | % | **58.2** | 60.4 | 63.2 | 64.5 | 66.0 | 68.2 | 59.9 | 60.3 | 57.6 | 54.3 |
| Commission ratio | % | **18.4** | 17.2 | 16.8 | 16.8 | 16.2 | 14.9 | 15.5 | 16.2 | 17.2 | 18.5 |
| Expense ratio | % | **17.4** | 17.3 | 16.1 | 16.5 | 14.9 | 13.7 | 14.3 | 13.1 | 13.7 | 13.1 |
| Combined operating ratio | % | **94.0** | 94.9 | 96.1 | 97.8 | 97.1 | 96.8 | 89.7 | 89.6 | 88.5 | 85.9 |
| Investment income | | | | | | | | | | | |
| before investment gains/losses | US$M | **641** | 541 | 676 | 691 | 723 | 948 | 658 | 632 | 1,237 | 837 |
| after investment gains/losses | US$M | **746** | 885 | 814 | 772 | 1,227 | 767 | 657 | 1,153 | 1,199 | 1,130 |
| Insurance profit | US$M | **1,076** | 1,031 | 1,074 | 841 | 1,262 | 1,085 | 1,703 | 1,609 | 1,830 | 1,895 |
| Insurance profit to net earned premium | % | **9.7** | 8.4 | 7.6 | 5.5 | 8.0 | 7.1 | 15.0 | 17.0 | 19.7 | 22.2 |
| Financing and other costs | US$M | **294** | 244 | 297 | 345 | 324 | 275 | 222 | 191 | 223 | 189 |
| Operating profit (loss) | | | | | | | | | | | |
| before income tax | US$M | **1,072** | 953 | 931 | (448) | 941 | 869 | 1,551 | 1,891 | 2,028 | 2,135 |
| after income tax and non-controlling interests | US$M | **844** | 687 | 742 | (254) | 761 | 704 | 1,278 | 1,532 | 1,559 | 1,612 |
| Number of shares on issue[1] | millions | **1,370** | 1,370 | 1,363 | 1,247 | 1,194 | 1,112 | 1,046 | 1,020 | 982 | 881 |
| Shareholders' funds | US$M | **10,284** | 10,505 | 11,030 | 10,356 | 11,358 | 10,366 | 10,311 | 9,164 | 7,634 | 7,435 |
| Total assets | US$M | **41,583** | 42,176 | 45,000 | 47,271 | 50,748 | 46,737 | 41,386 | 36,723 | 33,967 | 34,737 |
| Net tangible assets per share[1] | US$ | **4.90** | 5.07 | 5.32 | 4.75 | 4.49 | 3.93 | 4.78 | 4.64 | 4.04 | 6.02 |
| Borrowings to shareholders' funds | % | **33.8** | 33.6 | 32.5 | 44.1 | 43.4 | 45.8 | 31.5 | 29.1 | 32.9 | 40.8 |
| Basic earnings per share[1] | US cents | **61.6** | 50.3 | 57.4 | (22.8) | 65.1 | 64.9 | 123.7 | 152.8 | 175.0 | 189.0 |
| Basic earnings per share-cash basis[2] | US cents | **66.6** | 65.3 | 63.5 | 62.9 | 69.1 | 73.0 | 127.7 | 156.4 | 177.2 | 190.5 |
| Diluted earnings per share | US cents | **60.8** | 49.8 | 55.8 | (22.8) | 61.6 | 61.3 | 119.8 | 148.9 | 172.2 | 181.8 |
| Return on average shareholders' funds | % | **8.1** | 6.4 | 6.9 | (2.3) | 7.0 | 6.8 | 13.1 | 18.0 | 22.3 | 26.0 |
| Dividend per share | Australian cents | **54** | 50 | 37 | 32 | 60 | 87 | 128 | 128 | 126 | 122 |
| Dividend payout | A$M | **741** | 685 | 492 | 394 | 593 | 956 | 1,336 | 1,306 | 1,187 | 1,088 |
| Total investments and cash[3] | US$M | **24,236** | 26,708 | 26,583 | 30,619 | 31,525 | 28,024 | 25,328 | 22,446 | 19,985 | 21,552 |

1 Reflects shares on an accounting basis.

2 Earnings per share on a cash basis is calculated with reference to cash profit, being profit after tax adjusted for amortisation and impairment of intangibles and other non-cash items net of tax.

3 Includes financial assets at fair value through profit or loss, cash and cash equivalents and investment properties.

# Glossary of insurance terms

| | |
|---|---|
| **Accident year experience** | The matching of all claims occurring (regardless of when reported or paid) during a given 12 month period with all premium earned over the same period. |
| **Acquisition cost** | The total of net commission and operating expenses incurred in the generation of net earned premium and often expressed as a percentage of net earned premium. |
| **Admitted insurance** | Insurance written by an insurer that is admitted (or licensed) to do business in the (US) state in which the policy was sold. |
| **Agent** | One who negotiates contracts of insurance or reinsurance as an insurance company's representative i.e. the agent's primary responsibility is to the insurance carrier, not the insurance buyer. |
| **Attritional claims ratio** | Total of all claims with a net cost of less than £2.5 million as a percentage of net earned premium. |
| **Broker** | One who negotiates contracts of insurance or reinsurance on behalf of an insured party, receiving a commission from the insurer or reinsurer for placement and other services rendered. In contrast with an agent, the broker's primary responsibility is to the insurance buyer not the insurance carrier. |
| **Capacity** | In relation to a Lloyd's member, the maximum amount of insurance premiums (gross of reinsurance but net of brokerage) which a member can accept. In relation to a syndicate, the aggregate of each member's capacity allocated to that syndicate. |
| **Cash profit** | Net profit after tax attributable to QBE shareholders, adjusted for the post-tax effect of amortisation and impairment of intangibles and other non-cash items. This definition is used for the purpose of the Group's dividend policy. |
| **Casualty insurance** | Insurance that is primarily concerned with the losses resulting from injuries to third persons or their property (i.e. not the policyholder) and the resulting legal liability imposed on the insured. It includes, but is not limited to, general liability, employers' liability, workers' compensation, professional liability, public liability and motor liability insurance. |
| **Catastrophe reinsurance** | A reinsurance contract (often in the form of excess of loss reinsurance) that, subject to specified limits and retention, compensates the ceding insurer for losses related to an accumulation of claims resulting from a catastrophe event or series of events. |
| **Claim** | The amount payable under a contract of insurance or reinsurance arising from a loss relating to an insured event. |
| **Claims incurred** | The aggregate of all claims paid during an accounting period adjusted by the change in the claims provision for that accounting period. |
| **Claims provision** | The estimate of the most likely cost of settling present and future claims and associated claims adjustment expenses plus a risk margin to cover possible fluctuation of the liability. |
| **Claims ratio** | Net claims incurred as a percentage of net earned premium. |
| **Coefficient of variation** | The measure of variability in the net discounted central estimate used in the determination of the probability of adequacy. |
| **Combined operating ratio** | The sum of the net claims ratio, commission ratio and expense ratio. A combined operating ratio below 100% indicates profitable underwriting results. A combined operating ratio over 100% indicates unprofitable underwriting results. |
| **Commercial lines** | Refers to insurance for businesses, professionals and commercial establishments. |
| **Commission** | Fee paid to an agent or broker as a percentage of the policy premium. The percentage varies widely depending on coverage, the insurer and the marketing methods. |
| **Commission ratio** | Net commission expense as a percentage of net earned premium. |
| **Credit spread** | The difference in yield between a corporate bond and a reference yield (e.g. LIBOR, BBSW or a fixed sovereign bond yield). |
| **Credit spread duration** | The weighted average term of cash flows for a corporate bond. It is used to measure the price sensitivity of a bond to changes in credit spreads. |

# Glossary of insurance terms CONTINUED

| | |
|---|---|
| **Deductible** | The amount or proportion of some or all losses arising under an insurance contract that the insured must bear. |
| **Deferred acquisition costs** | Acquisition costs relating to the unexpired period of risk of contracts in force at the balance date which are carried forward from one accounting period to subsequent accounting periods. |
| **Excess of loss reinsurance** | A form of reinsurance in which, in return for a premium, the reinsurer accepts liability for claims settled by the original insurer in excess of an agreed amount, generally subject to an upper limit. |
| **Expense ratio** | Underwriting and administrative expenses as a percentage of net earned premium. |
| **Facultative reinsurance** | The reinsurance of individual risks through a transaction between the reinsurer and the cedant (usually the primary insurer) involving a specified risk. |
| **General insurance** | Generally used to describe non-life insurance business including property and casualty insurance. |
| **Gross claims incurred** | The amount of claims incurred during an accounting period before deducting reinsurance recoveries. |
| **Gross earned premium (GEP)** | The proportion of gross written premium recognised as income in the current financial year, reflecting the pattern of the incidence of risk and the expiry of that risk. |
| **Gross written premium (GWP)** | The total premium on insurance underwritten by an insurer or reinsurer during a specified period, before deduction of reinsurance premium. |
| **Incurred but not reported (IBNR)** | Claims arising out of events that have occurred before the end of an accounting period but have not been reported to the insurer by that date. |
| **Insurance profit** | The sum of the underwriting result and investment income on assets backing policyholders' funds. |
| **Insurance profit margin** | The ratio of insurance profit to net earned premium. |
| **Inward reinsurance** | See Reinsurance. |
| **Large individual risk and catastrophe claims ratio** | The aggregate of claims each with a net cost of $2.5 million or more as a percentage of net earned premium. |
| **Lenders' mortgage insurance (LMI)** | A policy that protects the lender (e.g. a bank) against non-payment or default on the part of the borrower on a residential property loan. |
| **Lead/non-lead underwriter** | A lead underwriter operates in the subscription market and sets the terms and price of a policy. The follower or non-lead is an underwriter of a syndicate or an insurance company that agrees to accept a proportion of a given risk on terms set by the lead underwriter. |
| **Letters of credit (LoC)** | Written undertaking by a financial institution to provide funding if required. |
| **Lloyd's** | Insurance and reinsurance market in London. It is not a company but is a society of individuals and corporate underwriting members. |
| **Lloyd's managing agent** | An underwriting agent which has permission from Lloyd's to manage one or more syndicates and carry on underwriting and other functions for a member. |
| **Long tail** | Classes of insurance business involving coverage for risks where notice of a claim may not be received for many years and claims may be outstanding for more than one year before they are finally quantifiable and settled by the insurer. |
| **Managing General Agent (MGA)** | A wholesale insurance agent with the authority to accept placements from (and often to appoint) retail agents on behalf of an insurer. MGAs generally provide underwriting and administrative services such as policy issuance on behalf of the insurers they represent. Some may handle claims. |
| **Maximum event retention (MER)** | An estimate of the largest claim to which an insurer will be exposed (taking into account the probability of that loss event at a return period of one in 250 years) due to a concentration of risk exposures, after netting off any potential reinsurance recoveries and inward and outward reinstatement premiums. |

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| **Modified duration** | The weighted average term of cash flows in a bond. It is used to measure the price sensitivity of a bond to changes in credit spreads. |
| **Multi-peril crop scheme** | US federally regulated crop insurance protecting against crop yield losses by allowing participating insurers to insure a certain percentage of historical crop production. |
| **Net claims incurred** | The amount of claims incurred during an accounting period after deducting reinsurance recoveries. |
| **Net claims ratio** | Net claims incurred as a percentage of net earned premium. |
| **Net earned premium (NEP)** | Net written premium adjusted by the change in net unearned premium. |
| **Net investment income** | Gross investment income including foreign exchange gains and losses and net of investment expenses. |
| **Net written premium (NWP)** | The total premium on insurance underwritten by an insurer during a specified period after the deduction of premium applicable to reinsurance. |
| **Outstanding claims liability** | The amount of provision established for claims and related claims expenses that have occurred but have not been paid. |
| **Personal lines** | Insurance for individuals and families, such as private motor vehicle and homeowners' insurance. |
| **Policyholders' funds** | Those financial assets held to fund the net insurance liabilities of the Group. |
| **Premium** | Amount payable by the insured or reinsured in order to obtain insurance or reinsurance protection. |
| **Premium solvency ratio** | Ratio of net tangible assets to net earned premium. This is an important industry indicator in assessing the ability of general insurers to settle their existing liabilities. |
| **Prescribed Capital Amount (PCA)** | This comprises the sum of the capital charges for asset risk, asset concentration risk, insurance concentration risk and operational risk as required by APRA. The PCA must be disclosed at least annually. |
| **Probability of adequacy** | A statistical measure of the level of confidence that the outstanding claims liability will be sufficient to pay claims as and when they fall due. |
| **Proportional reinsurance** | A type of reinsurance in which the original insurer and the reinsurer share claims in the same proportion as they share premiums. |
| **Prudential Capital Requirement (PCR)** | The sum of the Prescribed Capital Account (PCA) plus any supervisory adjustment determined by APRA. The PCR may not be disclosed. |
| **Recoveries** | The amount of claims recovered from reinsurance, third parties or salvage. |
| **Reinsurance** | An agreement to indemnify a primary insurer by a reinsurer in consideration of a premium with respect to agreed risks insured by the primary insurer. The enterprise accepting the risk is the reinsurer and is said to accept inward reinsurance. The enterprise ceding the risks is the cedant or ceding company and is said to place outward reinsurance. |
| **Reinsurance to close** | A reinsurance agreement under which members of a syndicate, for a year of account to be closed, are reinsured by members who comprise that or another syndicate for a later year of account against all liabilities arising out of insurance business written by the reinsured syndicate. |
| **Reinsurer** | The insurer that assumes all or part of the insurance or reinsurance liability written by another insurer. The term includes retrocessionaires, being insurers that assume reinsurance from a reinsurer. |
| **Retention** | That amount of liability for which an insurance company will remain responsible after it has completed its reinsurance arrangements. |
| **Retrocession** | Reinsurance of a reinsurer by another reinsurance carrier. |
| **Return on allocated capital (RoAC)** | Divisional management-basis profit as a percentage of allocated capital as determined by the Group's economic capital model. |

# Glossary of insurance terms CONTINUED

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| Return on equity (ROE) | Group statutory net profit after tax as a percentage of average shareholders' funds. |
| Short tail | Classes of insurance business involving coverage for risks where claims are usually known and settled within 12 months. |
| Stop loss reinsurance | A form of excess of loss reinsurance which provides that the reinsurer will pay some or all of the reassured's losses in excess of a stated percentage of the reassured's premium income, subject (usually) to an overall limit of liability. |
| Surplus (or excess) lines insurers | In contrast to "admitted insurers", every US state also allows non-admitted (or "surplus lines" or "excess lines") carriers to transact business where there is a special need that cannot or will not be met by admitted carriers. The rates and forms of non-admitted carriers generally are not regulated in that state, nor are the policies back-stopped by the state insolvency fund covering admitted insurance. Brokers must inform insurers if their insurance has been placed with a non-admitted insurer. |
| Syndicate | A member or group of members underwriting insurance business at Lloyd's through the agency of a managing agent. |
| Survival ratio | A measure of how many years it would take for dust disease claims to exhaust the current level of claims provision. It is calculated on the average level of claims payments in the last three years. |
| Total shareholder return (TSR) | A measure of performance of a company's shares over time. It includes share price appreciation and dividend performance. |
| Treaty reinsurance | Reinsurance of risks in which the reinsurer is obliged by agreement with the cedant to accept, within agreed limits, all risks to be underwritten by the cedant within specified classes of business in a given period of time. |
| Underwriting | The process of reviewing applications submitted for insurance or reinsurance coverage, deciding whether to provide all or part of the coverage requested and determining the applicable premium. |
| Underwriting expenses | The aggregate of policy acquisition costs, excluding commissions, and the portion of administrative, general and other expenses attributable to underwriting operations. |
| Underwriting result | The amount of profit or loss from insurance activities exclusive of net investment income and capital gains or losses. |
| Underwriting year | The year in which the contract of insurance commenced or was underwritten. |
| Unearned premium | The portion of a premium representing the unexpired portion of the contract term as of a certain date. |
| Volume weighted average price (VWAP) | A methodology used for determining the share price applicable to dividend and other share related transactions. |
| Written premium | Premiums written, whether or not earned, during a given period. |

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QBE

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16 March 2017

Mr Michael Savery
Chief Risk Officer
QBE Lenders Mortgage Insurance Limited
Level 5, 2 Park Street
Sydney, NSW 2000

Dear Mr Savery

**Re: QBE Lenders Mortgage Insurance Limited Actuarial Report at 31 December 2016.**

Section 77 and 78 of the Insurance (Prudential Supervision) Act 2010 requires a licensed insurer to ensure that actuarial information included in the financial statements has been reviewed by the insurer's Appointed Actuary. As the Appointed Actuary for QBE LMI New Zealand Branch (QBE LMI NZ), I, Benoit Laganiere have conducted this review for QBE LMI NZ and QBE Lenders Mortgage Insurance Limited (QBE LMI) financial statements for the period ending 31 December 2016. QBE LMI NZ is a branch of QBE LMI which is an APRA regulated entity. I am also the Appointed Actuary for QBE LMI.

This review involved ascertaining whether actuarial information used in the preparation of the financial statements has applied appropriately. No limitations were placed on me in conducting this review, and all information requested has been made available to me.

For the purposes of this review, actuarial information includes

- Outstanding claims liabilities
- Premium Liabilities
- Application of the Liability Adequacy Test
- Reinsurance and other recovery assets
- Deferred Acquisition Costs.

I am an employee of QBE Management Services (QMS), which is a related company to QBE LMI and QBE LMI NZ in that the companies are fully owned by QBE Insurance Group. In addition to this, I held equity positions (current or deferred) in QBE Insurance Group securities at the date of this report. This holding is an immaterial proportion of the total shares issued by QBE.

From my review, it is my opinion that

- the actuarial information included in QBE LMI and QBE LMI NZ' financial statements has been appropriately included;
- the actuarial information used to prepare the financial statements of QBE LMI and QBE LMI NZ has been appropriately used;
- it is understood that QBE LMI NZ was granted exemption from complying with the RBNZ solvency standards for non-life insurance business under Section 59 of the Insurance Act. As a branch of QBE LMI, QBE LMI NZ is therefore dependent on QBE LMI's capital surplus to remain solvent under most adverse scenarios developed as part of QBE LMI's capital management plan; and
- from a solvency point of view, QBE LMI has held capital in excess of APRA's Prescribed Capital Requirement as at 31 December 2016.

Yours faithfully

Benoit Laganiere
New Zealand Appointed Actuary of QBE Lenders Mortgage Insurance Limited
Fellow of the Institute of Actuaries of Australia