

Risk: Our business

QBE is in the business of managing risk. The Board and management are fully committed to ensuring that our disciplined approach to managing risk delivers global best practice and that our risk management processes and systems are robust and independent. Our risk framework supports our businesses across all divisions and provides a sound foundation for reducing uncertainty and volatility in business performance.

Our approach to managing risk is based on the following key principles:

- Our businesses operate across many different regions and product sectors, allowing us to benefit from **diversification and global leverage**;
- A strong, open, **leader-led culture of active risk management** across all levels of the organisation;
- **Risk-based decision-making** delivered by experienced people with excellent underwriting skills;
- A **high-performing and motivated risk team**, operating as a globally integrated group;
- **Clear accountabilities** at all levels, supported by clear delegated authorities and rewarded by appropriate incentive and performance measures; and
- Optimising risk/return decisions through **transparency** and relevant and insightful supporting information.

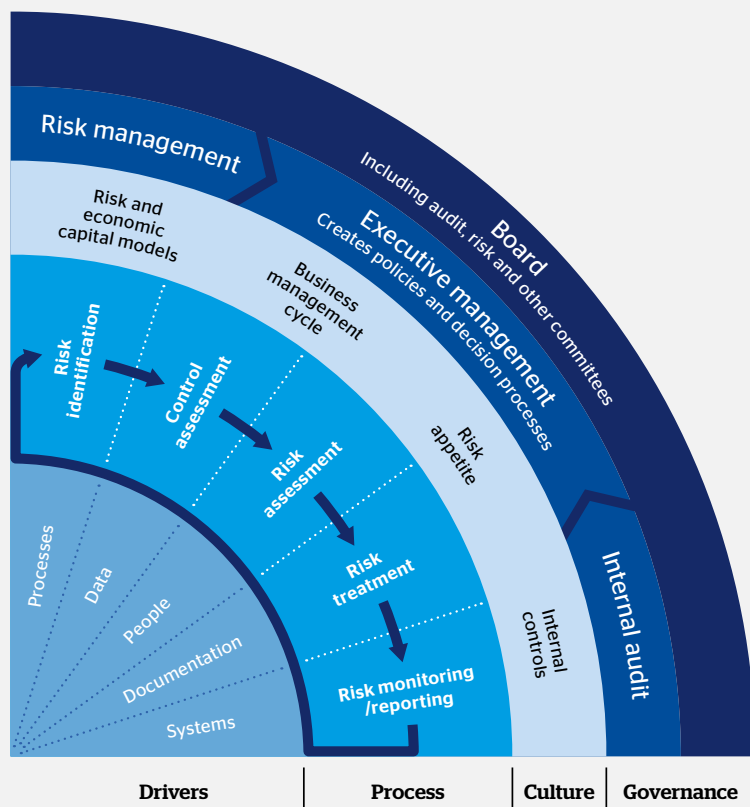
At the heart of our approach to managing risk is our risk appetite. Set by the Board, our risk appetite establishes the parameters across all our key risk categories within which risk exposures must be maintained. We monitor our exposures against appetite on an ongoing basis and use them to inform forward-looking strategic and tactical decisions. During 2014 we have revised and extended our risk appetite statements with quantitative and qualitative statements across all our major risk types (refer to the table on page 61).

The QBE Board monitors the Group's performance and, as such, plays a significant role in ensuring that an effective risk management strategy is established and maintained. The Board Risk and Capital Committee meets at least quarterly to review performance against appetite and capital plans, and takes a central role in overseeing that risks are being actively and appropriately managed according to the Board's stated risk appetite, strategy and business plan.

The risk framework has been designed to support improved, risk-aware decision making by our people. It provides the basis for identifying, assessing, monitoring and managing our risks. Reporting requirements of the framework promote transparency and increased awareness and understanding of risks. Responsibilities across all three lines of defence have been set out and these ensure that we are coordinated across QBE in managing our risks and that accountabilities are clear for our staff, as follows:

1. **Any risk-taking business unit** forms the first line of defence - they manage and own risk and comply with risk frameworks;
2. **Risk management and compliance functions** form the second line of defence. They own and monitor the application of risk management frameworks and measure and report on risk performance and compliance; and

Risk management framework elements



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Jason Brown

Group Chief Risk Officer

3. The third line of defence is formed by **Internal and External Audit**. They provide independent assurance to the Board and its various audit and risk committees over controls and risk management practices.

Additionally we now have in place risk management objectives for all levels of staff across all divisions and these have been built into our performance appraisal and management system.

Capital and risk

A wide range of tools are utilised by QBE in the risk and capital management processes including:

- **QBE's Economic Capital Model** – our 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, make better business decisions, assess economic capital requirements and measure performance on a risk-adjusted basis;
- **Scenario analysis** – based on the analysis of severe but plausible (though improbable) events or circumstances, this analysis enables management to understand the potential impact of these events if they were to occur, inform the appropriate risk management approach including the design of controls, formulate contingency plans and assess

the adequacy of resources (including capital) to absorb unexpected losses arising from these events;

- **Stress testing** – similarly to scenario analysis, our stress tests, including reverse stress tests, are a means by which we can consider our exposure to risks under extreme circumstances and the potential financial and non-financial impacts of these events so that we can ensure we have sufficient capital to withstand the event. Business plans also undergo extensive stress tests so that plausible impacts can be considered and mitigation can be put in place to support the achievement of planned profitability under stressed circumstances;
- **Analysis of regulatory and rating agency capital models** – we conduct financial modelling analysis of the implications of the various regulatory capital and rating agency capital environments. This allows us to understand the impact of strategic decisions on the regulatory and rating agency views of the risk profile and capital requirements; and
- A number of **bespoke risk assessment tools**, including stress test scenarios applied to evaluate business plans and support our capital plan.

These tools support the assessment of risk and the allocation of capital to the risks to which the group is exposed.

QBE's Internal Capital Adequacy Assessment Process (ICAAP), supported by our Economic Capital Model, considers a broad range of these tools. This process is integrated across a large number of business processes including the allocation of capital to operating entities for planning and performance monitoring purposes. This approach ensures that the risk taken by QBE is commensurate with required returns and it is an integral component of QBE's incentive schemes. Other key uses of the ICAAP and the tools which support it include management of the capital held by QBE, monitoring of risk profile against appetite, analysis of alternative reinsurance options, and regulatory and rating agency submissions.

As a result of these processes, and in line with the broader strategic direction of QBE, several actions were initiated during 2014 to reduce the risk profile of the group including: reinsurance of the claims reserves relating to the European medical malpractice business, sale of non-core assets, the plan for a partial IPO of the Australian Lenders Mortgage Insurance business, and institutional and private capital raising and debt restructure. This comprehensive risk and capital management approach resulted in improvements to regulatory and rating agency capital metrics, a reduction in gearing, conversion of intangibles to tangible capital and an overall strengthening of the balance sheet.

Regulatory developments

The insurance regulatory environment in which QBE operates continues to evolve, with international developments around a common framework for the supervision of international groups being particularly relevant. QBE takes a proactive approach to managing and mitigating insurance regulatory risk globally.

As a global insurance group, QBE is subject to over 30 local and 'whole group' regulatory regimes around the world. Our approach is to combine local expertise with a globally consistent framework to manage regulatory change and provide effective compliance with the varied and evolving requirements.

QBE supports sound prudential regulation as a key element in the stability and sustainability of the insurance and wider financial markets in which we operate. To this end, we will continue to encourage and support developments that promote fair competition and efficiency whilst reinforcing public confidence.

Risk culture

Creating a culture across QBE that understands risk and keeps it at the forefront of the minds of all our people is a key objective for the group. There are three primary components to our approach to managing risk culture:

- Target culture - this involves the promotion of desired risk culture including through performance objective setting and KPIs, and our ONE QBE values;
- Culture assessment - this includes the monitoring of key indicators and metrics, completing risk culture assessments across the first, second and third lines of defence perspectives and considering trends and themes; and
- Cultural change - this component includes risk culture awareness and education initiatives alongside more formal risk training.

We promote and raise awareness of the importance of a good risk culture through various activities. With risk awareness training delivered and mandatory risk objectives built into performance objectives we continue to invest in this important area of our day to day operations. To support this, in 2014 we launched a campaign entitled 'My Risk' that personalises risk management responsibilities at the individual level and highlights how our people fulfil risk management responsibilities in many of our daily activities.

Stress and scenario testing

Over the course of 2014 we have undertaken business plan stress and sensitivity testing, incorporating scenario analysis to fully understand the risks inherent within business plans. This has allowed us to consider the various risk exposures we face and what additional mitigation or remediation we can put in place to counter-balance these exposures.

Scenario analysis is also used across all our key risk categories to consider extreme but plausible events and our ability to respond to them. Through completing stress tests in many forms across our business we better inform management and the Board as to the nature and extent of our risk profile under a range of environments. We are also able to better prepare ourselves for these scenarios and ensure that we are not taking on more risk than is acceptable to the Board, as set out in our risk appetite statements.

Additionally, QBE has adopted sophisticated modelling which is used to estimate losses, manage catastrophe exposure and assist in making decisions regarding catastrophe risk management and coverage. This capability is critical to manage exposure to potential losses - to QBE, our customers and investors - from possible catastrophic events, such as powerful earthquakes and major cyclones and typhoons.

The results generated from this tool coupled with our highly-skilled catastrophe modelling team informs post-event response planning such as local staffing levels, reporting and turnaround times as well as the opportunity to undertake a comprehensive post-event incident response review and reassess future risks. These catastrophe models are explained in more detail on page 54 in the Spotlight Section.

Globally integrated Enterprise Risk Management (ERM) framework

QBE's One ERM framework has been further embedded across all divisions during 2014 and incorporates all of our key risk management processes, including risk and control assessments; key risk indicators and reporting; issue and loss capture; scenario analysis; risk appetite and governance. Our operating model in delivering the One ERM framework is now in place across our various global risk teams, creating better sharing of information and our risk knowledge.

Our Group Risk team has been strengthened in 2014 by appointing specialised risk personnel and developing our risk analytics capabilities.

Jason Brown
Group Chief Risk Officer

Key risks and mitigants

The following table provides some examples of the types of key risks QBE faces, drivers of these risks and mitigation approaches. Quantitative and qualitative appetites have been set for all key risk types below.

RISK TYPE	KEY DRIVERS	MITIGATION
Strategic and business risk The current and prospective impact on earnings and/or capital arising from strategic business decisions, and responsiveness to external change.	<ul style="list-style-type: none"> Changes in the commercial environment including competitive landscape, customer behaviour and distribution approaches. Business strategy and change, investment strategy and corporate governance. Risks related to acquisitions, divestments and capital management. 	<ul style="list-style-type: none"> Considering our strategic options in light of the impact on return variance and capital requirements. Scenario planning augmented by use of an economic capital model in assessing capital requirements and allocation for insurance, credit, market, liquidity and operational risks. Planning and monitoring capital levels on an ongoing basis, with reference to regulatory and rating agency requirements and other benchmarks. Assessing acquisition strategic fit and setting minimum requirements for conducting due diligence.
Insurance risk The risk of fluctuations in the timing, frequency and severity of insured events and claims settlements, relative to the expectations. This includes underwriting, catastrophe claims concentration and claims estimation risks.	<ul style="list-style-type: none"> Natural or man-made catastrophic events. Pricing of individual insurance contracts. Reserving. Insurance claims. 	<ul style="list-style-type: none"> Maintaining a sound pricing basis based on regular exposure and claims analyses. Setting and monitoring an appetite for concentration risk. Ensuring consistency of appropriate provisioning practices across all divisions. Regular monitoring and performance review of key portfolios. Comprehensive reinsurance designed to manage insurance risk within the risk appetite. In-house and external actuarial review of claims provisions with appropriate independence.
Credit risk The risk of default by borrowers and transactional counterparties as well as the loss of value of assets due to deterioration in credit quality.	<ul style="list-style-type: none"> Reduction or delay in repayments or interest payments from the default of a counterparty such as a bond issuer, policyholder or reinsurer. 	<ul style="list-style-type: none"> Group-wide credit risk policies. Setting net exposure limits for each counterparty in relation to deposits and investments. Strict guidelines covering limits and terms of net open asset positions. Maximising placement of reinsurance with highly rated counterparties and limiting concentration of exposure.
Market risk The risk of variation in the value of investments due to movement in market factors.	<ul style="list-style-type: none"> Market dynamics. Change in market value and/or volatility of portfolios. Changes in interest rates or shape of yield curve. Changes in spot/forward currency rates, volatility and correlations. 	<ul style="list-style-type: none"> Active asset management. Strategic and tactical asset allocation. Use of a well calibrated and validated economic scenario generator and asset model to assess market risk and reward against appetite. Executive Asset Liability Committee chaired by the Group CFO. A diversified portfolio of assets controlling the impact of a single source of risk and reflecting the diverse nature of QBE's liabilities.
Liquidity risk The risk of insufficient liquid assets being available to meet liabilities as they fall due to policyholders and creditors.	<ul style="list-style-type: none"> Cash inflows from premiums, investment income, capital injections, dividends and loans. Cash outflows for claims and redemptions, debt service requirements, tax payments, dividends and expenses. Cash collateral requirements. 	<ul style="list-style-type: none"> Stress testing of liquidity needs relative to major catastrophe events. Holding a minimum percentage of liabilities in liquid, short-term money market securities. Negotiating cash call clauses in reinsurance contracts and seeking accelerated settlements for large reinsurance recoveries. Maintaining sufficient liquidity in investment portfolios to address claims needs. Banking facilities. Asset/liability matching of major currency holdings and claims payment patterns.
Operational risk The risk of financial loss resulting from inadequate or failed internal processes, people and systems or from external events including legal risk.	<ul style="list-style-type: none"> Systems errors or failure in information that impacts delivery of services. Failure of key processes and controls resulting in losses. 	<ul style="list-style-type: none"> Active monitoring of key processes. Business continuity and disaster recovery planning and testing. Scenario reviews to identify and quantify potential exposures for mitigation. Use of external loss databases and shared learning from internal incidents and near misses. Effective segregation of duties, access controls, authorisation and reconciliation.