

Financial and operations overview

I joined QBE because it has a unique global footprint of high quality insurance and reinsurance businesses. Despite economic headwinds, we reported a strong rebound in earnings in 2014 and dividends increased by 16% compared with 2013. After two years of transformation, including a strong set of capital initiatives, the Group is well positioned heading into 2015.

General overview

In my first CFO report in the 2014 half year accounts, I set out my priorities under three key headings:

1. Drive financial performance;
2. Financial strength and flexibility; and
3. Investment performance and strategy.

While I believe there is still more to do, I am pleased to report we have made good progress in all three areas.

1. Drive financial performance

Firstly, and most importantly, earnings have rebounded strongly. The Group reported a profit after tax of \$742 million for the year ended 31 December 2014, representing a \$1.0 billion turnaround from the \$254 million after tax loss reported in 2013. Our profit recovery was driven by the improvement in underwriting profitability, together with the non-recurrence of the very substantial North American goodwill impairment charge recognised in 2013.

Secondly, and as emphasised at the half year result, it is critical that the Group consistently achieves its targets. In that context, I am pleased the Group's 96.1% combined operating ratio was broadly in line with the 95-96% target set at the interim result. This was despite the significant reduction in risk-free rates (excluding Argentina) which adversely impacted the underwriting result by \$324 million, including \$206 million in the second half alone (thereby adding 1.5% to the 2014 combined operating ratio relative to the 95-96% target).

In light of recent experience, the key to achieving our profit guidance (and restoring confidence in the balance sheet) was to demonstrate stable prior accident year claims development.

After strengthening the net outstanding claim provisions by \$131 million in the first half, the Group recorded \$132 million of favourable prior accident year claims development in the second half, resulting in \$1 million of positive development for the full year. Not since 2011 has the Group recorded positive prior accident year development.

Supporting our decision to sacrifice revenue for margin where competitive pressures are excessive, the attritional claims ratio continued the trend seen in previous periods, improving on an underlying basis to 46.6% from 47.5% in 2013 and 49.1% in 2012.

Despite a 9% reduction in net earned premium, the underwriting expense ratio improved marginally to 16.1% from 16.5% in 2013, reflecting an absolute reduction in costs of \$270 million. Faced with relatively muted economic growth prospects and heightened competitive pressure globally, we will clearly need to further improve expense management and efficiency.

The 2014 insurance profit margin of 7.6% represented a pleasing improvement on the 5.5% margin achieved in 2013, with an improved underwriting margin supplemented by a lift in the net investment yield on technical reserves to 2.7% from 2.4% a year earlier.

2. Financial strength and flexibility

At the half year result in August 2014, we announced a comprehensive capital plan that included a series of measures aimed at substantially reducing gearing and improving the financial strength and flexibility of the Group. Since then we have successfully completed the following capital initiatives:

- \$600 million institutional equity raising that was approximately six times oversubscribed;



Our focus will be on pursuing growth where we can, driving expense efficiencies, enhancing investment returns and growing dividends.”



Patrick Regan Group Chief Financial Officer • QBE Insurance Group

- \$180 million retail SPP equity raising that was more than three times oversubscribed;
- repurchase and cancellation of \$500 million of convertible securities;
- \$700 million tier 2 capital qualifying subordinated debt issue;
- buyback of \$393 million of non-capital qualifying senior debt;
- sale of the US agencies for up-front cash of \$217 million and an additional performance based earn out of up to \$83 million; and
- sale of the Australian agencies for a performance based price range of A\$232 million - A\$348 million, including up-front cash of A\$290 million.

The completed capital initiatives have had a significantly positive impact on the Group's financial strength and flexibility.

Key metrics as at 31 December 2014 adjusted on a pro forma basis for the settlement of the agency sales (assuming 50% of the agency sales proceeds are applied to reduce outstanding debt) are as follows:

- debt to equity has reduced to 30.4% from 44.1% a year earlier;
- debt to tangible equity has reduced to 46.5% from 77.8% a year earlier; and
- APRA PCA multiple has increased to 1.71x from 1.59x a year earlier.

The only capital plan initiative outstanding is the initial public offering of a minority stake in the Australian lenders' mortgage insurance business. While planning for this initiative continues, in light of the Group's significantly strengthened balance sheet neither the timing nor activation is critical to meeting our expected capital needs.

The other area highlighted for improvement was free cash flow (measured by cash remittances from the divisions to the Group centre). Strong and growing free cash flow supports our external dividend paying capacity and will be an increasingly important area of emphasis for us going forward.

Free cash flow increased 44% to \$770 million from \$534 million in 2013 as Australia, Asia Pacific and Equator Re paid increased dividends. Returning North American Operations to dividend paying status remains a priority.

Effective 1 January 2015, we restructured our worldwide reinsurance program including purchasing more US occurrence limit at the top of the program and an aggregate stop loss cover which limits the net cost of large individual risk and catastrophe claims (excluding crop and lenders' mortgage insurance) under most scenarios. We have also significantly restructured the reinsurance arrangements protecting the US crop portfolio, including the purchase of additional hail quota share.

Our revised reinsurance structures reduce potential earnings volatility while at the same time benefiting our capital charges. A detailed explanation of the revised reinsurance structure is included in the "other developments" section of the Equator Re business review.

Consistent with these positive developments, A.M. Best recently revised QBE's rating outlook from 'negative' to "stable" and affirmed the financial strength rating of QBE's key subsidiaries at 'A' (Excellent). We expect similar recognition from S&P as we demonstrate continuing stability in 2015.

As we focus on growing profit, we will target strong growth in dividends.

3. Investment performance and strategy

Notwithstanding periods of significant equity and debt market volatility, the cash and investment portfolio performed in accordance with expectations achieving a net investment return of 2.7%, up from 2.6% in 2013.

At the half year result, we set out plans to enhance the investment yield over the next few years, primarily via three actions:

- increasing the portfolio's exposure to growth assets;
- extending the duration of assets to more closely match the duration of claims liabilities; and
- further diversifying the fixed income portfolio by introducing modest BBB exposure.

The Group commenced 2014 with growth assets of around 2% of the total investment portfolio. By 31 December 2014, we had increased that exposure to 8.9% and the revised asset allocation contributed 0.2% to our overall gross investment return of 2.8%. Subsequent to year end, we have further increased the allocation to growth assets to around 14% of the portfolio. We took advantage of early falls in market values to increase our positions in emerging market investments, high yield debt and developed market equities, a reweighting that has to date proved beneficial.

With respect to asset duration, at the right time and with regard to global yield curves we will extend the duration of our assets (around six months currently) to more closely match the duration of our liabilities (approximately three years). Given that most yield curves have actually fallen since the August 2014 half year result, we have not yet meaningfully extended duration in any major currency. We will continue to monitor global yield curve expectations to take advantage of opportunities to sensibly extend duration.

We are also broadening the range of fixed income securities that we own. In the second half of the year we added to our infrastructure debt and structured credit exposures and switched a portion of our 'AA' holdings into 'A' rated securities for additional yield.

Notwithstanding revisions to the Group's investment strategy, the portfolio remains conservative relative to the majority of global peers. In particular, the fixed income component of the portfolio retains excess liquidity relative to the Group's claims payment obligations. We will therefore selectively introduce additional yield into the portfolio throughout the course of 2015, as appropriately high quality opportunities present themselves.

Economic and financial market landscape

Growth and policy divergence remained the predominant global economic themes during the second half of 2014.

While the US remained a growth engine, softening in Europe, China and Japan weighed on global growth momentum, resulting in increased volatility in financial markets and a reassessment of the pace of monetary policy normalisation across key economies. As a result, yield curves are trading at historically low levels. A benign inflation outlook and further monetary policy stimulus in major economies provide solid support for growth assets as a whole, although some markets remain exposed to US dollar strength and the precipitous drop in oil prices.

The US economy made considerable progress over 2014 and remains a bright spot for the global economy. Despite the recent strength in the dollar, the outlook for 2015 is encouraging, supported by lower borrowing and energy costs. Domestic demand should also be bolstered by an improving labour market, with the US currently enjoying the strongest jobs recovery since 1999. As a result, the Federal Reserve is expected to commence rate tightening in 2015.

Europe remains a headwind for global growth and a source of market instability. Recent policy actions by the ECB should help to dampen some of this volatility; however, Europe is in need of further structural reform over the longer term. Growth momentum in the UK has been impacted by developments in Europe, resulting in market expectations of a tightening in UK policy rates being pushed further into the future.

A softer commodity cycle will keep economic growth in Australia at moderate levels and rates near historical lows, although the recent weakness in the Australian dollar will accelerate necessary rebalancing in the economy.

Operating and financial performance

Summary income statement

FOR THE YEAR ENDED 31 DECEMBER	2014 US\$M	2013 US\$M
Gross written premium	16,332	17,975
Gross earned premium	16,521	17,889
Net earned premium	14,084	15,396
Net claims expense	(8,900)	(9,931)
Net commission	(2,363)	(2,580)
Underwriting and other expenses	(2,274)	(2,544)
Underwriting result	547	341
Net investment income on policyholders' funds	527	500
Insurance profit	1,074	841
Net investment income on shareholders' funds	270	301
Financing and other costs	(297)	(345)
Share of net profits of associates	1	-
Amortisation/impairment of intangible assets	(117)	(1,245)
Profit (loss) before tax	931	(448)
Tax (expense) credit	(182)	204
Profit (loss) after tax	749	(244)
Profit attributable to non-controlling interests	(7)	(10)
Net profit (loss) after tax	742	(254)

Overview of the 2014 result

The Group reported a net profit after tax of \$742 million in 2014 compared with a \$254 million after tax loss in 2013. The \$1.0 billion profit turnaround reflected a healthy improvement in underwriting profitability coupled with the non-recurrence of the very substantial North American goodwill impairment charge recognised in 2013.

Excluding the cost of amortisation and impairment of intangibles, the cash profit before tax increased 31% to \$1,048 million due to a 28% uplift in the insurance profit coupled with reduced financing costs as a result of lower gearing.

The cash profit after tax increased by only 8% to \$821 million, reflecting an increase in the effective tax rate on cash profit to 21% from 3% in the prior corresponding period.

Cash profit

FOR THE YEAR ENDED 31 DECEMBER	2014 US\$M	2013 US\$M
Cash profit before tax	1,048	797
Tax expense on cash profit	(220)	(26)
Profit attributable to non-controlling interests	(7)	(10)
Net cash profit after tax	821	761
Amortisation/impairment of intangible assets after tax	(79)	(1,015)
Net profit (loss) after tax	742	(254)
Basic earnings per share - cash basis (US cents)	63.5	62.9
Dividend payout ratio (percentage of cash profit)	49%	50%

Headline gross written premium fell 9% to \$16,332 million; however, the reduction was only 6% on a constant currency basis and was largely due to reduced writings in our North American and European Operations, while our Asia Pacific Operations generated strong underlying growth during the period.

Indicative of a more competitive global pricing environment, Group-wide premium rate increases averaged 0.1% in 2014 compared with 0.7% in the first half of the year and slightly less than 4% in 2013.

The Group's reinsurance expense ratio increased to 14.8% in 2014 from 13.9% a year earlier as a result of the medical malpractice reinsurance transaction announced in conjunction with the half year result. Excluding this transaction, the reinsurance expense ratio decreased to 12.6%, largely reflecting cost savings associated with the restructuring of the Group's external reinsurance program and reduced aggregate exposure.

Net earned premium fell 9% to \$14,084 million or 5% on a constant currency basis.

The combined operating ratio improved to 96.1% from 97.8% in 2013, due to an improvement in both the net claims ratio and the combined commission and expense ratio.

The net claims ratio fell to 63.2% from 64.5% a year earlier. The non-recurrence of adverse prior accident year claims development, a net risk margin release, the medical malpractice reinsurance transaction and a lenders' mortgage insurance premium earnings adjustment more than offset the impact of the adverse discount rate movement, higher large individual risk and catastrophe claims and a deterioration in the headline attritional claims ratio due to Argentina.

As discussed overleaf, on an underlying basis the Group's attritional claims ratio improved to 46.6% in 2014 from 47.5% a year earlier.

Notwithstanding the 9% reduction in net earned premium, the combined commission and expense ratio improved to 32.9% from 33.3% previously. A reduction in restructuring costs coupled with emerging operational transformation benefits were partially offset by the impact of the medical malpractice reinsurance transaction, increased systems development spend, investment in Asian growth initiatives and reduced fee income.

The Group delivered a 2014 insurance profit of \$1,074 million, up 28% from \$841 million in the prior corresponding period. The insurance profit margin improved to 7.6% from 5.5% a year earlier, reflecting both an improved underwriting margin and investment return. The net investment yield on technical reserves increased to 2.7% from 2.4% in 2013, contributing 3.7% to the insurance profit margin compared with 3.2% last year.

Investment income on shareholders' funds declined to \$270 million from \$301 million in 2013, due to a reduction in other income as a result of an \$18 million loss on the repurchase of QBE's senior debt securities and a \$17 million loss on sale of a related entity in North America. Excluding other income and foreign exchange, investment income on shareholders' funds increased to \$312 million from \$282 million last year, largely due to enhanced returns generated by the Group's increased exposure to growth assets.

Interest expense fell 14% to \$297 million from \$345 million a year earlier, reflecting the \$990 million or 22% reduction in total borrowings since 31 December 2013.

The effective tax rate was 20% and compared with a tax credit in 2013. The effective tax rate benefited from increased profits in lower tax-paying jurisdictions and the release of provisions following settlement of tax disputes.

Significant items in 2014 result

The results and financial statements include a number of significant items that should be highlighted.

Notwithstanding another year of relatively benign global catastrophe experience, the total cost of large individual risk and catastrophe claims increased by 10% to \$1,611 million, reflecting persistently high crop catastrophe claims and an increase in the frequency and severity of large individual risk claims, particularly in European Operations, Australia & New Zealand, Equator Re and Asia Pacific. Catastrophe claims increased in Europe and Australia & New Zealand following an especially benign 2013, while Equator Re effectively ran catastrophe-free.

Consistent with our revised reinsurance structure effective 1 January 2015, under most scenarios the net cost of large individual risk and catastrophe claims (excluding crop and lenders' mortgage insurance) is limited.

Risk-free rates used to discount net outstanding claims liabilities decreased significantly during 2014 resulting in an adverse discount rate adjustment of \$324 million compared with a gain of \$272 million in the prior year. Over the course of 2014, the currency weighted average risk-free rate (excluding the Argentine peso) fell from 2.17% to 1.45%.

In the context of the Group's recent history, a prominent feature of the 2014 result was the absence of adverse prior accident year claims development. Indeed, the 2014 result actually benefited from \$1 million of favourable prior accident year claims development compared with adverse development of \$552 million in 2013 and \$464 million in 2012.

The amortisation and impairment charge against intangibles was \$117 million, down from \$1,245 million last year, reflecting the non-recurrence of a \$600 million goodwill impairment and \$413 million of accelerated amortisation, primarily relating to Balboa and Sterling intangibles following the collapse in lender-placed premium and profitability.

Partly driven by a \$1.05 billion reduction in the central estimate of net outstanding claims, the result included risk margin releases of \$184 million that contributed to a reduction in the probability of adequacy to 88.7% from 90.7% a year earlier.

The earnings pattern of the Australian lenders' mortgage insurance business was revised to more appropriately match the flow of risk and the incidence of claims. Net earned premium benefited by \$82 million and pre-tax profit by \$75 million.

Significant items in profit before tax

FOR THE YEAR ENDED 31 DECEMBER	2014 US\$M	2013 US\$M
Realised and unrealised gains on investments	137	86
Cost of large individual and catastrophe claims (current accident year)	(1,611)	(1,462)
Discount rate (cost) benefit, excluding Argentine peso	(324)	272
Prior accident year central estimate claims development ¹	1	(552)
Risk margin release (strengthening)	184	(266)
Amortisation and impairment of intangibles	(117)	(1,245)
QBE LMI premium earning pattern	75	-

¹ Net of \$523 million of discount movement (2013 \$69 million) due to long tail classes (dust disease in Australia and workers' compensation in Argentina) where the level of assumed claims inflation is directly linked to the discount rate.

The Group is exposed to multiple risks in the conduct of its insurance business as evidenced by the 2014 results. Managing risk is central to the sustainability of QBE's business and is a core part of our governance framework and management processes. A summary of our key risks is set out in the Chief Risk Officer's report in the Annual Report and in note 5 to the financial statements.

Premium income

Gross written premium fell 9% to \$16,332 million from \$17,975 million in 2013, with the decrease exaggerated by a \$601 million foreign exchange impact.

On a cumulative average basis and compared with 2013, the Australian dollar and the Argentine peso depreciated 7% and 32% respectively against the US dollar. Coupled with other intra-divisional cross currency movements against the US dollar, foreign exchange movements adversely impacted reported premium income in Australian & New Zealand Operations and Emerging Markets by \$289 million and \$343 million respectively.

On a constant currency basis, gross written premium fell by 6% to \$16,933 million.

Premium income reductions in North American and European Operations of 11% and 14% respectively on a constant currency basis were partially offset by growth in Emerging Markets, driven by strong organic growth in Asia and (inflation-linked) rate increases in Latin America. Australian & New Zealand Operations reported a 2% contraction in gross written premium on the same basis.

Gross written premium in North America decreased \$641 million, reflecting commodity price related reductions in crop insurance, remediation of the program business, a further reduction in loans tracked (and thus premium production) in the lender-placed business and heightened competition in assumed reinsurance. European Operations reported a \$673 million reduction in gross written premium on a constant currency basis, largely due to \$543 million of previously identified remediation and disposal activities as well as in response to market conditions in the international markets and reinsurance business units.

Asia Pacific enjoyed gross written premium growth of 11% on a constant currency basis, with particularly strong growth in our engineering, workers' compensation, fire and marine portfolios. Latin America recorded gross written premium growth of 25% on the same basis, largely driven by growth in Argentina due to significant (inflation-linked) premium rate increases and a one-off change in the basis of recognition of workers' compensation premium.

Although Australia & New Zealand reported a slight reduction in gross written premium on a constant currency basis, solid growth was achieved in CTP and lenders' mortgage insurance and across most lines of business in New Zealand.

Equator Re's gross written premium fell by 18% relative to 2013, reflecting generally softer reinsurance market conditions coupled with increased retentions on a number of divisional catastrophe and per risk retentions.

Group-wide premium rate movements averaged 0.1% across 2014 compared with 0.7% in the first half and slightly less than 4% in 2013. North America and Australia & New Zealand averaged rate increases of 0.4% and 0.1% respectively, down from 3.7% and 5.6% respectively in 2013. European Operations saw competition intensify, experiencing an average rate reduction of 1.3% compared with a 1.6% increase in the previous year. Emerging Markets achieved an average rate increase of 6.8% compared with 5.9% a year earlier, with Latin America experiencing an average rate increase of 10.6% due to relatively high inflation, while premium rates in Asia Pacific reduced by 0.4% on average.

The Group's reinsurance expense ratio increased to 14.8% of gross earned premium from 13.9% in 2013, as a result of the \$362 million medical malpractice reinsurance transaction, which reduced both net claims incurred and net earned premium. Excluding this transaction, the reinsurance expense ratio decreased to 12.6%, largely reflecting cost savings associated with the restructuring of the Group's external reinsurance program and reduced aggregate exposure.

Net earned premium reduced by 9% to \$14,084 million from \$15,396 million in 2013; however, on a constant currency basis the reduction was only 5% to \$14,600 million.

Excluding the impact of the medical malpractice reinsurance and the \$82 million lenders' mortgage insurance premium adjustment, underlying net earned premium fell by only 4% on a constant currency basis, with reduced reinsurance spend coupled with the earning of prior year premiums softening the impact of the larger reduction in gross written premium.

Underwriting performance

Key ratios - Group

FOR THE YEAR ENDED 31 DECEMBER	2014 %	EX MED MAL 2014 %	2013 %
Net claims ratio	63.2	64.1	64.5
Net commission ratio	16.8	16.4	16.8
Expense ratio	16.1	15.7	16.5
Combined operating ratio	96.1	96.2	97.8
Insurance profit margin	7.6	7.4	5.5

Divisional performance

Contributions by region

FOR THE YEAR ENDED 31 DECEMBER	GROSS WRITTEN PREMIUM		NET EARNED PREMIUM		COMBINED OPERATING RATIO		INSURANCE PROFIT BEFORE INCOME TAX	
	2014 US\$M	2013 US\$M	2014 US\$M	2013 US\$M	2014 %	2013 %	2014 US\$M	2013 US\$M
North American Operations	5,310	5,951	4,471	5,030	100.8	111.5	8	(535)
European Operations	4,526	5,236	3,567	4,160	93.8	93.7	345	376
Australian & New Zealand Operations	4,392	4,805	3,834	4,028	87.0	87.9	680	693
Emerging Markets	2,179	2,107	1,705	1,702	112.7	96.6	(109)	121
Equator Re	642	783	525	509	79.9	84.2	145	135
Equator Re elimination	(642)	(783)	-	-	-	-	-	-
Corporate adjustments	(75)	(124)	(18)	(33)	0.1	(0.2)	5	51
Group	16,332	17,975	14,084	15,396	96.1	97.8	1,074	841
Direct and facultative	15,198	16,610	13,053	14,156	96.5	99.8	951	490
Inward reinsurance	1,134	1,365	1,031	1,240	91.0	74.5	123	351
Group	16,332	17,975	14,084	15,396	96.1	97.8	1,074	841

Incurred claims

The aforementioned medical malpractice reinsurance transaction distorts the main components of the Group's 2014 net claims ratio as highlighted in the table overleaf. The claims commentary following refers to the 2014 claims ratio (and components therein) excluding the impact of the medical malpractice reinsurance.

The net claims ratio improved to 64.1% in 2014 compared with 64.5% in 2013.

The Group's current accident year attritional claims ratio increased to 50.7% from 49.6% a year earlier, due entirely to the increase in the Argentine attritional claims ratio to 111.9% from 65.8% in the prior corresponding period.

The Argentine business ordinarily generates an above portfolio average attritional claims ratio reflecting its longer tail workers' compensation bias and relatively low property catastrophe exposure. The recent and quite extreme increase in inflation has contributed to a very material uplift in the current accident year attritional claims ratio, well above historical levels. In an insurance margin context, significantly increased yields on peso denominated assets backing peso denominated insurance reserves serve to counter the impact of increased inflation.

Excluding the medical malpractice reinsurance transaction, our US crop and lender-placed businesses as well as Argentina, the Group's underlying current accident year attritional claims ratio improved to 46.6% in 2014 from 47.5% a year earlier. Solid year-on-year improvements in the attritional claims ratio were achieved in Australia & New Zealand, Europe and Asia Pacific, while North America reported a more modest improvement.

The total cost of large individual risk and catastrophe claims increased to \$1,611 million or 11.2% of net earned premium, up from 9.5% a year earlier. This was above the Group's annual allowance of 10.5%, largely reflecting persistently high crop catastrophe claims coupled with higher than normal frequency and severity of large individual risk claims, particularly in European

Operations, Australia & New Zealand, Equator Re and Asia Pacific. Catastrophe claims increased in Europe and especially in Australia & New Zealand following a benign 2013, while Equator Re effectively ran catastrophe-free.

The net cost of catastrophe claims (excluding crop) was \$516 million or 3.6% of net earned premium. This was within our annual catastrophe allowance but up from \$348 million or 2.3% of net earned premium in 2013, largely due to the UK floods in January and February as well as the Brisbane hailstorm in November. Net of significant recoveries under the Group's aggregate risk reinsurance program, large individual risk claims cost \$835 million or 5.8% of net earned premium, up from 5.2% of net earned premium in 2013.

Over the course of 2014, the weighted average risk-free rate (excluding the Argentine peso) used to discount net outstanding claims liabilities fell from 2.17% to 1.45%. This gave rise to an adverse underwriting impact of \$324 million (including a \$206 million adverse impact in the second half of the year alone) that added 2.2% to the net claims ratio, compared with a benefit of \$272 million in the prior corresponding period, reducing the net claims ratio by 1.8%.

In the context of the Group's recent history, a prominent feature of the 2014 result was the \$1 million of favourable prior accident year claims development compared with adverse development of \$552 million in 2013 and \$464 million in 2012. After strengthening net outstanding claims provisions by \$131 million in the first half, the Group recorded \$132 million of favourable prior accident year claims development in the second half.

Driven by Argentine workers' compensation, Latin America experienced \$212 million of adverse prior accident year claims development, including an additional \$42 million of development during the second half, partly due to a further increase in frequency of litigated claims pertaining to the Argentine workers' compensation portfolio.

Having reported significant adverse prior accident year development in recent years including \$51 million in the first half, North America experienced \$10 million of favourable development in the second half which reduced overall 2014 adverse development to \$41 million. Equator Re reported \$28 million of adverse prior accident year claims development with positive catastrophe claim development more than offset by adverse development in the casualty excess of loss portfolio.

Despite some strengthening of long-tail disease claims in the UK, European Operations reported favourable prior accident year claims development of \$158 million while Australia & New Zealand booked \$114 million and Asia Pacific \$20 million.

The full year result included risk margin releases of \$184 million that improved the net claims ratio by 1.3%. The releases were partly due to the \$1.05 billion reduction in the net central estimate, with the remainder due to a lower adopted probability of adequacy. European Operations booked a risk margin release of \$140 million while Equator Re and North America both had releases of \$32 million and \$19 million respectively.

The material European Operations risk margin release reflected the significant reduction in the level of uncertainty in the consolidated net discounted central estimate of claims, principally due to the medical malpractice reinsurance transaction which eliminated long-tail liabilities that have been challenging to accurately model. The release also reflected a reduction in the net central estimate driven by the aforementioned favourable prior accident year claims development.

The overall risk margin release resulted in a reduction in the outstanding claims probability of adequacy to 88.7% from 90.7% a year earlier (and 89.4% at the half year) but still comfortably within our newly established probability of adequacy benchmark range of 87.5% to 92.5%.

The following table provides a summary of the major components of the 2014 net claims ratio before and after the impact of the medical malpractice reinsurance.

Analysis of net claims ratio

FOR THE YEAR ENDED 31 DECEMBER	2014 %	EX MED MAL 2014 %	2013 %
Attritional claims	52.1	50.7	49.6
Large individual risk and catastrophe claims ¹	11.4	11.2	9.5
Claims settlement costs ¹	2.8	2.7	2.8
Claims discount	(3.9)	(3.8)	(2.7)
Net incurred claims estimate claims ratio (current accident year)	62.4	60.8	59.2
Changes in undiscounted prior accident year central estimate ²	(2.6)	-	3.6
Changes in discount rates	2.3	2.2	(1.8)
Other (including unwind of prior year discount)	2.4	2.4	1.8
Net incurred central estimate claims ratio	64.5	65.4	62.8
Movement in risk margins	(1.3)	(1.3)	1.7
Net incurred claims ratio (current financial year)	63.2	64.1	64.5

1 Prior year adjusted for minor reallocation between crop catastrophe claims and claims settlement costs.

2 Net of \$523 million of discount movement (2013 \$69 million) due to long-tail classes (dust disease in Australia and workers' compensation in Argentina) where the level of assumed claims inflation is directly linked to the discount rate.

The following table provides an analysis of the year-on-year movement in the attritional claims ratio.

Analysis of attritional claims ratio

FOR THE YEAR ENDED 31 DECEMBER	2014		2013	
	NEP US\$M	ATTRITIONAL %	NEP US\$M	ATTRITIONAL %
Rest of world	12,303	46.6	12,721	47.5
Medical malpractice reinsurance ¹	(362)	-	-	-
US multi-peril crop insurance ²	965	67.0	1,141	67.0
Lender-placed insurance ³	544	43.6	797	43.5
Argentina ⁴	634	111.9	737	65.8
QBE Group	14,084	52.1	15,396	49.6

1 One-off medical malpractice reinsurance premium.

2 Crop does not lend itself to attritional versus catastrophe claims analysis so the attritional claims ratio is assumed constant at 67.0%.

3 The significant decline in North American lender-placed premium distorts the trend in the Group's underlying attritional claims ratio.

4 Argentina's attritional claims ratio is distorted by the heightened level of claims inflation.

Material large individual risk and catastrophe claims reported during the year are summarised in the table below.

Large individual risk and catastrophe claims

IN THE YEAR ENDED 31 DECEMBER 2014	COST US\$M	% OF NEP
North American crop ¹	260	1.8
UK Floods (January and February)	136	1.0
Brisbane & SE Queensland hailstorm (27 November)	85	0.6
North American wind/hail (April to June)	78	0.6
Hurricane Odile (15 September)	52	0.4
European Hailstorms (15 June)	25	0.2
North American winter storms (5 January)	22	0.2
North American tornadoes (3 April)	21	0.1
Cyclone Ita (13 April)	12	0.1
Other catastrophe claims including bulk IBNR	85	0.5
Total catastrophe claims including bulk IBNR	776	5.5
Forge Group Limited (11 February)	46	0.3
Jade Sa (15 May)	38	0.3
Bo Kwang Printing (29 May)	30	0.2
Big River Group (5 November)	21	0.1
Atlantic Ltd (4 February)	15	0.1
Synergy Sterilisation Rawang (15 April)	13	0.1
Brian Bell & Co (23 January)	13	0.1
Shih-Teng Hsu (22 March)	12	0.1
Conma Industries (4 February)	11	0.1
Buckby's Coaches (13 April)	11	0.1
Mbay Netherlands (11 August)	11	0.1
Kenwick Park Hotel Ltd (13 October)	11	0.1
SVI Public Company (12 November)	10	0.1
Other individual risk claims including bulk IBNR	593	4.1
Total large individual risk claims including bulk IBNR	835	5.9
Total large individual risk & catastrophe claims including bulk IBNR	1,611	11.4

1 Crop catastrophe claims are defined as claims in excess of a 67% net claims ratio.

Large individual risk and catastrophe claims

IN THE YEAR ENDED 31 DECEMBER 2013	COST US\$M	% OF NEP
Total catastrophe claims including bulk IBNR	665	4.3
Total large individual risk claims including bulk IBNR	797	5.2
Total large individual risk & catastrophe claims including bulk IBNR	1,462	9.5

Commission and expenses

The aforementioned medical malpractice reinsurance transaction distorts the Group's 2014 commission and expense ratios as highlighted in the key ratios table on page 18. The commission and expense ratio commentary below refers to the 2014 commission and underwriting expense ratios excluding the impact of the medical malpractice reinsurance.

The Group's combined commission and expense ratio decreased to 32.1% compared with 33.3% last year.

The commission ratio improved to 16.4% from 16.8% in the prior corresponding period, reflecting relatively minor business mix related improvements across all divisions with the exception of Latin America. Latin America's commission ratio increased to 22.1% from 21.6% in the previous year, due to increased commission rates in Colombia and Ecuador as well as changes in the mix of business in Brazil.

The underwriting expense ratio improved to 15.7% from 16.5% in the previous year. Notwithstanding reduced premium income and increased systems development spending, significant improvements in the underwriting expense ratio were achieved in North America and Australia & New Zealand, largely due to operational transformation and reduced restructuring charges, while the expense ratio increased slightly in European Operations, Asia Pacific Operations and Equator Re. The improvement in the North American expense ratio was achieved despite a material reduction in fee income, mainly relating to the lender-placed business.

Although European Operations achieved an absolute year-on-year reduction in expenses, the underlying expense ratio deteriorated slightly as a result of a greater than anticipated reduction in premium income. Asia Pacific Operations' underwriting expense ratio increased due to continued investment for growth, while Equator Re's expense ratio increased as a result of the ongoing build-out of capability in Bermuda coupled with a change in the basis of expense allocation.

Income tax expense

The Group reported income tax expense of \$182 million in 2014 compared with a tax benefit of \$204 million in 2013, the prior year having been significantly impacted by the large underwriting loss in the US and goodwill impairment.

Income tax expense as a percentage of profit before tax was 20%. Although less than our prima facie tax rate, the effective tax rate of 20% was broadly in line with management expectations and reflected increased profits in lower taxpaying jurisdictions and the release of provisions following completion of audit activity by taxation authorities and the settlement of tax disputes.

QBE paid \$383 million in corporate income tax to tax authorities globally in 2014, including \$272 million in Australia. Income tax payments in Australia benefit our dividend franking account, the balance of which stood at A\$404 million as at 31 December 2014. The Group is therefore capable of fully franking A\$944 million of dividends.

The strong franking account balance, coupled with the expected ongoing level of Australian income tax payments, should support the continued payment of fully franked dividends to shareholders in 2015 and 2016.

Foreign exchange

The key exchange rates used in the preparation of the financial statements are set out in note 1 to the financial statements. The table below shows the impact of foreign exchange on the 2014 result and balance sheet on a constant currency basis.

Impact of exchange rate movements

	2014 ACTUAL US\$M	2014 AT 2013 EXCHANGE RATES ¹ US\$M	EXCHANGE RATE IMPACT	
			US\$M	%
Gross written premium	16,332	16,933	(601)	(4)
Gross earned premium	16,521	17,056	(535)	(3)
Net earned premium	14,084	14,600	(516)	(4)
Net profit after tax	742	761	(19)	(3)
Total investments and cash	28,583	30,425	(1,842)	(6)
Total assets	45,000	47,547	(2,547)	(6)
Gross outstanding claims provision	20,412	21,748	(1,336)	(7)
Total liabilities	33,918	35,765	(1,847)	(5)

1 Income statement items are restated to 31 December 2013 average rates of exchange and balance sheet items to 31 December 2013 closing rates of exchange.

The impact of exchange rate movements (excluding hedging transactions) on the 2014 result was a \$17 million operational foreign exchange gain, with the net movement in the foreign currency translation reserve, share capital and other reserves due to foreign currency fluctuation being a \$684 million negative impact on equity before tax.

Balance sheet

Capital management summary

During the year, the Board and management implemented a number of initiatives to improve the financial strength of the balance sheet, thereby ensuring that our regulatory and ratings agency capital levels were within our strengthened benchmark ranges.

In addition to the numerous capital initiatives announced with the half year result and largely completed as outlined in my general overview at front, other balance sheet initiatives undertaken over the past 12 months included:

- conversion of \$250 million of subordinated debt into ordinary shares in June 2014; and
- elimination of the 1% discount on our dividend reinvestment programs announced in conjunction with the interim result.

Capital summary

AS AT 31 DECEMBER	2014 US\$M	2013 US\$M
Net assets	11,082	10,403
Less: intangible assets	(3,831)	(4,480)
Net tangible assets	7,251	5,923
Add: borrowings	3,581	4,571
Total capitalisation	10,832	10,494

AS AT 31 DECEMBER	2014 US\$M	2013 US\$M
APRA's Prescribed Capital Amount (PCA)	5,887	5,624
QBE's regulatory capital base	10,008	8,955
PCA multiple	1.70x	1.59x

The Group's regulatory and rating agency capital levels are at or above minimum benchmark levels, with an indicative APRA PCA multiple of 1.70x at year end, up strongly from 1.59x at 31 December 2013.

The Group's insurance concentration risk charge increased 22% or \$258 million to \$1,429 million, largely reflecting finalisation of the methodology supporting the Group's whole of portfolio catastrophe calculation which is based on the Group's peak catastrophe region of North America. The asset risk charge increased 34% or \$437 million to \$1,821 million, mainly as a result of the increase in exposure to growth assets from around 2% to 8.9% of the total cash and investments portfolio.

Although arguably more relevant for banks, as at 31 December 2014 our CET1 ratio was 128%, up from 114% at 31 December 2013 and more than double APRA's 60% minimum requirement.

Key financial strength ratios

	BENCHMARK	2014	2013
Debt to equity	25% to 35%	32.5%	44.1%
Debt to tangible equity		49.7%	77.8%
PCA multiple	1.7x to 1.9x	1.70x	1.59x
Premium solvency ¹		51.5%	38.5%
Probability of adequacy of outstanding claims	87.5% to 92.5%	88.7%	90.7%

¹ Premium solvency ratio is calculated as the ratio of net tangible assets to net earned premium.

Borrowings

Total borrowings at 31 December 2014 were \$3,581 million, down \$990 million or 22% from \$4,571 million a year earlier.

Consistent with the capital management initiatives announced in conjunction with the interim result, the Group's treasury department was active in debt markets during the year completing the following transactions:

- repayment of \$484 million of senior debt that matured on 14 March 2014;
- conversion of \$250 million of subordinated debt in to ordinary shares on 11 June 2014;
- issuance of \$700 million of 30 year non call 10 tier 2 subordinated debt securities due 2044 on 2 December 2014;
- repurchase and cancellation of \$500 million of convertible subordinated debt securities due 2038 on 5 December 2014; and
- repurchase of \$393 million of senior notes due 2015 on 15 December 2014.

At 31 December 2014, the debt to equity ratio was 32.5% and within our benchmark range of 25%-35%. Although down substantially from 44.1% at the end of 2013, gearing would have reduced to around 30% except for the adverse impact of the stronger US dollar on closing equity. Debt to tangible equity fell to 49.7% from 77.8% a year earlier, reflecting the reduction in borrowings concurrent with a further material reduction in intangibles as discussed overleaf.

Interest expense for the year was \$297 million, down 14% from \$345 million for the same period last year, consistent with the year-on-year reduction in average borrowings. The weighted average annual cost of borrowings outstanding at the balance date was 6.2%, down modestly from 6.5% at 31 December 2013, due to the repayment of relatively expensive senior debt.

In addition to achieving an absolute reduction in the level of borrowings, the profile of borrowings has been restructured with senior debt swapped for capital qualifying tier 2 subordinated debt and the term structure lengthened appreciably.

Borrowings maturity¹

AS AT 31 DECEMBER	2014 %	2013 %
● Less than one year	13	10
● One to five years	26	51
● More than five years	61	39



Borrowings profile

AS AT 31 DECEMBER	2014 %	2013 %
● Subordinated debt	61	50
● Senior debt	30	43
● Capital securities	9	7



¹ Based on first call date.

Further details of borrowings are set out in note 22 to the financial statements.

Insurance liabilities

The table below summarises our provisions for outstanding claims and unearned premium, separately identifying the central estimate and risk margins.

Insurance liabilities

AS AT 31 DECEMBER	2014 US\$M	2013 US\$M	2012 US\$M	2011 US\$M	2010 US\$M
Net outstanding claims	16,948	18,208	18,412	16,984	15,017
Unearned premium net of deferred insurance costs ¹	5,341	5,968	6,023	5,929	4,785
	22,289	24,176	24,435	22,913	19,802
Central estimate - outstanding claims	15,595	16,643	17,079	15,783	13,747
Central estimate - unearned premium	4,398	4,956	5,024	5,062	3,901
Risk margin - outstanding claims	1,353	1,565	1,333	1,201	1,270
Risk margin - unearned premium ¹	943	1,012	999	867	884
	22,289	24,176	24,435	22,913	19,802
Risk margin in excess of 75% probability of adequacy using APRA's risk weighted capital adequacy model	1,396	1,606	1,374	1,152	1,353
	%	%	%	%	%
Probability of adequacy - outstanding claims	88.7	90.7	87.5	86.3	89.8
Probability of adequacy - total insurance liabilities	94.7	95.3	93.9	92.6	95.5
Weighted average discount rate	3.5	2.8	2.2	2.1	3.2
Weighted average term to settlement	2.8	3.0	2.9	2.9	3.0

¹ Includes deferred reinsurance expense for future business not yet written of \$6 million (2013 \$5 million).

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

As at 31 December 2014, risk margins in outstanding claims were \$1,353 million or 8.7% of the net discounted central estimate. This was down from \$1,565 million or 9.4% of the net discounted central estimate a year earlier, largely as a result of an explicit \$184 million risk margin release and a \$23 million adverse foreign exchange impact.

The probability of adequacy of the outstanding claims provision decreased to 88.7% from 90.7% a year earlier, reflecting the decrease in risk margins. The coefficient of variation of the net discounted central estimate increased slightly more than offsetting the dampening impact on volatility as a result of the reinsurance of the medical malpractice portfolios.

The probability of adequacy of total insurance liabilities was 94.7% compared with 95.3% at 31 December 2013, with the level of risk margins deemed appropriate to cover the inherent uncertainty in the net discounted central estimate.

Identifiable intangibles

As at 31 December 2014, the carrying value of intangibles was \$3,831 million, down 14% from \$4,480 million a year earlier but down 37% from \$6,054 million at 31 December 2012.

Intangibles reduced by \$649 million in 2014, mainly reflecting a \$216 million foreign exchange impact and reclassification of \$326 million of intangibles largely pertaining to the Australian and North American agencies to 'held for sale' status. Based on sales completed post year end, the transactions are expected to be profitable thus confirming the recoverability of these balances.

The amortisation charge against identifiable intangibles was \$62 million, down from \$642 million last year, reflecting the non-recurrence of \$413 million of accelerated amortisation predominantly relating to Balboa and Sterling intangibles following the very substantial decline in lender-placed premium income and profitability. As a result of this significant acceleration, the Group's annual amortisation charge has reduced from around \$200 million in the previous year.

QBE monitors goodwill and other intangibles for indicators of impairment at each reporting date.

Following completion of year end impairment testing, a \$55 million impairment charge was recognised, mainly in relation to identifiable intangibles in North and South America, with a small goodwill impairment recognised with respect to Colombia and Ecuador.

Although the year end impairment testing indicated that the recoverable value of North American Operations' group of cash generating units exceeded the carrying value, there remains limited headroom. Moreover, the impairment calculation remains 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. Details of the sensitivities associated with this valuation are included in note 16 to the financial statements.

As at 31 December 2014, total identifiable intangibles and goodwill pertaining to our North American Operations were \$1,794 million compared with \$2,053 million at 31 December 2013, with \$198 million of the reduction representing agency assets transferred to "held for sale" status and sold subsequent to year end.

Reconciliation of movement in intangible assets

	31 DECEMBER 2014			31 DECEMBER 2013		
	IDENTIFIABLE INTANGIBLES US\$M	GOODWILL US\$M	TOTAL US\$M	IDENTIFIABLE INTANGIBLES US\$M	GOODWILL US\$M	TOTAL US\$M
Opening balance	579	3,901	4,480	1,240	4,814	6,054
Acquisitions	-	-	-	5	(3)	2
Disposals	-	-	-	(3)	(8)	(11)
Transfer to assets held for sale	(35)	(291)	(326)	-	-	-
Additions/reclassifications	9	1	10	8	(2)	6
Amortisation/impairment	(106)	(11)	(117)	(645)	(600)	(1,245)
Foreign exchange	(24)	(192)	(216)	(26)	(300)	(326)
Closing balance	423	3,408	3,831	579	3,901	4,480

Investment performance and strategy

Investment returns were broadly in line with expectations in 2014, with the increased allocation to growth assets supporting solid fixed income returns.

Whilst our short duration portfolio did not benefit meaningfully from the significant rally in global bond markets over the course of the year, our credit portfolio did reap the benefits of additional credit spread income and modest capital gains from a degree of spread contraction.

This was particularly the case for our European exposures and our global financials. Our European exposures benefited from expectations of quantitative easing measures by the ECB while our global financials saw a continuation of the outperformance they have been enjoying since the major dislocation experienced during the GFC. Excess spreads on global financials are now negligible compared with similar term and quality industrials.

Our modest infrastructure debt and structured credit portfolios also generated good returns and we intend adding incrementally to these positions throughout 2015.

The additional asset classes introduced to the portfolio in 2014 (emerging market equity, emerging market debt and high yield debt) saw strong returns in the first half of the year, although we gave up much of these gains in the second half. This enabled more attractive entry levels to increase these positions early in 2015.

Our developed market equity and property allocations delivered excellent returns for the year with superior equity stock selection contributing to returns above those of the respective indices.

Exposure to growth assets has been increased to 14% of net investments and cash since year end through a combination of additional exposure to existing asset classes and a new allocation to alternatives. We expect this allocation to alternatives to progressively increase towards 2% of the portfolio by the end of 2015.

Notwithstanding revisions to the Group's investment strategy, our portfolio remains conservative relative to the majority of our global peers. In particular, the fixed income component of the portfolio retains excess liquidity relative to our claims payment obligations. We will therefore selectively introduce additional yield into the portfolio throughout the course of 2015 as appropriately high quality opportunities present themselves.

Total net investment income

FOR THE YEAR ENDED 31 DECEMBER	POLICYHOLDERS' FUNDS		SHAREHOLDERS' FUNDS		TOTAL	
	2014 US\$M	2013 US\$M	2014 US\$M	2013 US\$M	2014 US\$M	2013 US\$M
Income on growth assets	86	53	66	59	152	112
Income on fixed interest securities, short-term money and cash	448	447	246	223	694	670
Foreign exchange gain	17	24	-	-	17	24
Realised (losses) gains on repurchased debt securities	-	1	(18)	1	(18)	2
Realised (losses) gains on sale of related entities	-	-	(17)	29	(17)	29
Other income (expense)	2	(2)	7	-	9	(2)
Gross investment income	553	523	284	312	837	835
Investment expenses	(26)	(23)	(14)	(11)	(40)	(34)
Net investment income	527	500	270	301	797	801

Gross and net yield

FOR THE YEAR ENDED 31 DECEMBER	YIELD ON INVESTMENT ASSETS BACKING POLICYHOLDERS' FUNDS		YIELD ON INVESTMENT ASSETS BACKING SHAREHOLDERS' FUNDS		TOTAL	
	2014 %	2013 %	2014 %	2013 %	2014 %	2013 %
Gross ¹	2.9	2.5	2.7	3.0	2.8	2.7
Net ²	2.7	2.4	2.6	2.9	2.7	2.6
Gross excluding foreign exchange gain (loss)	2.8	2.4	2.7	3.0	2.8	2.6
Net excluding foreign exchange gain (loss)	2.6	2.3	2.6	2.9	2.6	2.5

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 before borrowing costs 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		INVESTMENT ASSETS BACKING SHAREHOLDERS' FUNDS		TOTAL	
	2014 US\$M	2013 US\$M	2014 US\$M	2013 US\$M	2014 US\$M	2013 US\$M
Cash and cash equivalents	544	826	308	412	852	1,238
Short-term money	4,965	4,352	2,806	2,173	7,771	6,525
Government bonds	3,077	5,030	1,738	2,514	4,815	7,544
Corporate bonds	7,827	9,635	4,422	4,812	12,249	14,447
Infrastructure debt	162	107	92	53	254	160
Unit trusts	47	57	26	28	73	85
Equities - listed and unlisted	466	106	378	187	844	293
Emerging market debt	155	-	88	-	243	-
Emerging market equity	155	-	88	-	243	-
High yield debt	176	-	100	-	276	-
Property trusts	606	210	342	104	948	314
Investment properties	10	9	5	4	15	13
Total investments and cash	18,190	20,332	10,393	10,287	28,583	30,619

Interest bearing financial assets - security grading

AS AT 31 DECEMBER	2014 %	2013 %
Moody's rating		
Aaa	26	31
Aa	30	36
A	39	28
<A	5	5

Currency mix

AS AT 31 DECEMBER	MARKET VALUE OF GROWTH ASSETS		MARKET VALUE OF TOTAL INVESTMENTS AND CASH	
	2014 %	2013 %	2014 %	2013 %
US dollar	61	22	32	31
Australian dollar	25	58	32	31
Sterling	11	12	19	19
Euro	3	8	7	9
Other	-	-	10	10

Dividend

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

The final dividend for 2014 will be 22 Australian cents per share. Combined with the 2014 interim dividend of 15 Australian cents per share, the total dividend for 2014 will be 37 Australian cents per share, up 16% compared with the total 2013 dividend of 32 Australian cents per share.

The payout for the 2014 full year is A\$492 million or around 49% of cash profit calculated by converting cash profit to Australian dollars at the closing rate of exchange. The calculation of cash profit is shown on page 15.

The dividend will be franked at 100% and is due to be paid on 13 April 2015. The dividend reinvestment programs continue at a nil discount.

Closing remarks

On every financial metric, completion of the capital plan initiatives to date has substantially improved QBE's balance sheet strength and flexibility. At the same time we have demonstrated reserving stability, delivered a result in line with market expectations and increased free cash flow.

Looking forward, we aim to deliver stable and high quality underwriting results, aggressively pursue additional cost savings and efficiencies, further enhance investment returns on our \$28.6 billion investment portfolio and optimise our capital usage in light of available growth opportunities.

All of this should translate into stable and steadily growing dividends to our shareholders.

Patrick Regan
Group Chief Financial Officer