# 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.

## 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%[2] 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

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.

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.

## 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**

1 Combined operating ratio excluding discount rate impact.

# Outlook for 2017

**2017 targets:**

**Gross written premium:**

**Relatively stable** [1,2]

**Combined operating ratio:**

**93.5%** to **95.0%** [3,4,5]

**Investment return:**

**2.5%** to **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 of the 2016 Annual Report for further details), the target range does not allow for a potentially more extreme legislative outcome.