

# Equator Re business review

“Equator Re continues to play a critical role in managing the Group’s risk appetite through optimised divisional retentions. Our quality underwriting and in-depth knowledge of the Group’s business, coupled with a benign catastrophe year, have produced an excellent 2014 result, despite a significant number of large individual risk claims.”

**Jim Fiore**

Group Chief Reinsurance Officer • Equator Re

Gross written premium US\$ million	Net earned premium US\$ million	Underwriting result US\$ million	Insurance profit US\$ million
<b>642</b>	<b>525</b>	<b>105</b>	<b>145</b>
↓ 18% from 2013	↑ 3% from 2013	↑ \$25M from 2013	↑ \$10M from 2013
		Combined operating ratio <b>79.9%</b> (2013 84.2%)	Insurance profit margin <b>27.7%</b> (2013 26.5%)

## Competitive landscape

In conjunction with the Group’s external global reinsurance programs, Equator Re provides excess of loss reinsurance protection as well as proportional cover to each of our four operating divisions. The results reported here exclude the whole account proportional covers that are now discussed in detail in the reviews of each of our underwriting divisions.

Premium rates on the excess of loss business fell across most lines of business throughout the year, particularly in US property business. Our efforts to de-risk the portfolio by modifying retentions on the larger catastrophe and per risk programs were successful, which also contributed to the reduced premium volume on the excess of loss business.

## Underwriting performance

The 79.9% combined operating ratio represented a solid improvement on the 84.2% combined operating ratio reported last year. The portfolio benefited from lower than expected catastrophe claims activity with no events exceeding divisional event retentions; however, the per risk portfolio was impacted by a number of weather-related losses in the UK, large fire losses in Asia Pacific and Latin America, a surety claim in Australia following the Forge Group voluntary administration and a number of medium sized casualty/motor losses in our UK book.

Equator Re benefits from the Group’s external catastrophe and per risk reinsurance programs, a stand-alone catastrophe aggregate treaty and a whole account quota share.

In 2014, there were no significant recoveries for Equator Re under our external excess of loss reinsurance programs.

## Underwriting result

FOR THE YEAR ENDED 31 DECEMBER		2014	2013	2012
Gross written premium	US\$M	642	783	939
Gross earned premium	US\$M	764	802	922
Net earned premium	US\$M	525	509	621
Net claims expense	US\$M	389	400	553
Net commission	US\$M	18	21	17
Expenses	US\$M	13	8	6
Underwriting result	US\$M	105	80	45
Net claims ratio	%	74.2	78.6	89.0
Net commission ratio	%	3.3	4.1	2.7
Expense ratio	%	2.4	1.5	1.0
Combined operating ratio	%	79.9	84.2	92.7
Insurance profit margin	%	27.7	26.5	29.7

## Premium income

Gross written premium fell by 18% to \$642 million compared to \$783 million for the previous year, whilst net earned premium increased 3% to \$525 million from \$509 million in the previous year.

A reduction in written premium on the excess of loss book was driven by increased retentions on a number of divisional catastrophe and per risk programs and the introduction of aggregate deductibles on certain per risk covers. Softer market conditions further contributed to an overall reduction in premium rates consistent with market conditions. The margin impact of these premium rate reductions was partially mitigated by the increase in QBE Group catastrophe retentions and corresponding increased premium generated by Equator Re writing the extra layers up to the increased Group retention.

The disparity between the year-on-year movement in gross written and net earned premium reflected a change in the underwriting strategy which impacted business mix as well as a 16% reduction in reinsurance costs, due to softer market conditions and changes to the structure of the external programs.

## Claims expense

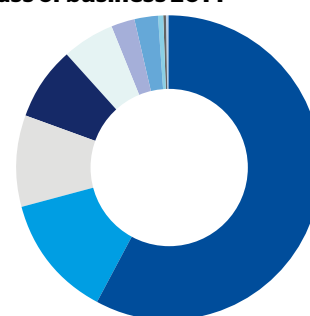
The net claims ratio improved to 74.2% from 78.6% in the previous year.

Whilst the various QBE divisions were impacted by natural catastrophes to varying degrees, the year was benign for Equator Re in terms of catastrophe claims activity due, in part, to the higher divisional catastrophe retentions. Equator Re's underwriting result, however, was impacted by a higher than usual frequency and severity of large individual risk claims across property, liability and surety lines of business.

Equator Re's claims ratio was impacted by \$28 million of adverse prior accident year claims development compared with \$7 million of favourable development in 2013. Prior accident year claims development in the casualty excess of loss portfolio drove this outcome, more than offsetting positive prior accident year claims development for catastrophe claims. In relation to catastrophe claims, there was some minor deterioration in the New Zealand 2011 earthquake claims on the reinsurance portfolio, with an overall saving in prior accident year catastrophe claims driven by positive development with regards to Typhoon Haiyan, the Thai floods and Superstorm Sandy.

Risk margins decreased \$32 million as compared with an increase of \$115 million in 2013. The risk margin release in the current year is consistent with the reduction in the central estimate over the period and maintains a reserving probability of adequacy broadly equivalent with last year.

Gross earned premium  
by class of business 2014



	2014 %	2013 %
Commercial & domestic property	58.0	51.6
Public/product liability	13.0	9.8
Professional indemnity	9.6	15.2
Financial & credit	7.9	7.7
Marine energy & aviation	5.4	6.5
Motor & motor casualty	2.6	3.3
Workers' compensation	2.5	3.9
Accident & health	0.6	1.2
Agriculture	0.3	0.4
Other	0.1	0.4

The result also included a \$26 million or 5.0% adverse impact from lower risk-free rates used to discount claims liabilities.

### Commission and expenses

The overall combined commission and expense ratio was relatively stable at 5.7% of net earned premium compared with 5.6% in the previous year.

The commission ratio improved to 3.3% from 4.1% in the previous year, largely due to a change in business mix.

Underwriting expenses increased modestly reflecting investment in our operating model upgrade and build-out of capabilities in Bermuda as well as a change in the basis of expense allocation between the excess of loss and proportional portfolios. Relative to the only minor increase in net earned premium, Equator Re's underwriting expense ratio increased to 2.4% from 1.5% in the prior year.

### Other developments

QBE Insurance Group's reinsurance program has been significantly enhanced in 2015.

Our new structure will maintain strong protection against large individual risk and catastrophic events whilst reducing overall volatility of claims accumulated over a year.

The Group continues to refine its view of risk and enhance modelling and predictive capabilities. As a result, the revised program provides broader coverage for large individual risk and catastrophe claims in the aggregate combined with an increase in catastrophe occurrence retention, which results in a far more effective reinsurance structure.

The Group's captive reinsurer, Equator Re, is now even more central to the Group's reinsurance purchasing strategy.

Previously, Equator Re only provided cover up to the Group's retention. For 2015, Equator Re will provide 100% of the property & casualty per risk and catastrophe treaty reinsurance for each of our divisions. This new structure will increase the gross premium written into Equator Re and, in turn, Equator Re has purchased the Group per risk and catastrophe programs. This does not lead to a change in the Group's retained risk but facilitates more efficient bespoke coverage and allows for greater transparency around the costs associated with the specific risk in each of our divisions.

In view of their unique exposures, certain portfolios such as QBE lenders' mortgage insurance and crop continue to buy external reinsurance.

Complementing the revised excess of loss strategy, Equator Re has significantly enhanced coverage for the Group through an expanded quota share with competitive commission terms acknowledging our excellent track record, the investment in our underwriting over the past few years and our extensive product and geographic diversification.

The Group per risk and catastrophe programs continue to protect the Group in a similar fashion to previous years. The catastrophe program is designed to provide coverage in line with, and often in excess of, regulatory and rating agency requirements. The per risk treaty is designed to provide the Group with the capacity to write individual risks up to \$250 million which allows QBE to be an industry leading underwriter in all of its markets.

The Group catastrophe occurrence retention has increased to \$500 million in 2015. This was a strategic decision as our analysis indicated that QBE would be better served to buy more US occurrence limit at the top of the program as well as a more robust and broader aggregate program. All catastrophe layers (other than the catastrophe bond) provide a reinstatement without additional cost to QBE. This is a unique feature in a worldwide catastrophe program that provides meaningful additional protection.

The catastrophe program includes a catastrophe bond placed last year for three years and expanded limits for our exposures outside of Australia (mainly in the US). Australia remains QBE's peak gross exposure.

In addition to our single risk loss and event protections, we have further restructured our 2015 program to more consistently deliver total annual net losses within our large loss and cat allowance. This has been achieved by combining our per risk and catastrophe aggregate covers and materially reducing the threshold at which losses can contribute to this cover down to a \$2.5 million franchise. In conjunction with Equator Re's quota share protection, this large individual risk and catastrophe aggregate cover more than offsets any heightened volatility arising from the increased retention under our catastrophe program and provides QBE with unparalleled protection in today's marketplace.

Our new large individual risk and catastrophe aggregate cover along with much of our per risk and catastrophe programs have been placed for two years to maximise efficiencies in the market, and minimise volatility in our reinsurance costs.

Equator Re continues to upgrade its operating model, particularly in relation to its underwriting, catastrophe modelling, claims and risk management activities. We expanded our pricing capability following the acquisition of external pricing tools and all contracts continue to be benchmarked against open market rates. Equator Re has implemented an extensive internal review program covering both underwriting and claims and is in the process of upgrading IT systems that will improve data quality. In addition, Equator Re is strengthening its overall governance framework and expects to be in position to meet Bermuda Monetary Authority equivalence requirements under Solvency II within the next 12 months.

“Our core focus remains delivering underwriting results in line with plan and providing innovative, multi-faceted reinsurance solutions to the Group and its operating divisions that optimise capital, risk management and shareholder returns.”

## Equator Re

# Outlook for 2015



2015 target  
gross written  
premium:

**US\$1.1 billion**



2015 target  
net earned  
premium:

**US\$500 million**

Equator Re is expected to play an increasingly central role within the Group's external reinsurance program by facilitating the Group's catastrophe program with expanded divisional protections and consequently driving an increase in gross written premiums for 2015. Similarly, we expect to purchase expanded reinsurance coverage in 2015 resulting in generally stable net earned premiums.

Market dynamics are expected to impact Equator Re's revenue and profit capabilities in a manner similar to 2014 and underwriting profit expectations remain strong.

Efforts to improve our operating model and broaden capabilities will continue as we finish relocating Equator Re's management operations to Bermuda and leverage the enhanced operational service offering of the Group's Shared Service Centre in Manila.

2014 was both a challenging and rewarding year for Equator Re and its employees as our efforts to improve our performance and capabilities required significant investments in time and energy. I would like to thank the team for their hard work and dedication and look forward to building on the foundation further in 2015.