North American Operations business review

North American Operations more than doubled underwriting profit in 2016, reflecting a strong Crop performance and continued profitable growth in Specialty. Ongoing cost efficiencies, coupled with a more focused Property & Casualty portfolio, bodes well for further margin improvement."

Russ Johnston

Chief Executive Officer • North American Operations

Gross written premium	Net earned premium	Underwriting result	Insurance profit
US$ million	US$ million	US$ million	US$ million
4,647	3,318[1]	72[1]	155[1]
↑ 2% from 2015[2]	↑ 1% from 2015[2]	↑ $42M from 2015	↑ $62M from 2015
		Combined operating ratio 97.8%[1] (2015 99.2%)	Insurance profit margin 4.7%[1] (2015 2.5%)

2016 overview

North American Operations is a specialist insurance and reinsurance franchise focused on four key business units: Property & Casualty (formerly known as Standard Lines and includes commercial and personal lines), Specialty, Crop and Assumed Reinsurance (a component of QBE's global reinsurance business headquartered in London).

Over the course of 2016, premium rates remained flat overall, compared with a modest 0.4% increase in the prior corresponding period. It has become increasingly important to drive continuous improvement in how we define, target, select and price risk while driving greater efficiency and enhancing customer experience. Our investment in both talent and analytics has helped us to improve profitability whilst ensuring that we remain focused on areas where we have a competitive advantage.

North American Operations has established a strong Specialty business that continued to grow profitably with discipline in core segments of accident and health and errors and omission. Our Crop business outperformed expectations, generating a superior underwriting return. Notwithstanding significant challenges in commercial auto, our Property & Casualty business continues to improve while results in our Reinsurance business met expectations.

During 2016, a decision was taken to exit the mono-line commercial auto segment. This included the termination of a major program and the reinsurance of all related outstanding claims and unearned premium reserves to the Group's captive, Equator Re. The exit of this portfolio represented approximately half of the overall commercial auto portfolio. We also reinsured legacy multi-line property and casualty (program) run-off liabilities to a third party.

Collectively, these strategic decisions will remove management distractions, sharpen our Property & Casualty underwriting focus, improve property and casualty earnings quality and enhance capital efficiency.

1 Adjusted for transactions to reinsure run-off liabilities.
2 Prior period comparable figures exclude premium associated with the sale of M&LS in 2015.

Operating and financial performance

Underwriting performance

The aforementioned reinsurance transactions resulted in a reinsurance expense of $587 million with a consequent impact on net earned premium, more than offset by a $603 million reduction in net incurred claims. In addition to reducing the level of uncertainty in the remaining net discounted central estimate, as highlighted in the table below, the reinsurance transactions improved North American Operations' combined operating ratio by 0.8% (with an 8.2% positive impact on the net claims ratio largely offset by a 7.4% adverse impact on the combined commission and expense ratio).

In order to assist year on year comparability, the underwriting commentary hereafter refers to the 2016 results excluding the impact of these reinsurance transactions.

North American Operations delivered an improved combined operating ratio of 97.8% compared with 99.2% in 2015. The results benefited from an outstanding Crop performance, largely offset by continued and significant challenges in commercial auto. We have exited our mono-line commercial auto portfolio, which reported an underwriting loss of $105 million.

Lower corn and soybean pricing coupled with farmers opting for higher deductibles adversely impacted Crop gross written premium. Nevertheless, the Crop business performed extremely well, outperforming industry average profitability.

Our maturing Specialty franchise is delivering strong and profitable growth across core business in accident and health and errors and omissions. Specialty saw 50% premium growth while continuing to diversify across a number of businesses, including directors and officers, transactional liability, aviation and inland marine.

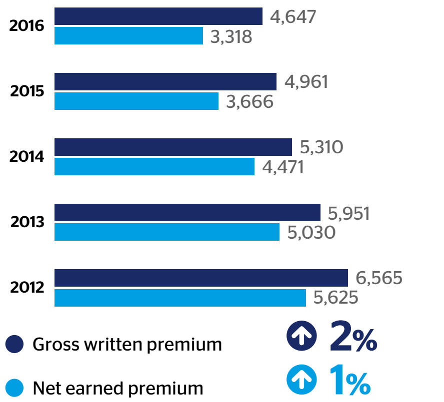
The insurance profit margin improved to 4.7% from 2.5% in 2015.

Underwriting result

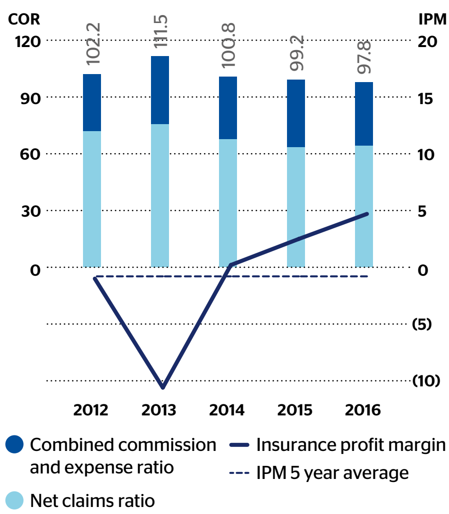
FOR THE YEAR ENDED 31 DECEMBER		2016	2016[1] ADJUSTED	2015[2]	2014[2]	2013[2]	2012[2]
Gross written premium	US$M	**4,647**	**4,647**	4,961	5,310	5,951	6,565
Gross earned premium	US$M	**4,657**	**4,657**	4,930	5,457	6,225	6,984
Net earned premium	US$M	**2,731**	**3,318**	3,666	4,471	5,030	5,625
Net incurred claims	US$M	**1,528**	**2,131**	2,323	3,023	3,804	4,038
Net commission	US$M	**564**	**564**	635	698	795	883
Expenses	US$M	**556**	**551**	678	788	1,011	830
Underwriting result	US$M	**83**	**72**	30	(38)	(580)	(126)
Net claims ratio	%	**56.0**	**64.2**	63.4	67.6	75.6	71.8
Net commission ratio	%	**20.7**	**17.0**	17.3	15.6	15.8	15.7
Expense ratio	%	**20.4**	**16.6**	18.5	17.6	20.1	14.7
Combined operating ratio	%	**97.0**	**97.8**	99.2	100.8	111.5	102.2
Adjusted combined operating ratio[3]	%	**97.7**	**98.5**	99.8	100.4	–	–
Insurance profit margin	%	**6.1**	**4.7**	2.5	0.2	(10.6)	(1.0)

1 Adjusted for transactions to reinsure run-off liabilities.
2 Comparability of prior period data is diminished as a result of the sale of M&LS and the adoption of a significantly revised crop premium earning pattern in 2015.
3 Combined operating ratio adjusted to exclude the impact of changes in risk-free rates used to discount net outstanding claims. Management-basis results were not reported in 2013 and prior.

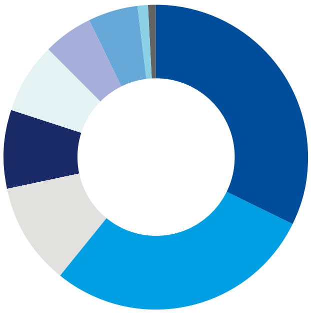
Gross written premium and net earned premium (US$M)



Combined operating ratio (COR) and insurance profit margin (IPM) (%)



Gross earned premium by class of business 2016



	2016 %	2015 %
Commercial & domestic property	32.3	36.5
Agriculture	28.6	28.3
Motor & motor casualty	10.9	12.5
Workers' compensation	8.4	8.1
Public/product liability	7.6	7.3
Accident & health	5.3	3.7
Professional indemnity	5.1	2.0
Marine energy & aviation	1.1	0.9
Financial & credit	0.8	0.7

Premium income

North American Operations' gross written premium declined 6% to $4,647 million compared with $4,961 million in 2015. Excluding $383 million of premium from the M&LS business that was sold in 2015, gross written premium increased 2%.

Strong growth in Specialty continued with gross written premium up $211 million or 50% relative to prior period. New business across the segment almost doubled with a diversity of growth across the portfolio including accident and health, errors and omissions and transactional liability, as well as from the addition of new specialty programs. Growth in Specialty outpaced reductions across Property & Casualty and Crop, resulting in modest growth overall.

Property & Casualty premium declined 5% as a result of continued underwriting action in underperforming areas and new business shortfalls, primarily in our program business. The reduction in premium was largely due to commercial lines where an increasingly competitive property premium rate environment and corrective underwriting actions in auto led to lower premium production. Conversely, we continue to see strong growth in the affiliated agencies business within Property & Casualty, which grew by 5% due to increased housing starts.

Crop gross written premium fell $135 million or 10% compared with 2015, reflecting insured buying patterns and lower commodity prices.

Allowing for the sale of M&LS and despite significantly higher government cessions on the back of better than expected crop margins, North American Operations' net earned premium increased 1% to $3,318 million.

Claims expense

North American Operations reported a 2016 net adjusted claims ratio of 64.2% compared with 63.4% in 2015.

The claims ratio benefited from a significantly stronger Crop result offset by a heightened level of large individual risk and catastrophe claims that added an additional 2.1% to the net claims ratio following an especially benign 2015.

The net cost of catastrophe claims increased by $43 million or 1.3% as significant hail activity in Texas and hurricane Matthew impacted the affiliated agencies portfolio and the program business within the Property & Casualty portfolio. The net cost of large individual risk claims increased by 0.8%, reflecting an increase in claims across Property & Casualty and the impact of growth in Specialty.

Excluding Crop and M&LS, the attritional claims ratio improved slightly as improvements across Specialty and Property & Casualty outpaced challenges in commercial auto. This is despite a significant increase in attritional claims in our affiliated agencies business due to adverse weather in Texas that impacted industry-wide results.

Consistent with 2015, the result included $121 million of adverse prior accident year claims development that increased the net claims ratio by 3.7%. The vast majority of this relates to now terminated and reinsured mono-line commercial auto business.

Commission and expenses

The combined commission and expense ratio improved to 33.6% from 35.8% in the prior corresponding period.

The commission ratio decreased to 17.0% from 17.3% in 2015, reflecting a lower proportion of higher commission paying program business.

North American Operations' expense ratio decreased to 16.6% from 18.5% in the prior year and included a 1.4% benefit associated with the sale of M&LS in 2015. The improvement in the expense ratio was less than anticipated due to lower than budgeted premium revenue as a result of significantly higher government cessions on the back of better than expected crop profitability.

Having stabilised net earned premium and indeed resumed (albeit modest) growth, additional expense management efforts are underway. These include streamlining and modernising our technology and operating infrastructure, consistent with a simplified business strategy. North American Operations is in the process of further consolidating its real estate footprint and increasing utilisation of the Group Shared Services Centre (GSSC) in the Philippines. Excluding the sale of M&LS, over $40 million of cost savings were achieved during 2016, which was partially offset by non-recurring rationalisation charges and investment in ongoing initiatives.

Summary

North American Operations continues its focus on building a specialist franchise that delivers profitable organic growth by building market leading and proprietary products tailored to customer needs. Since 2013, Specialty has launched nine new business units and has developed a culture of innovation and excellence with over 30 new products brought to market. We have a well-diversified portfolio, anchored around accident and health and errors and omissions, augmented with offerings across directors and officers, transactional liability, aviation and inland marine. This has allowed us to develop an organic growth capability that we are now leveraging across the Property & Casualty portfolio. We have launched an "excess and surplus lines" business and are building out our existing personal lines platform to further enhance portfolio diversification. The Property & Casualty franchise is moving forward with a more focused distribution footprint. Our value proposition is centred around the scale of our Specialty and Property & Casualty product offerings and our delivery of integrated capabilities to customers. Our high quality Crop and Reinsurance businesses are also integral, providing additional portfolio diversification and confidence in posting a further improved underwriting result in 2017.

Implementation of a series of initiatives focused on claims, analytics and human capital are well underway as we continue to build sustainable financial results and brand value. In 2016, we started deploying advanced analytics to enable claims triage, subrogation and anti-fraud capabilities to improve recoveries as well as third party management to ensure we drive a positive customer experience with efficient and effective practices. In addition, utilisation of machine learning is improving our analytical capabilities with respect to customer analysis and underwriting which is driving improved decision making at a transactional and portfolio level across our businesses. The introduction of drone technology in our crop business has enabled us to better serve our customers. Over the course of 2017, we will increase our deployment of analytics and technology to improve business optimisation throughout the North American Operation. Moreover, continued development of a performance-driven and results-focused culture, while building in house technical expertise through the launch of our underwriting academy, further underpins our confidence in delivering on our medium-term financial targets.

2016 provides a window into the emerging strength of the North American platform. This follows significant organisational change undertaken in 2013 and the repositioning achieved thereafter. This change included the build-out of Specialty, improvements to our Crop business, remediation of Property & Casualty and the sale of M&LS, all of which contributed to a return to profitability in 2015 followed by significant further improvement in 2016. With the transformation nearing completion, our 2016 performance evidences the breadth and depth of capabilities our new operating model provides and underpins our confidence in sustaining modest growth while driving to a mid-90s combined operating ratio over the medium-term.

As we continue to strengthen the diversity of our leadership team, we were pleased to announce the appointment of Kris Hill who joined as our new Chief Financial Officer replacing Richard Dziadzio, who left the company in mid-2016. The strength of the QBE brand has positioned us well to continue to attract the best and brightest to our organisation.