Financial and operations overview

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

General overview

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

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

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

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

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

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

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

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

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1. Driving improved financial performance

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(d) Expense reduction initiatives on track

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

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

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

(e) Targeted reinsurance cost savings achieved

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

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

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

(f) Strong cash remittances from subsidiaries

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

Group head office cash flows

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

2. Investment performance and strategy

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

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

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

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

3. Financial strength and capital management

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

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

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

Operating and financial performance

Summary income statement

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

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

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

Overview of the 2016 result

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

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

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

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

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

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

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

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

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

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

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

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

Cash profit

FOR THE YEAR ENDED 31 DECEMBER	2016 US$M	2015 US$M
Cash profit before tax	**1,147**	1,096
Tax expense on cash profit	**(249)**	(197)
Profit attributable to non-controlling interests	**–**	(6)
Net cash profit after tax	**898**	893
Losses on sale of entities after tax	**–**	(94)
M&LS deferred acquisition cost write-down after tax	**–**	(27)
Amortisation and impairment of intangibles after tax [1]	**(54)**	(85)
Net profit after tax	**844**	687
Return on average shareholders' funds	**8.1%**	6.4%
Basic earnings per share – cash basis (US cents)	**65.5**	65.3
Dividend payout ratio (percentage of cash profit)	**61%**	56%

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

Premium income

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

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

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

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

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

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

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

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

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

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

Underwriting performance

Key ratios – Group

FOR THE YEAR ENDED 31 DECEMBER	2016		2015	
	STATUTORY %	% [1]	STATUTORY %	ADJUSTED [2] %
Net claims ratio	**58.2**	**60.4**	60.4	59.8
Net commission ratio	**18.4**	**17.5**	17.2	17.3
Expense ratio	**17.4**	**16.5**	17.3	16.9
Combined operating ratio	**94.0**	**94.4**	94.9	94.0
Combined operating ratio ex risk-free rate movement [3]	**93.2**	**93.7**	95.2	94.3
Insurance profit margin	**9.7**	**9.1**	8.4	9.0

1 Presented excluding transactions to reinsure legacy US multi-line property and casualty (program) run-off liabilities and UK long-tail liabilities.
2 Excludes Argentine workers' compensation and M&LS deferred acquisition cost write-down.
3 Excludes the impact of changes in risk-free rates used to discount net outstanding claims.

Divisional performance

Contributions by region

FOR THE YEAR ENDED 31 DECEMBER	GROSS WRITTEN PREMIUM		NET EARNED PREMIUM		COMBINED OPERATING RATIO		INSURANCE PROFIT BEFORE INCOME TAX	
	2016 US$M	2015 US$M	2016 US$M	2015 US$M	2016 %	2015 %	2016 US$M	2015 US$M
North American Operations	**4,647**	4,961	**3,318**	3,666	**97.8**	99.2	**155**	93
European Operations	**4,076**	4,386	**3,115**	3,454	**93.6**	89.1	**314**	464
Australian & New Zealand Operations	**3,933**	3,787	**3,410**	3,282	**92.7**	91.3	**418**	467
Emerging Markets	**1,632**	1,728	**1,328**	1,436	**99.5**	99.2	**73**	71
Equator Re	**1,349**	1,007	**468**	367	**70.7**	89.0	**164**	103
Equator Re elimination	**(1,349)**	(1,007)	**–**	–	**–**	–	**–**	–
Corporate and other adjustments	**(200)**	(80)	**(3)**	8	**–**	0.1	**(60)**	(99)
Group	**14,088**	14,782	**11,636**	12,213	**94.4**	94.0	**1,064**	1,099
M&LS fronting [1]	**307**	131	**–**	(77)	**–**	–	**–**	–
Reinsurance transactions	**–**	–	**(570)**	–	**101.9**	–	**11**	–
Other 2015 adjustments	**–**	179	**–**	178	**–**	134.3	**–**	(68)
Group statutory	**14,395**	15,092	**11,066**	12,314	**94.0**	94.9	**1,075**	1,031
Direct and facultative	**13,369**	14,138	**10,219**	11,511	**94.3**	95.2	**958**	921
Inward reinsurance	**1,026**	954	**847**	803	**90.0**	90.2	**117**	110
Group statutory	**14,395**	15,092	**11,066**	12,314	**94.0**	94.9	**1,075**	1,031

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

Incurred claims

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

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

Analysis of net claims ratio

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

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

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

Analysis of attritional claims ratio

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

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

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

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

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

Large individual risk and catastrophe claims

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

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

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

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

Movement in weighted average risk-free rates

CURRENCY		31 DECEMBER 2016	30 JUNE 2016	31 DECEMBER 2015	30 JUNE 2015	31 DECEMBER 2014
Australian dollar	%	**2.26**	1.77	2.37	2.43	2.46
US dollar	%	**2.04**	1.20	1.80	1.59	1.33
Sterling	%	**0.68**	0.56	1.47	1.53	1.30
Euro	%	**0.19**	(0.16)	0.59	0.75	0.58
Group weighted average (ex Argentine peso)	**%**	**1.33**	0.92	1.62	1.60	1.45
Estimated impact of discount rate movement [1]	**$M**	**(80)**	(283)	38	45	(324)

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

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

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

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

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

Commission and expenses

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

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

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

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

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

Income tax expense

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

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

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

Foreign exchange

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

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

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

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

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

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

Impact of exchange rate movements

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

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

Balance sheet

Capital management summary

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

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

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

Each transaction is discussed separately overleaf.

Capital summary

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

AS AT 31 DECEMBER	2016 [1] US$M	2015 [2] US$M
QBE's regulatory capital base	**9,277**	9,737
APRA's Prescribed Capital Amount (PCA)	**5,186**	5,637
PCA multiple	**1.79x**	1.73x

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

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

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

Key financial strength ratios

AS AT 31 DECEMBER	BENCHMARK		2016	2015
Debt to equity	25% to 35%	%	**33.8%**	33.6%
Debt to tangible equity		%	**52.2%**	51.1%
PCA multiple [1]	1.6x to 1.8x	x	**1.79x**	1.73x
Premium solvency [2]		%	**60.6%**	56.5%
Probability of adequacy of outstanding claims	87.5% to 92.5%	%	**89.5%**	89.0%

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

Borrowings

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

During 2016, the Group established:

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

The Group also executed the following transactions during the year:

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

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

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

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

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

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

Borrowings maturity [1]

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

1 Based on first call date.

Borrowings profile

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

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

Net outstanding claims liabilities

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

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

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

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

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

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

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

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

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

Intangible assets

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

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

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

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

Investment performance and strategy

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

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

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

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

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

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

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

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

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

Total net investment income

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

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

Gross and net investment yield

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

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

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

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

Total investments and cash

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

Interest bearing financial assets

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

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

Dividend

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

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

The dividend will be franked at 50% and is due to be paid on 13 April 2016. The dividend reinvestment programs will continue at a nil discount with demand for shares under the Dividend Reinvestment Plan to be satisfied by acquiring shares on-market. As previously noted, the franking percentage is expected to reduce to around 30% in 2017 and 2018.

The payout for the 2016 full year is A$741 million or around 61% of cash profit calculated by converting cash profit to Australian dollars at the average rate of exchange during the period. The calculation of cash profit is shown on page 16.

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

Closing remarks

I am pleased with our performance during 2016, particularly in the second half of the year. We performed strongly against our combined operating ratio target of 94% – 95% and made progress in restoring the attritional claims ratio in our Australian & New Zealand Operations, particularly in the final quarter.

That said, we believe that there remain significant opportunities for improvement across the Group.

Our priorities for 2017 will focus on the following key areas;

- capitalise on the efficiency benefits of our refined and restructured reinsurance program;
- drive our expense ratio below 16%;
- achieve profitable organic growth where it is available;
- sustain earnings stability and continue to deliver positive prior accident year claims development;
- maintain a strong capital position and strong cash remittances to the Group centre; and
- provide capital and dividend growth for our shareholders.

Patrick Regan
Group Chief Financial Officer