QBE Insurance Group Annual report 2012

Made possible by QBE

QBE is a major insurer of the mining sector, from leading global players to specialist service providers and smaller operations.

QBE Insurance Group Limited
ABN 28 008 485 014

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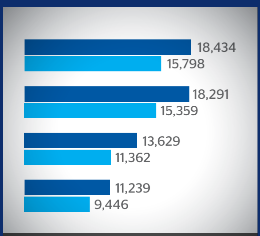

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Risk: Our business

QBE has been one of the most successful insurers of the past two decades and, to continue that success, we must evolve.

We have reset our vision – to be *the* most successful global insurer and reinsurer in the eyes of our customers, our people, our shareholders and the community. Our vision lies at the heart of everything we do, driving both our internal and our external behaviours.

Our **culture** is described by our values and behaviours.

Open Minded

Networked

Empowered

Quality Approach

Business Acumen

Excellent Outcomes

Whatever way we choose to structure ourselves, whatever products and services we offer, we are **ONE QBE**.

Our **strategy** describes the way we will achieve our vision and how we will create value.

- Leadership in our core businesses
- Operational excellence – global reach and scale
- Financial strength and flexibility
- Profitable growth and diversification

Our strategy is underpinned by a commitment to developing world-class talent and leadership.

We are in the business of managing risk. We understand risk and, in an increasingly volatile world, we believe our ability to manage risk makes it possible for things to happen.

- For our customers to turn their business ambitions into reality
- For our people to realise their abilities and potential
- For our shareholders to grow their long-term wealth
- For the communities in which we operate to develop and prosper

Our aim is to make your vision a reality.

All amounts in this report are US dollars unless otherwise stated.

Made possible by QBE

Delivering value to our stakeholders

QBE's strength lies in the international scale and diversity of its operations and the local expertise of its people. QBE has large, well-established and valuable franchises in the major markets in which we operate. Market conditions in recent years have challenged our long record of profitable growth. In order to manage the challenges of increasingly competitive insurance markets, the Board has adopted a refreshed strategy and vision designed to enhance value for all our stakeholders.

QBE's strategic mission is to become a truly global insurer and reinsurer that thinks and acts as one company, which is critical to unlocking our full potential. We believe a shared vision and purpose across the Group will underpin our future success.

2012

Against the backdrop of greatly reduced investment yields and adverse catastrophe experience, the last few years have proved challenging for insurers and reinsurers. This trend continued in 2012. The natural disasters of 2010 and 2011 were followed in 2012 by a severe drought in the US impacting crop yields and then in October by Superstorm Sandy. In addition, a review of our underperforming and run-off portfolios in the US led to a strengthening of the claims provision for our North American Operations and a subsequent downgrade of our profit forecast for the year. Reflecting the challenging year for QBE and the global insurance industry, QBE's share price underperformed the broader market.

While North American Operations underperformed, European, Australian & New Zealand, Asia Pacific and Latin American Operations produced strong results. In addition, our investments team produced an above target net yield of 4.1% on our $31.5 billion portfolio of cash and investments.

The Board is confident that the remediation work undertaken has significantly strengthened our business. Underlying results are trending favourably and the equity and debt capital raised during the year position us well heading into 2013. There are signs of a modest recovery in the commercial insurance market after a number of years of weakness, with premium rate increases starting to reflect the historically low interest rate environment.

Although the Board is disappointed with the final outcome for 2012, we believe we have addressed a number of key market concerns and have put in place a strong foundation on which to build towards our vision.

Leadership in a year of transition

2012 was also a landmark year for QBE with the appointment of John Neal as Group Chief Executive Officer following the retirement of Frank O'Halloran in August. Frank was the architect of QBE's successful international expansion and growth into the ranks of the top 20 insurance and reinsurance companies. After a number of years of strong acquisition-driven growth, QBE is entering a new stage of development.

The growth and maturity of the business in recent years has brought with it a need for an increased focus on collaboration across QBE, with the divisional CEOs having a greater degree of accountability and involvement in the Group's direction, together with a higher level of cross divisional interaction. While we are still in the early days of John Neal's leadership, QBE has commenced the cultural change that the Board believes is required. We have reset our vision and values and implemented a strategy to transform QBE into a truly global insurer and reinsurer. As part of the rollout of the refreshed vision and strategy, changes were made to the organisational structure including the combination of Australian & New Zealand Operations into a new reporting segment, the establishment of ›

"By developing a more consistent and aligned approach to the way we build and operate our businesses, we are confident that we can grow and deliver above average returns to our shareholders.

Belinda Hutchinson AM Chairman • QBE Insurance Group

Asia Pacific Operations as a stand alone reporting segment with a new CEO commencing in 2013 and the creation of a new position to head our global operational transformation program.

As part of our ongoing commitment to improving the company's governance and performance, we commissioned an independent audit to understand investor perceptions across a range of areas which we had identified in our own review over the past year. One key finding was the need for further diversification of the Board's geographic experience and market expertise as we grow and expand globally. In August, we appointed the US-based insurance and financial services industry expert, John Graf, as a non-executive director, enhancing the insurance industry experience of the Board. We are planning further appointments as the business develops. Our long serving non-executive director, Len Bleasel, retired from the Board in September and we thank him for his commitment and service to QBE over many years.

We believe we now have a strong foundation on which to build towards our refreshed vision – to be *the* most successful global insurer and reinsurer in the eyes of our customers, our people, our shareholders and the community.

Delivering value to shareholders

We recognise that QBE's share price performance over recent years has been disappointing. Our focus in 2013 is on supporting management to implement its strategy of growing the profitability of our core businesses by leveraging our global capabilities. We support management's plans to realise at least $250 million in annual run-rate benefits by the end of 2015 as a result of the strategic shift from our regionally based operating model into that of a fully integrated global insurance company. These plans should allow the company to produce a market-leading combined operating ratio and insurance margin.

Our 2013 outlook anticipates a significantly improved return on shareholders' equity as discussed further in the Group Chief Executive Officer's report.

Throughout the year, I met with many shareholders to hear their views. Your Board has taken note of the concerns raised by shareholders. In particular, shareholders confirmed that they shared the Board's view about the importance of robust and conservative capital management, including the sustainability of QBE's dividend over the longer term. As part of this exercise, your Board has reconsidered the Group's dividend policy and, for 2013 and onwards, has agreed a payout ratio of up to 50% of cash profit i.e. reported net profit after tax but before amortisation and impairment of intangibles and tax thereon. Given that goodwill and intangibles are excluded from our capital base for regulatory and ratings agency purposes, the Board regards cash profit to be a more relevant measure of profitability for the purposes of determining the Group's dividend. This reduced payout ratio will assist QBE to retain capital to fund its ongoing expansion and meet the more stringent capital adequacy requirements being imposed by regulators and rating agencies.

We recognise that some shareholders will be disappointed with the lower proposed dividend; however, we must balance our obligations to maintain financial strength and flexibility with an appropriate dividend policy.

The Board meets key regulators on a routine basis. Whilst we are satisfied that QBE is comfortably within the capital adequacy requirements set by the various regulatory authorities, there remains uncertainty around foreshadowed amendments to the rating criteria used by Standard & Poor's (S&P). We will continue to work with S&P and other agencies regarding the current ratings outlook. QBE's capital adequacy multiple at 31 December 2012 was 1.7 times the minimum requirement set by the Australian Prudential Regulation Authority's risk-based capital approach for Australian insurance groups.

We also took further steps during the year to improve our communication to the market and to provide more transparency on our various businesses. We recognise the need for consistency in our communications, delivering results which meet our published targets with no surprises.

Delivering value to our customers

As a global insurer, our customers include brokers and agents, small to large businesses and individuals. QBE has a broader footprint than most insurers in terms of products and services, distribution channels and geographic reach. By joining deep technical expertise with broad market and industry relationships, we have a combination that few, if any, of our competitors can replicate. Working as individuals we are good, but what makes us successful is the way we collaborate to provide solutions which are not available elsewhere.

We have made a definitive statement – to be *the* most successful. You might ask why this is important. Being a leader affords us many advantages – our global scale and breadth positions us so that brokers and potential clients actively seek out QBE to take advantage of QBE's specialist knowledge in our chosen market segments.

Meeting the needs of QBE's people and communities

QBE recognises that as society changes, so do the skills and expectations of our workforce. To attract, motivate and retain the best people, we understand it is important to have a workplace that is responsive to the professional and personal needs of our employees. QBE aims to create a workplace that is fair and inclusive. We offer a range of programs to support the continued success of our employees. We have invested in a range of leadership programs aimed at supporting our leaders through the key stages in their careers at QBE, including greater access to inter-divisional mobility and development opportunities. Our global flexible working policy and parental leave transition programs help employees balance their professional and personal lives.

QBE seeks to make a positive impact in the communities in which it operates. The Group's values, which drive the day to day behaviour of our people, recognise QBE's responsibilities to the community. We strive to contribute to economic and social development and help make it possible for the communities in which we operate to thrive and prosper. We set ourselves high standards of corporate governance and seek to operate in a socially responsible and ethical way. QBE also places great importance on constructive interaction with the communities in which we operate. In 2011, the QBE Foundation was launched to create a coordinated platform for QBE and its employees to engage with the community. The Foundation not only seeks to support vocational opportunities globally through philanthropy but also encourages QBE's employees to be more involved in community-based initiatives.

The road ahead

QBE's business has grown and developed a great deal in recent years. We will continue our evolution towards becoming a more cohesive, global organisation. In doing so, we will retain the characteristics which have made us great – the entrepreneurial spirit, the deep expertise in underwriting and distribution and the breadth of our local relationships. Most importantly, we will continue to work together to offer solutions to our customers.

Our major stakeholders will have different demands and view success through various lenses. Our aim is to provide value to all, and to hear them say "our success was made possible by QBE". I am confident that after the challenges of the last few years, we have built a solid platform for future profitable growth.

On behalf of the Board, I wish to acknowledge the hard work and contribution of QBE staff around the world. We thank you for your commitment to the task in a year of challenges and change.

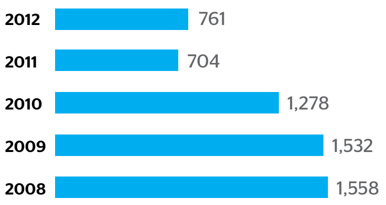
Finally, I wish to thank my fellow directors for their diligence and valuable advice to and support of the management team during a year of transition.

BJ Hutchinson AM
Chairman

2012 snapshot

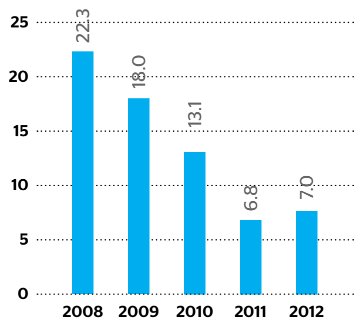
Performance

Net profit after income tax (US$M)

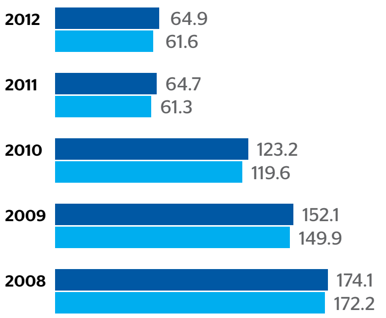


8%

Return on average shareholders' funds (%)



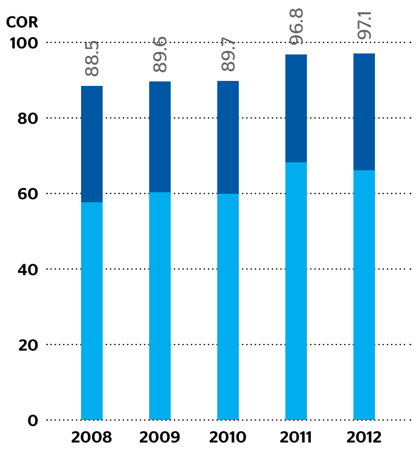
Earnings per share (EPS) (US¢)



Basic EPS

Diluted EPS

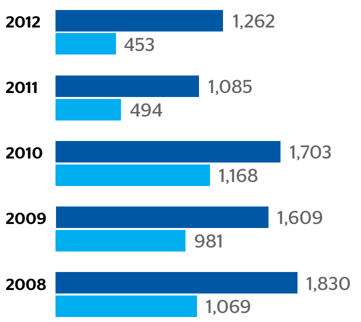
Combined operating ratio (COR) (%)



Combined commission and expense ratio

Net claims ratio

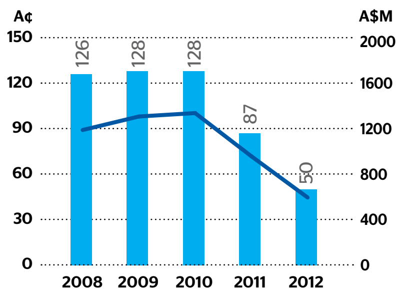
Insurance profit and underwriting result (US$M)



Insurance profit 16%

Underwriting result 8%

Dividend per share (A¢) and dividend payout (A$M)

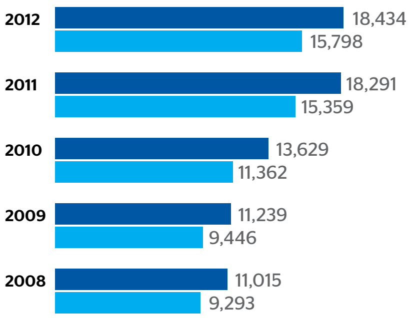


Dividend per share (A¢) 43%

Total dividend payout (A$M) 38%

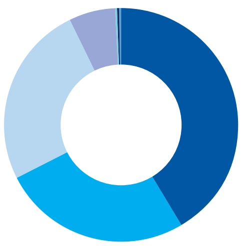
Profile

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



- Gross written premium ↑ 1%
- Net earned premium ↑ 3%

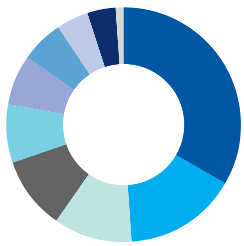
Investment portfolio at 31 December 2012



US$31.5 billion

Corporate bonds	41.7%
Short-term money	25.9%
Government bonds	25.3%
Cash	6.4%
Equities	0.4%
Unit trusts	0.2%
Properties	0.1%

Gross earned premium by class of business



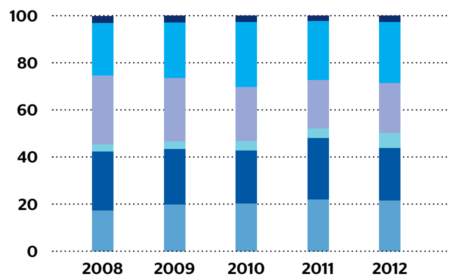
Property	33.4%
Motor & motor casualty	15.5%
Public/product liability	11.0%
Agriculture & bloodstock	10.1%
Workers' compensation	7.9%
Marine energy & aviation	7.1%
Financial & credit	5.8%
Accident & health	4.3%
Professional indemnity	4.0%
Other	0.9%

Net earned premium by type

93% direct and facultative insurance

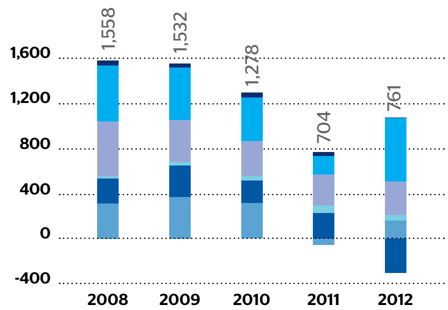
7% inward reinsurance

Divisional analysis of net earned premium (%)



- Equator Re
- North America
- Latin America
- Europe
- Australia & New Zealand
- Asia Pacific

Net profit after income tax by division (US$M)



- Equator Re
- North America
- Latin America
- Europe
- Australia & New Zealand
- Asia Pacific

> We have set out a clear vision for the future as we look to meet our obligations to our policyholders, fulfil the expectations of our shareholders, excite our people and be trusted and valued by the communities in which we do business.

John Neal Group Chief Executive Officer • QBE Insurance Group

Turning possibilities into reality

2012 has shown once again the importance of insurance in a world still economically challenged and where natural catastrophes have become regular headline news. Going forward, our objective is to prudently manage risk while carefully balancing the security our insurance policies offer with the returns our shareholders expect.

Year in review

Before discussing the key performance drivers and influences on our 2012 result, it is worth reflecting upon 2012 which was a year of transition for QBE in a number of respects. After more than 36 years with QBE and 15 years as Group CEO, Frank O'Halloran retired in August 2012. As with any change in leadership, we took the opportunity to review our diverse global insurance and reinsurance interests and to affirm and reposition our strategy for future profitable growth.

A snapshot of the 2012 result is set out on pages 6 to 7. Insurance profit was up 16% to $1,262 million based on a broadly unchanged combined operating ratio of 97.1%. A strong investment performance lifted the insurance profit margin to 8.0% compared with 7.1% last year. The overall underwriting result was disappointing mainly due to adverse prior accident year claims development. We also decided to strengthen the Group's risk margins. More details are provided later in this report.

Net profit after tax (NPAT) before non-cash charges for amortisation and impairment of intangibles (cash profit) was $1,042 million, up 32% from last year. Reported NPAT was $761 million, an increase of 8% compared with $704 million in 2011. The headline NPAT was adversely impacted by an increase in amortisation and impairment charges following changes to the structure and operation of our business, predominantly in North America. Further details are provided in the Group Chief Financial Officer's Report on page 16.

Assisted by strong operating cash flow, our in-house managed investment portfolio grew to $31.5 billion from $28.0 billion last year. Whilst global interest rates fell to all time lows, the Group's investment returns were well ahead of expectations, benefiting from narrowing credit spreads and strong equity returns.

In response to the increased catastrophe experience of 2011 and historically low interest rates, the pricing of our insurance products increased on average by slightly in excess of 5%, comfortably outstripping generally benign claims inflation. Despite this modest firming of premium rates, QBE achieved gross written premium growth of only 1%. Additional premium income generated by price increases, organic growth initiatives and bolt-on acquisitions was largely offset by the impact of portfolio remediation initiatives (the deliberate shedding of inadequately priced risks), lower soft commodity prices impacting our US crop portfolio and a gradual recovery in the US economy adversely impacting lender-placed homeowner volumes.

Our renewed focus on diligent use of our underwriting capacity in a manner consistent with our risk management protocols is demonstrated by the portfolio remediation undertaken in our Australian & New Zealand Operations following unacceptably high claims costs in 2011. This division delivered a substantially improved result in 2012, reflecting an increased focus on technical pricing discipline, risk selection and portfolio management. The very material improvement in the attritional claims ratio and the fact that our catastrophe experience was lower than our market share in Australia during 2012 represent tangible evidence that the remedial actions taken over the past 18 months were appropriate and well considered.

In 2012, worldwide insured catastrophe losses were around $65 billion compared with $119 billion in 2011. Although lower than the prior year, 2012 catastrophe losses were still above the 10 year industry average of $50 billion. Moreover, 90% or nearly $59 billion of the 2012 losses occurred in the US (compared with only $32 billion in 2011) underpinned by substantial crop claims stemming from the worst drought conditions for over 50 years and Superstorm Sandy, the second largest hurricane in US history. ›

Given that QBE derives around 36% of gross written premium from US licensed entities, and we also have US exposure through business written in our European Operations, it is not surprising that these two events severely impacted the profits of our largest division and the Group as a whole.

Notwithstanding improved or stable profitability across most of our other divisions, the Group's overall 2012 underwriting result was extremely disappointing, tarnished by $464 million of adverse prior accident year claims development which largely related to North America and Equator Re, partly offset by releases in Australian & New Zealand and Asia Pacific Operations. The poor underwriting result also reflects the decision to strengthen the Group's risk margins by $88 million or 7%, thereby improving the probability of adequacy of outstanding claims.

Together these items impacted our combined operating ratio by 3.5% and our net profit after tax by $475 million.

As the final step in the remediation of our US program business, in mid-2012 we established a standalone unit to manage the run-off of $1.2 billion of gross claims provisions. Multiple claims reviews led to the recognition of $236 million of prior accident year development with a further $80 million relating to a number of other US portfolios, following a rigorous and comprehensive year end review of our outstanding claims provision.

Partially offsetting the benefit of Equator Re's improved catastrophe experience was $235 million of prior accident year claims development (excluding inward quota shares). These claims reflect the unusual catastrophe experience of 2011 as outlined in our 2012 interim result and development on a number of portfolios, notably in North America and Europe, where we took the decision to strengthen claims provisions on some longer tail liability classes.

Our Australian & New Zealand Operations enjoyed favourable central estimate provision releases. Asia Pacific Operations also benefited from prior year claims releases as did some portfolios in our European Operations.

In addition to a thorough year end review by our in-house divisional and head office actuarial teams, the Group's $22.8 billion gross claims provision was also subject for the first time to a coordinated global actuarial review by a single firm of independent actuaries. In addition to the actions we have taken, the assessment of the independent external actuaries is that our claims central estimate is appropriate, giving us a valuable external perspective. The prior accident year claims strengthening and risk margin top up, coupled with aggressive portfolio remediation initiatives and the additional year end provisioning focus, give us confidence in the appropriateness of our year end claims provision.

The Group's overall probability of adequacy of outstanding claims stands at 87.5% compared with 86.3% at the end of 2011.

There has been much discussion in 2012 about our two specialty businesses in the US. Our crop business suffered at the hands of one of the worst US droughts on record but will, I am confident, exceed our hurdle return expectations over time. Our lender-placed insurer provides a bespoke set of loan tracking and insurance products to the US banks and their customers. We were pleased to conclude our pricing negotiations satisfactorily with a number of key state regulators in February 2013 and believe we can profitably grow this business over the medium term.

We are disappointed in our 2012 underwriting result but are confident in the broader remediation plans we have in place to improve the future underwriting results of targeted portfolios. We have also taken action to strengthen the balance sheet as discussed in greater detail in the Chief Financial Officer's report on page 16.

Made possible by QBE

Our strategy and value creation model

Our vision is to be *the* most successful global insurer and reinsurer in the eyes of our customers, our people, our shareholders and the community. In order to achieve our vision, we are committed to increasing the intrinsic value of our company and to delivering a significant increase in shareholder returns.

Our brand should espouse our vision and explain how we benefit our stakeholders – "**Made possible by QBE**" encapsulates that vision and is very clearly demonstrated in our US crop case study on page 26.

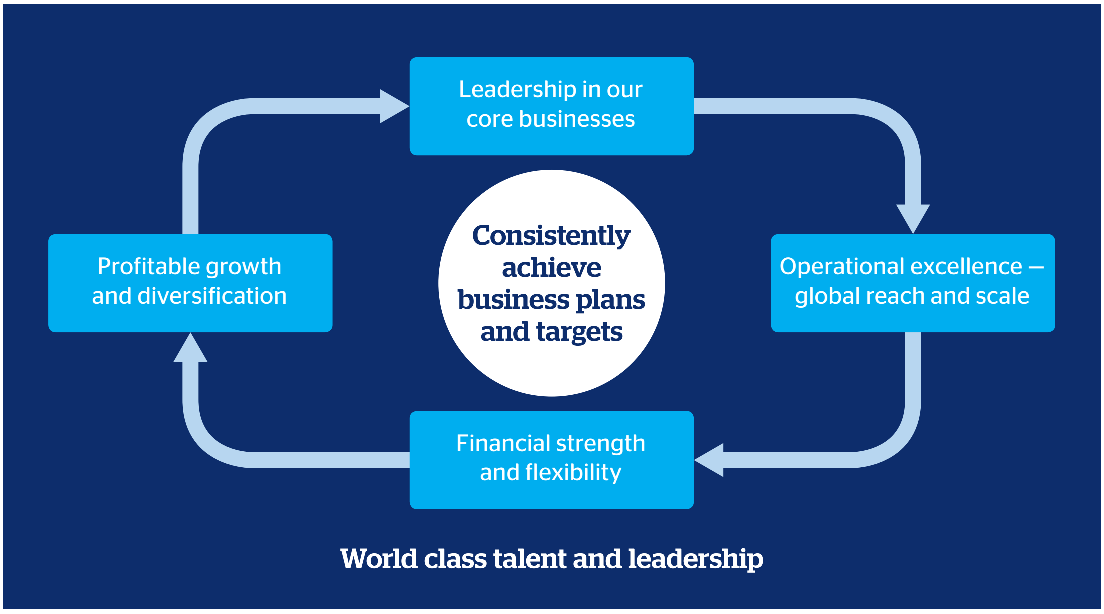
We have developed a clear strategy and set of priorities designed to significantly enhance the value of QBE. This is captured in the value creation model illustrated on page 11.

Delivery of excellent performance sits at the heart of what we aim to do. Our immediate focus is always to deliver against our stated targets consistently and in full – to "say what we do and do what we say". Our historical focus on profitability remains but we also recognise that delivering profitable growth in line with targets underpins our ability to fund future growth and increase shareholder wealth.

We will pursue our vision through a strategy that is designed to be iterative and cumulative, each component building and supporting the overall goal of creating value.

Not all parts of our value creation model will be in play at all times. As part of the strategic management process, QBE's Group Executive prioritises and focuses its activities according to the state of the market and our internal requirements.

Value creation model



1. Leadership in our core businesses

We will focus on our core businesses where we are widely recognised as world-class and can lead the market. We will prioritise our investment in these businesses, thereby maximising our growth and profit potential.

In 2012, we strengthened components of our core businesses through a number of acquisitions in Argentina, Hong Kong, Puerto Rico and the UK. These acquisitions, which will add around $930 million in gross written premium on an annualised basis, are now being integrated into our business operations.

We also made a strategic decision to exit Macedonia and to put our motor business in Estonia into run-off.

We pushed hard to achieve rate increases which properly reflect the risk we are carrying, implemented initiatives to strengthen underperforming portfolios and actively reduced exposures in catastrophe-prone areas.

We will continue to re-evaluate our portfolios with an eye to differentiating core from non-core, and will exit non-core businesses when growth prospects and/or the sustainability of acceptable returns dictate.

2. Operational excellence – global reach and scale

By collaborating across our worldwide businesses and skill sets, we will achieve economies of scale and share best practice to ensure we operate more efficiently and effectively than our peers. This will in turn enhance profit margins and further strengthen our leadership in selected markets.

We are implementing a program of operational excellence, taking advantage of global synergies and economies of scale to achieve annual run-rate benefits of at least $250 million by the end of 2015.

We will also use this operational transformation initiative as an opportunity to re-engineer our processes and achieve a ONE QBE way of working – a flexible, highly scalable and efficient model which will underpin our future success.

Our global reach enables us to work better with the largest insurance broking companies in the world, as well as ensuring that our products and services match the demands of our increasingly global clients.

We are looking to develop at least $300 million of new gross written premium in 2013 through broadening relationships with our key intermediary partners.

During 2012, we launched QBE Re as a global business, integrating our reinsurance businesses in Lloyd's, Europe and North America into a single unit.

Our restructured outward reinsurance programs for 2013 have been purchased at a saving of $50 million and, importantly, offer improved cover over 2012.

3. Financial strength and flexibility

We will continue to manage our balance sheet to ensure we minimise risk and maintain the financial strength to meet all our stakeholder requirements and to provide flexibility for our future needs.

During 2012, our financial position was strengthened through capital initiatives and retained profits, increasing shareholders' funds by 9% to over $11.3 billion. Specifically, we raised A$600 million of ordinary share capital, issued $500 million of subordinated convertible debt securities and sold $150 million of perpetual capital securities originally repurchased by QBE in 2008, enhancing our tier 1 and 2 capital levels. In addition, with prospective effect, we have revised the Group's dividend payout ratio to a more conservative approach based on cash profit. More details are provided in the Chief Financial Officer's report on page 16.

We continue to carefully manage our investment portfolio by seeking low-risk strategies that will enhance returns in the ongoing low interest rate environment while, at the same time, reducing overall portfolio volatility. In this regard, plans are underway for a cautious entry into property and infrastructure-related debt instruments in 2013.

Our provision for outstanding claims was strengthened and risk margins increased, improving our overall probability of adequacy.

4. Profitable growth and diversification

We will pursue our ambition for further growth and profitability by expanding into new products, markets and territories where we believe we can build leadership positions.

In 2012, we undertook a fundamental review of our Asian strategy and business model. Our intention is to build upon the Group's many years of experience and broad footprint in the region by better exploiting our core product set, building on established intermediary relationships and exploiting advantages in technology.

Since our entry into Latin America 12 years ago, the division has grown substantially through acquisition into one of the leading franchises in the region. In 2012, we acquired businesses in both Argentina and Puerto Rico, further adding to the scale and diversity of our Latin American Operations and underpinning our expectations for $1.5 billion of gross written premium in 2013.

We will complete the integration of our 2012 acquisitions in Latin America and Asia and will implement our growth strategy in Asia.

We are forecasting net earned premium growth in Asia and Latin America in excess of 20% whilst still achieving the Group's performance hurdles.

We currently have no plans to expand into new geographies in 2013.

We envisage limited acquisition activity during 2013, and only where a strong business case exists to support an established profitable business.

Our value creation model is underpinned by our people

ONE QBE – our culture

Our value creation model is underpinned by one absolute belief – our ultimate key differentiator has to be our people. Consistent with this belief, we are implementing a global model designed to develop world-class talent and leadership.

In 2012, we took the opportunity to refresh our vision and values and the way in which we communicate our brand internally and externally. Our people are our most precious asset and a strong culture builds the best platform for success for QBE and therefore for all of our stakeholders.

In parallel with day to day challenges and the achievement of targets and business plans, in 2012 we began the transformation of our business towards our refreshed vision. We are progressing on two fronts – internally and externally.

Our people and the way they interact are fundamental to our success. Our unique culture has provided the cornerstone for our success. Recognising the changing social environment and business demands, we have refreshed and modernised the way we describe this. The values and behaviours that describe our culture are represented by the acronym ONE QBE as outlined on page 1 of the annual report. These values and behaviours form the common thread that makes us think and act as one company, whenever and wherever we do business in the world.

ONE QBE is embedded in the language we use internally, in our learning and development and in our performance management systems. You won't see it explicitly in our marketing materials or documentation, but you will see it in our people – in the way they work with you, in their decision making and in their collaboration with the market and with each other.

In late 2012, we began the ONE QBE roll out across our entire organisation. Through a series of interactive workshops, all 17,000 of our people will get a chance to think about what it means for them and how they can contribute towards our vision.

Outlook for 2013

I want to re-emphasise our commitment to open and transparent communication. Our 2013 focus will be a balance between short-term performance and the progression of our value creation strategy.

2013 targets:

Gross written premium

US$18.5–19billion

Net earned premium

US$15.5–16billion

Combined operating ratio

92%

Insurance profit margin

11% of net earned premium

Our objective is always to achieve an attractive (market-leading) return on equity across the market cycle; however, the very nature of our business and the risks we cover often make it a challenge to provide detailed and accurate guidance.

We expect premium rates to continue to firm in 2013, rising by 5% on average most notably in Australia, New Zealand and North America, and thereby exceeding the incremental cost of claims inflation. We are forecasting modest growth in gross earned and net earned premium, less than the expected rise in pricing. This reflects expected economic improvement resulting in reduced premium rates in our US lender-placed insurance portfolio, the full year impact of past remediation plans that were put in place in 2012 and a recognition that we will continue to withdraw our capacity where we consider pricing levels are unsatisfactory.

We believe we can maintain a high degree of control over our attritional claims ratio which should reduce due to price increases in excess of claims inflation and as a result of remediation initiatives. Our large individual risk and catastrophe claims allowance is unchanged at 10.5% of net earned premium, which we believe to be a more cautious stance given structural improvements to our reinsurance program.

Taking all key profit levers into account, we are targeting a 92% combined operating ratio which we believe will place us in the top quartile of our global insurance peers. Our commission and expense ratio includes an allowance of up to 1% before savings relating to set up costs for our operational transformation program.

When combined with a targeted margin contribution from investment income on policyholders' funds of 3.0% (a yield of 2.25%), we are targeting an insurance profit margin of around 11%.

Our 2013 targeted insurance profit margin and cash profit equates to a return on equity of 11%. Over the medium term, the expected improvement in our attritional claims ratio and emerging savings from our operational transformation program will drive the combined operating ratio down to 90% or better.

Our targeted returns assume no short-term recovery in investment yields from the current historic low.

In 2012, we increased our net tangible assets by nearly $1 billion and continued to work on a number of capital enhancing initiatives designed to further increase the regulatory and rating agency capital levels of our business.

We are developing a comprehensive five year strategic plan and we will be looking to update our shareholders on these initiatives throughout 2013. We will continue building a ONE QBE global culture where world class leadership is encouraged and developed. We will continue to share expertise and resources across regions, working as ONE QBE.

We are constantly striving to have the very best talent to manage our global business. The senior management changes and proposed succession arrangements announced to the market on 26 Febraury are testament to the depth of talent in our organisation and our capacity to attract high quality managers. My personal thanks to all those who have assisted QBE in the past and I look forward to working with the new team appointments.

There are few insurance and reinsurance businesses in the world today that have QBE's global reach, capability and talent. With operations in 48 countries, we provide insurance to policyholders in more than 140 countries and enjoy the commitment of 17,000 employees. We are well positioned for future success.

On behalf of our Group Executive, I would like to extend our thanks to our employees who are committed wholeheartedly to turning our new vision into a reality and to delivering value to all of our key stakeholders.

We are grateful to our shareholders for their continued investment in QBE. We respect and thank you for your trust.

John Neal
Group Chief Executive Officer

Divisions at a glance

North American Operations

General insurance and reinsurance in the US, through five specialist business units: Financial Partner Services (FPS), US Property & Casualty (US P&C), crop, program and reinsurance.

Latin American Operations

General insurance operations in seven countries throughout North, Central and South America, focused mainly on commercial classes of business.

European Operations

Commercial insurance and reinsurance principally in the Lloyd's market, the UK, Ireland and mainland Europe.

	North American Operations 2012	2011	Change	Latin American Operations 2012	2011	Change	European Operations 2012	2011	Change
Gross written premium (US\$M)	6,569	7,529	↓ 13%	1,223	768	↑ 59%	5,077	4,828	↑ 5%
Gross earned premium (US\$M)	6,978	7,431	↓ 6%	1,170	752	↑ 56%	4,854	4,635	↑ 5%
Net earned premium (US\$M)	3,501	4,018	↓ 13%	1,018	620	↑ 64%	3,331	3,150	↑ 6%
Combined operating ratio (%)	106.8	90.6	↑	94.7	89.7	↑	94.6	95.5	↓
Insurance profit (loss) (US\$M)	(170)	440	↓ \$610M	121	101	↑ 20%	327	298	↑ 10%
Insurance profit margin (%)	(4.9)	11.0	↓	11.9	16.3	↓	9.8	9.5	↑
Staff numbers	6,449	6,754	↓ 5%	1,782	1,044	↑ 71%	2,852	2,716	↑ 5%

Major events impacting operations in 2012

North American Operations

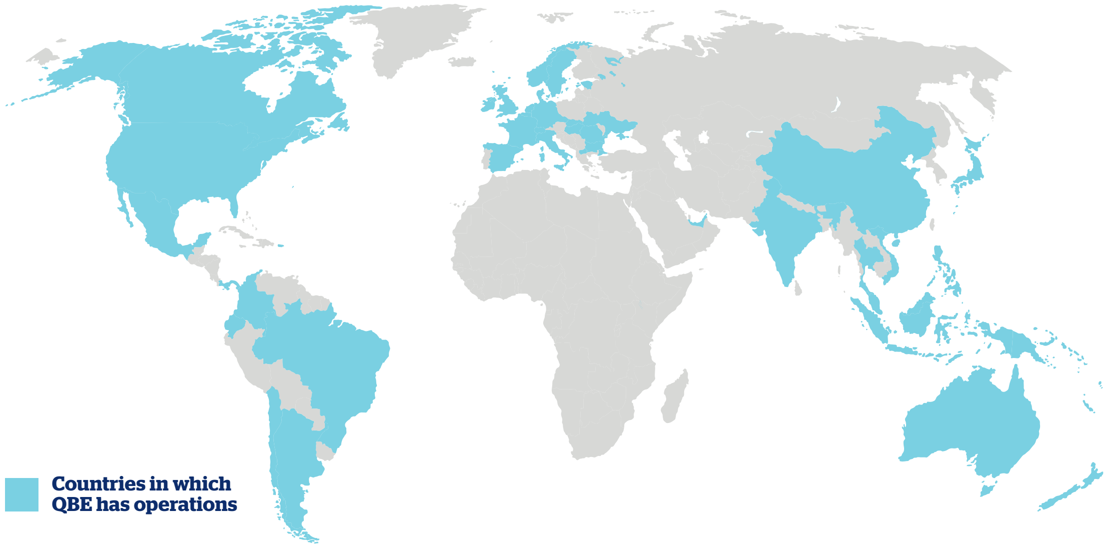
- Claims costs heavily impacted by Superstorm Sandy, the US drought and prior accident year claims development
- Restructure of the US P&C business and related management changes
- US pricing cycle continued to improve with moderate rate increases across most classes
- Reinsurance pooling implemented across North American Operations, reducing costs and assisting capital management

Latin American Operations

- Acquisition of HSBC Argentina general insurance business and related bancassurance distribution agreement
- Optima acquisition in Puerto Rico
- Premium rates tracking in line with inflation
- Investment portfolios repositioned to mitigate the impact of continuing volatile markets

European Operations

- Strong underwriting discipline in a tight pricing environment and tough economic conditions led to a strong overall performance
- Completed acquisition of Brit UK regional operations
- The bulk of QBE's global reinsurance business was consolidated into QBE Re and is now managed out of London
- Implementation of Solvency II delayed until 2014 at earliest



Australian & New Zealand Operations

General insurance operations throughout Australia and New Zealand, providing all major lines of insurance cover for personal and commercial risks.

Asia Pacific Operations

General insurance in 16 countries in the Asia Pacific region providing personal, commercial and specialist insurance covers.

Equator Re

Based in Bermuda, Equator Re is QBE's captive reinsurer, providing reinsurance protection to all of the Group's operating divisions.

	Australian & New Zealand Operations 2012	2011	Change	Asia Pacific Operations 2012	2011	Change	Equator Re 2012	2011	Change
Gross written premium (US$M)	4,987	4,699	6%	578	467	24%	3,710	3,807	3%
Gross earned premium (US$M)	4,794	4,551	5%	545	457	19%	3,712	3,697	–
Net earned premium (US$M)	4,123	3,868	7%	415	341	22%	3,410	3,362	1%
Combined operating ratio (%)	90.6	99.6		85.8	87.4		99.7	104.5	
Insurance profit (loss) (US$M)	779	242	222%	66	60	10%	139	(56)	$195M
Insurance profit margin (%)	18.9	6.3		15.9	17.6		4.1	(1.7)	
Staff numbers	4,623	4,606	–	1,254	1,122	12%	27	22	23%

Major events impacting operations in 2012

Australian & New Zealand Operations

- Combined management and reporting of Australian & New Zealand Operations
- Significantly improved combined operating ratio, driven by a substantial improvement in attritional claims ratio and reduced catastrophe claims
- Stable outlook for lenders' mortgage insurance business which continues to deliver profits
- NIBA general insurer of the year for the 11th consecutive year

Asia Pacific Operations

- Substantial strategic review undertaken in the region to position QBE for profitable growth in the market
- Strong top and bottom line growth augmented by improved risk management post the 2011 catastrophes
- Acquisition of Hang Seng Bank's Hong Kong general insurance operations and bancassurance distribution agreement

Equator Re

- Centralised management of outward reinsurance programs and external reinsurance placements
- Improved combined operating ratio despite Superstorm Sandy
- New executive management structure and increased underwriting resources

Financial strength and flexibility

QBE's financial position strengthened considerably during the year with net tangible assets up 22% or $976 million compared with 2011. The stronger balance sheet reflected an improved cash profit of $1,042 million (2011 $791 million).

Operating cash flow was strong at over $2.7 billion, up by over $600 million when compared with last year. Investment returns were well ahead of target with significant realised and unrealised gains on our considerable investment portfolio, now at $31.5 billion. We have taken measures to significantly strengthen our provision for outstanding claims for a number of underperforming and run-off portfolios. Risk margins were strengthened, resulting in an increased probability of adequacy of 87.5% (2011 86.3%).

Continuing weak global economic conditions, financial uncertainty in the eurozone and US budgetary concerns have restricted growth in developed markets. Competition remains strong, although 2012 was encouraging with modest premium rate increases, particularly in North American and Australian & New Zealand Operations. Although catastrophe loss activity was significantly reduced compared with 2011, weather-related events and other man-made disasters fully utilised our allowances for large individual risk and catastrophe claims.

We achieved overall premium rate increases on renewed business of slightly in excess of 5% and, in many cases, were able to increase deductibles, particularly for property classes of business. Despite the lower interest rate environment, pricing in our long tail liability portfolios in Europe remains stubbornly competitive.

The global regulatory environment has become much tighter in recent years and rating agencies have generally applied more onerous criteria when assessing capital charges and minimum capital requirements for insurers. QBE has actively engaged with global agencies as these initiatives have evolved. As a result, the Group has implemented a sound capital management framework to ensure that capital levels meet the requirements of our external stakeholders whilst remaining within management's benchmark range and targets. In the first half of 2012, we completed a A$600 million capital raising which replaced convertible debt falling due and thereby improved the mix of capital for regulatory purposes. Our position was also assisted by the Board's decision to reduce the dividend payout in order to maintain capital and allow for future growth. The proposed final dividend is 10 Australian cents per share compared with 25 Australian cents per share last year.

Operating and financial performance

Overview of the 2012 result

Net profit after tax was up 8% to $761 million compared with $704 million in 2011. The increased profit benefited from strong net investment income and a lower cost of large individual risk and catastrophe claims, partly offset by adverse prior accident year claims development.

> **We continue to focus on financial strength and flexibility, supporting the Group's vision and allowing us to respond to regulatory change.**

Neil Drabsch Chief Financial Officer • QBE Insurance Group

Amortisation of identifiable intangibles and impairment of goodwill was $407 million, up from $133 million in 2011. The increased charge was mainly due to a write-down of identifiable intangibles in the US following our decision to roll out the **ONE QBE** brand and rationalise distribution channels. The charge also included a reassessment of the amortisation profile appropriate to the Balboa renewal rights purchased in 2011 and the impairment of goodwill in Asia and Latin America. Further details are included in the intangibles section of this report on page 24.

Insurance profit was up 16% to $1,262 million, resulting in an insurance profit margin of 8.0% compared with 7.1% in 2011. Despite the improvement, the insurance profit margin was well below our target of 13% of net earned premium due to strengthening of claims provisions for underperforming and run-off portfolios, coupled with the impact of the severe drought on our US crop business. Deterioration of 2011 catastrophe claims estimates for the Thai floods and the Christchurch earthquakes, lower risk-free interest rates used to discount outstanding claims and an increase in risk margins further impacted underwriting profitability.

The combined operating ratio was 97.1% compared with 96.8% last year. With the exception of Equator Re which was impacted by development of 2011 catastrophe claims and our North American Operations which bore the brunt of the prior year claims development for run-off and underperforming portfolios, the other divisions were close to or exceeded their target combined operating ratio. Notably the combined operating ratio for our Australian & New Zealand Operations reduced from 99.6% last year to 90.6%, benefiting from portfolio remediation, strong adherence to pricing disciplines and the more benign claims environment.

The Group's combined commission and expense ratio increased to 31.1%, from 28.6%, reflecting changes in the mix of business coupled with various remediation and restructuring costs. The impact of these increases was exacerbated by the lower than expected net earned premium base, particularly in our North American Operations. This ratio also reflects our investment in the early stages of our operational transformation program which is expected to produce cost benefits from 2014 onwards.

Investment return for the year was excellent, with net investment income ahead of target and yields exceeding benchmarks. Contracting credit spreads throughout the year and improved equity markets contributed to a high level of realised and unrealised gains for most of our portfolios. Our strong operating cash flow assisted the overall level of investment income generated for the year.

Significant items in profit before tax

FOR THE YEAR ENDED 31 DECEMBER	2012 US$M	2011 US$M
Realised and unrealised gains (losses) on investments	504	(181)
Cost of large individual risk and catastrophe claims (current accident year)	(1,643)	(2,355)
Amortisation of identifiable intangibles and impairment of goodwill	(407)	(133)
Prior accident year central estimate claims development	(464)	64
Foreign exchange (loss) gain	(12)	188

Details of the results are set out in the following summary income statement table:

Summary income statement

FOR THE YEAR ENDED 31 DECEMBER	2012 US$M	2011 US$M
Gross written premium	18,434	18,291
Gross earned premium	18,341	17,840
Net earned premium	15,798	15,359
Net claims incurred	(10,428)	(10,466)
Net commission	(2,560)	(2,291)
Underwriting and other expenses	(2,357)	(2,108)
Underwriting result	453	494
Investment income on policyholders' funds	809	591
Insurance profit	1,262	1,085
Investment income on shareholders' funds	407	185
Share of net profit of associates	3	6
Financing and other costs	(324)	(275)
Amortisation/impairment of intangibles	(407)	(133)
Profit before income tax	941	868
Taxation	(161)	(149)
Profit after tax	780	719
Non-controlling interests	(19)	(15)
Net profit after tax	761	704

Determination of cash profit

FOR THE YEAR ENDED 31 DECEMBER	2012 US$M	2011 US$M
Net profit after tax	761	704
Add back: Amortisation/impairment of intangibles	407	133
Tax on amortisation/impairment of intangibles	(126)	(46)
Cash profit	1,042	791

Premium income

Gross written premium growth was modest, up 1% to $18.4 billion from $18.3 billion in 2011, with growth slightly higher in local currencies. Organic growth through premium rate increases and, in some cases improved distribution, was supplemented by acquisitions. This was largely offset by a reduction in gross written premium of $960 million in North American Operations, mainly due to the impact of weaker commodity prices on the crop portfolio and reduced premium from our lender-placed insurance business. We also reduced our exposure to a number of underperforming portfolios and cancelled distribution arrangements with a number of intermediaries in our North American Operations.

We experienced good organic growth in our Australian & New Zealand and Asia Pacific Operations, with European and Latin American Operations mainly benefiting from the acquisitions completed during the year.

The following acquisitions were completed during the year and assisted premium growth:

ANNUALISED GWP	US$M
Optima Insurance Group (Puerto Rico)	40
HSBC La Buenos Aires Seguros SA (HSBC Argentina) (Argentina)	545
Hang Seng General Insurance (Hong Kong)	60
BRIT regional renewal rights (UK)	285

In 2012, these acquisitions contributed $620 million of gross written premium and $390 million of net earned premium to the Group result.

Reinsurance expense

Reinsurance expense was 13.9% of gross earned premium, unchanged from 2011 but higher than our target of around 12.5%, mainly due to the US crop business. Despite the impact of an overall crop loss in 2012, the increased reinsurance expense reflected costs associated with those States that generated profits and were not affected by the drought conditions. The underlying reinsurance expense was 12.1% excluding US crop reinsurance.

Underwriting performance

Key ratios – Group

FOR THE YEAR ENDED 31 DECEMBER	2012 %	2011 %
Claims ratio	66.0	68.2
Commission ratio	16.2	14.9
Expense ratio	14.9	13.7
Combined operating ratio	97.1	96.8

Divisional performance

Contributions by region

	GROSS WRITTEN PREMIUM		NET EARNED PREMIUM		COMBINED OPERATING RATIO		INSURANCE PROFIT BEFORE INCOME TAX	
	2012 US$M	2011 US$M	2012 US$M	2011 US$M	2012 %	2011 %	2012 US$M	2011 US$M
North American Operations	6,569	7,529	3,501	4,018	106.8	90.6	(170)	440
Latin American Operations	1,223	768	1,018	620	94.7	89.7	121	101
European Operations	5,077	4,828	3,331	3,150	94.6	95.5	327	298
Australian & New Zealand Operations	4,987	4,699	4,123	3,868	90.6	99.6	779	242
Asia Pacific Operations	578	467	415	341	85.8	87.4	66	60
Equator Re	3,710	3,807	3,410	3,362	99.7	104.5	139	(56)
Elimination – internal reinsurance	(3,710)	(3,807)	–	–	–	–	–	–
Group	18,434	18,291	15,798	15,359	97.1	96.8	1,262	1,085
Direct and facultative	17,036	16,734	14,618	14,120	97.7	95.4	1,075	1,186
Inward reinsurance	1,398	1,557	1,180	1,239	90.3	112.5	187	(101)
Group	18,434	18,291	15,798	15,359	97.1	96.8	1,262	1,085

Incurred claims

The net claims ratio reduced from 68.2% of net earned premium in 2011 to 66.0%, with the reduction mainly due to the generally more benign level of catastrophe claims activity in 2012. The following table provides a summary of the major components of the net claims ratio:

Analysis of net claims ratio

FOR THE YEAR ENDED 31 DECEMBER	2012 %	2011 %
Attritional claims	49.4	49.2
Large individual risk and catastrophe claims	10.4	15.3
Claims settlement costs	1.9	2.5
Claims discount	(2.2)	(1.7)
Net incurred central estimate claims ratio – current accident year	59.5	65.3
Changes in prior accident year central estimate	2.9	(0.4)
Other including claims settlement costs, discount and risk margins	3.6	3.3
Net incurred claims ratio – current financial year	66.0	68.2

Notwithstanding the favourable pricing environment in Australia and North America, the attritional claims ratio increased slightly overall due to abnormal claims experience in Europe and North American Operations. The attritional claims ratio was also adversely impacted by an increase in the relative premium contribution from our Australian & New Zealand and Latin American Operations, where the attritional claims ratios are inherently above the Group average. Catastrophe claims were down in line with the reduced frequency and severity of such events and include $335 million for Superstorm Sandy and $331 million for crop claims following the US drought. Large individual risk claims in excess of $2.5 million were higher than last year, although within our allowance.

Large individual risk and catastrophe claims, defined as those claims with a cost of $2.5 million and above, were 10.4% of net earned premium compared with 15.3% last year. Details are provided in the tables below.

Large individual risk and catastrophe claims

IN THE YEAR ENDED 31 DECEMBER 2012	COST US $M	% OF NEP
Superstorm Sandy (28 October)	335	2.1
US tornadoes (29 February, 3 March, 2 and 12 April)	47	0.3
Hurricane Isaac (29 August)	26	0.2
Italian earthquake (29 May)	27	0.2
Western Australia storms (10 June)	23	0.1
Midwest US hailstorm (28 April)	19	0.1
Cyclone Evan (14 December)	15	0.1
US east coast storms (2 July)	15	0.1
Victoria & NSW floods (16 March)	13	0.1
Crop claims *	331	2.1
Other catastrophe claims including IBNR	110	0.7
Total catastrophe claims including IBNR	961	6.1
Other large individual risk claims incurred including IBNR	682	4.3
Total large individual risk and catastrophe claims including IBNR	1,643	10.4

* Crop catastrophe claims are defined as claims in excess of a 67% net claims ratio.

Large individual risk and catastrophe claims

IN THE YEAR ENDED 31 DECEMBER 2011	COST US $M	% OF NEP
Thailand floods (3 events – 15, 22 and 29 October)	261	1.7
19 severe US tornadoes (April – August)	243	1.6
Christchurch earthquakes (22 February, 13 June)	222	1.5
Japanese earthquake and tsunami (11 March)	154	1.0
Queensland floods (2 and 8 January)	142	0.9
Cyclone Yasi (2 February)	138	0.9
Victorian hail, floods and storms (9 January, 8 February, 25 December)	98	0.6
Hurricane Irene (26 August)	50	0.3
Western Australia bush fires (5 February)	31	0.2
Copenhagen floods (2 July)	11	0.1
Crop claims *	319	2.1
Other catastrophe claims including IBNR	64	0.4
Total catastrophe claims including IBNR	1,733	11.3
Other large individual risk claims incurred including IBNR	622	4.0
Total large individual risk and catastrophe claims including IBNR	2,355	15.3

* Crop catastrophe claims are defined as claims in excess of a 65% net claims ratio.

Strengthening of claims provisions for underperforming and run-off portfolios in North America and deterioration of 2011 catastrophe claims estimates in our captive Equator Re were the main reasons for the prior accident year claims development, which added 2.9% to the net claims ratio. In addition, the year end actuarial process resulted in further upgrades to provisions for long tail liability business in Equator Re, mainly relating to European casualty claims. Lower discount rates resulted in around $102 million of additional claims cost. The net impact on the underwriting result of increased risk margins was $88 million or 0.6%.

Actions taken to identify and deal with run-off and underperforming portfolios and the thorough review of claims at the balance date by both internal and external actuaries give us confidence in the adequacy of our claims provision. For the first time this year, we employed the services of a single independent actuarial firm across the majority of our global portfolios to ensure consistency of approach in establishing central estimates for outstanding claims provisions in each of our divisions. Around 96% of our outstanding claims provisions were reviewed by external actuaries, providing further assurance about the overall quality of our provisions.

Commission and expenses

The Group's combined commission and expense ratio increased to 31.1%, up from 28.6%, reflecting changes in the mix of business due to acquisitions, costs of integrating acquired Latin American and US lender-placed business and increased costs for IT systems and business change initiatives. Costs also increased due to higher government levies in Australia and Europe. Lower net earned premium in our North American Operations also contributed to the higher ratio.

The commission ratio was 16.2%, up from 14.9% last year, due to higher broking costs in Australia and Europe, the change in business mix, and a higher commission ratio on the HSBC Argentina acquisition.

The expense ratio was 14.9%, up from 13.7% last year. The increase in costs was mainly due to costs related to integration and portfolio remediation activities, the commencement of various global operational transformation programs as well as associated systems and depreciation costs and increased government levies. It is likely that the higher expense ratio will continue until the major transformation programs are completed.

Income tax expense

Income tax expense can vary from year to year due to the mix of profits from our various countries that have different rates of income tax. The income tax expense for 2012 was 17.1% of net profit before tax compared with 17.2% in 2011.

The income tax expense rate was lower than our market guidance of around 22%, mainly reflecting losses in the US taxed at a higher rate, a one-off saving due to the recovery of prior year capital losses, a reduced UK corporate tax rate and other beneficial prior year adjustments. Income tax payments in Australia benefit our dividend franking account. As a significant proportion of our 2012 profit was derived from Australia, the expected higher level of Australian income tax will support an increased franking rate for dividends paid to shareholders in the near term.

Cash flow

Operating cash flow for the year was very strong at $2.7 billion, significantly up from $2.1 billion in 2011. The increase was primarily attributable to overall business growth and reduced outward reinsurance costs. Further details are provided in the consolidated statement of cash flows on page 111.

Foreign exchange

The key exchange rates used in the preparation of the financial statements are set out in note 1 to the financial statements. The table below shows the impact of foreign exchange on the results and balance sheet.

Impact of exchange rate movements

	2012 ACTUAL US$M	2012 AT 2011 EXCHANGE RATES[1] US$M	EXCHANGE RATE IMPACT US$M	%
Gross written premium	18,434	18,566	(132)	(1)
Gross earned premium	18,341	18,484	(143)	(1)
Net earned premium	15,798	15,947	(149)	(1)
Net profit after income tax	761	775	(14)	(2)
Total investments and cash	31,526	31,159	367	1
Total assets	50,762	50,019	743	1
Gross outstanding claims provision	22,789	22,455	334	1
Total liabilities	39,345	38,835	510	1

1 Income statement items are restated to 31 December 2011 cumulative average rates of exchange and balance sheet items to 31 December 2011 closing rates of exchange.

Balance sheet

Capital management

During the year we were active in ensuring our capital levels for all stakeholder requirements remained within our benchmark range and targets. Major capital transactions and other initiatives included:

- the ordinary share capital raising in March and April 2012 of A$600 million;
- the issue of $500 million of subordinated convertible debt securities in December 2012; and
- the sale of $150 million of perpetual capital securities in December 2012, originally repurchased by QBE in 2008.

QBE's financial position is sound and, with action taken to preserve capital, we are confident that capital levels will continue to grow and provide flexibility for our future needs.

Capital summary

CAPITAL	2012 US$M	2011 US$M
Shareholders' equity	**11,358**	10,386
Intangibles	**(6,068)**	(6,065)
Net tangible assets	**5,290**	4,321
Interest-bearing liabilities	**4,932**	4,757
Total tangible capitalisation	**10,222**	9,078

REGULATORY CAPITAL	2012 US$M	2011 US$M
APRA Minimum Capital Requirement (MCR)	**5,230**	4,984
QBE's regulatory capital base	**8,913**	7,525
Regulatory capital surplus	**3,683**	2,541
MCR multiple	**1.7**	1.5

From 1 January 2013, all APRA authorised insurers and insurance groups are subject to revised regulatory capital adequacy requirements. These requirements apply new standards to both the measurement of capital for regulatory purposes and the calculation of the required minimum level of capital known as the Prudential Capital Requirement (PCR). The PCR for an APRA regulated entity equals the sum of a publicly disclosed Prescribed Capital Amount (PCA) plus any supervisory adjustment determined by APRA. A regulated entity may not disclose details of any supervisory adjustment.

QBE will formally report both the regulatory capital base and PCA as at 30 June 2013 in the half year report.

QBE's financial strength ratings remain unchanged at an equivalent A+ rating for our main insurance subsidiaries.

In 2013, we will continue to engage with ratings agencies as they update their frameworks and models for the insurance sector. Despite these changes, our capital strategy remains focused on providing assurance to stakeholders regarding the Group's compliance with regulatory and rating agency requirements. QBE is well positioned to manage the evolving requirements of regulators and ratings firms.

Key ratios

	BENCHMARK	2012	2011
Debt to equity	< 45%	**43%**	46%
Financial leverage	25% to 35%	**30%**	31%
APRA – MCR multiple	> 1.5x	**1.7x**	1.5x
Probability of adequacy of outstanding claims	> 85%	**87.5%**	86.3%

Insurance liabilities

The table below summarises our provisions for outstanding claims and unearned premium, separately identifying the central estimate and risk margins.

AS AT 31 DECEMBER	2012 US$M	2011 US$M	2010 US$M	2009 US$M	2008 US$M
Outstanding claims	**18,412**	16,984	15,017	12,864	11,346
Unearned premium net of deferred insurance costs [1]	**6,023**	5,929	4,785	4,374	3,608
	24,435	22,913	19,802	17,238	14,954
Central estimate – outstanding claims	**17,079**	15,783	13,747	11,847	10,504
Central estimate – unearned premium	**5,024**	5,062	3,901	3,487	2,931
Risk margin – outstanding claims	**1,333**	1,201	1,270	1,017	842
Risk margin – unearned premium [1]	**999**	867	884	887	677
	24,435	22,913	19,802	17,238	14,954
Risk margin in excess of 75% probability of adequacy using APRA's risk weighted capital adequacy model	**1,374**	1,152	1,353	1,198	816
	%	%	%	%	%
Probability of adequacy – outstanding claims	**87.5**	86.3	89.8	88.1	86.1
Probability of adequacy – total insurance liabilities	**93.9**	92.6	95.5	95.5	93.2
Weighted average discount rate	**2.16**	2.10	3.22	3.20	2.46
Weighted average term to settlement	**2.9**	2.9	3.0	2.8	2.7

1 Includes deferred reinsurance expense for future business not yet written of $70 million (2011 $292 million).

As required by Australian accounting standards, insurance liabilities are discounted applying sovereign bond rates as a proxy for risk-free interest rates and not the actual earning rate of our investments.

At 31 December 2012, the probability of adequacy of the outstanding claims provision was 87.5% compared with 86.3% at 31 December 2011. During the year, our discounted central estimate was impacted by lower risk-free rates, higher inflation due to our increased exposure in Latin America and the claims strengthening described above. Risk margins in outstanding claims increased compared with last year and are deemed appropriate to cover the inherent uncertainty in the central estimate. The probability of adequacy of total insurance liabilities was 93.9% compared with 92.6% at 31 December 2011.

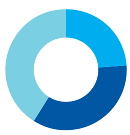
Borrowings

Borrowings were up $175 million to $4,932 million, with the increase mainly reflecting the sale of $150 million of perpetual capital securities which were repurchased by QBE in 2008. These securities receive Tier 1 capital treatment for regulatory purposes.

Based on the first call date, the maturity profile of borrowings indicates that $1,195 million is due and payable in 2013. We expect to take advantage of the prevailing low interest rates to refinance the majority of this amount with appropriate securities. We do not receive any regulatory or rating agency capital credit for the hybrid securities due May 2030 and are therefore able to refinance these securities with senior debt without impacting our capital position. Further details of borrowings are set out in note 25 of the financial statements.

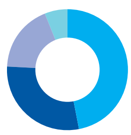
Borrowings maturity [1]

AS AT 31 DECEMBER	2012 %	2011 %
Less than one year	**24**	14
One to five years	**35**	52
More than five years	**41**	34



Borrowings profile

AS AT 31 DECEMBER	2012 %	2011 %
Subordinated debt	**47**	49
Senior debt	**29**	28
Hybrid securities	**18**	18
Capital securities	**6**	4
Bank loans	**–**	1



1 Based on first call date.

Goodwill and identifiable intangibles

The carrying value of goodwill and identifiable intangibles at the balance date was $6,068 million compared with $6,065 million at 31 December 2011. Details of goodwill and identifiable intangibles are set out in note 19 of the financial statements.

Amortisation of identifiable intangibles and impairment of goodwill was $407 million, up from $133 million in 2011, mainly due to:

- a write-down of $45 million of identifiable intangibles in the US following our decision to discontinue the use of various brand names as we roll out the ONE QBE brand;
- a write-down of $38 million as a result of our decision to rationalise distribution channels as part of our review of underperforming and run-off business;
- the reassessment of the amortisation profile appropriate to the Balboa renewal rights purchased in 2011 resulted in a further $80 million of amortisation; and
- the impairment of goodwill and identifiable intangibles in relation to the current year acquisition of Optima Insurance Group in Puerto Rico ($21 million) and goodwill in relation to Hang Seng General Insurance in Hong Kong ($37 million).

The impairment of goodwill for these newly acquired businesses reflected the use of cautious growth assumptions, discount rates and risk factors when impairment testing these assets. We continue to believe in the long-term value that these businesses will bring to the Group.

The table below summarises the major movements in our goodwill and identifiable intangibles balances.

Reconciliation of movement in intangible assets

	31 DECEMBER 2012			31 DECEMBER 2011		
	IDENTIFIABLE INTANGIBLES US$M	GOODWILL US$M	TOTAL US$M	IDENTIFIABLE INTANGIBLES US$M	GOODWILL US$M	TOTAL US$M
Opening balance	1,399	4,666	6,065	814	4,573	5,387
Acquisitions	204	156	360	693	128	821
Disposals	(6)	–	(6)	–	–	–
Additions/reclassifications	–	25	25	29	(24)	5
Amortisation/impairment	(354)	(53)	(407)	(133)	–	(133)
Foreign exchange	(3)	34	31	(4)	(11)	(15)
Closing balance	1,240	4,828	6,068	1,399	4,666	6,065

Our detailed impairment testing of goodwill and identifiable intangibles gives us confidence in the appropriateness of these carrying values at the balance date. Identifiable intangibles of $1,091 million with a finite life will be materially written off over the next nine years.

Investment performance and strategy

Investment income was higher than anticipated as a result of favourable developments in both credit spreads and equity markets. The overall net yield achieved was 4.1% compared with 2.9% in 2011. Positive international investor sentiment and abundant liquidity provided by global central banks contributed to rising equity markets, with our significant holding of corporate bonds also enjoying mark-to-market capital gains as credit spreads narrowed.

Our fixed interest and cash portfolios remain highly liquid, with the majority of securities held rated Aa3 or above. We adopted a very cautious approach to investment markets, in particular avoiding direct exposure to those European nations most susceptible to the ongoing sovereign debt crisis. We continue to have no permanent impairment of any of our securities.

In line with our strategy, the Group's exposure to corporate bonds is around 42% of our cash and fixed interest portfolio at 31 December 2012. As credit spreads improved during the year, realised and unrealised gains of $445 million on the fixed interest portfolio were achieved.

The underlying yields on our cash and fixed interest portfolios have continued to reduce during the year with an overall running yield on these portfolios at year end of 1.9% compared with 3.2% at the end of 2011.

At the balance date, we had an equity holding of less than 1%. During the year, we increased our equity exposure up to our 2.5% benchmark when buying opportunities permitted. We adopted a focus on low beta, high dividend stocks and locked in gains, consistent with our aim to reduce risk and enhance yield for our considerable shareholder's and policyholder's funds. The global economic outlook remains uncertain and market volatility is expected to continue. We will continue to diversify our exposures and enhance yield without compromising our strict risk criteria. Subject to market conditions and, where appropriate, we may seek a higher exposure to equities, property and infrastructure investments in 2013.

Total net investment income

FOR THE YEAR ENDED 31 DECEMBER	POLICYHOLDERS' FUNDS 2012 US$M	POLICYHOLDERS' FUNDS 2011 US$M	SHAREHOLDERS' FUNDS 2012 US$M	SHAREHOLDERS' FUNDS 2011 US$M	TOTAL INVESTMENT INCOME 2012 US$M	TOTAL INVESTMENT INCOME 2011 US$M
Equity income	**46**	–	**37**	(2)	**83**	(2)
Income on fixed interest securities, short-term money and cash	**822**	423	**392**	191	**1,214**	614
Foreign exchange (loss) gain	**(12)**	188	**–**	–	**(12)**	188
Property income	**2**	–	**–**	13	**2**	13
Other (loss) income	**(5)**	1	**(4)**	3	**(9)**	4
Gross investment income	**853**	612	**425**	205	**1,278**	817
(Loss) gain on sale of repurchased debt securities	**(8)**	–	**(4)**	2	**(12)**	2
Investment expenses	**(36)**	(21)	**(14)**	(22)	**(50)**	(43)
Net investment income	**809**	591	**407**	185	**1,216**	776

Gross and net yield

FOR THE YEAR ENDED 31 DECEMBER	YIELD ON INVESTMENT ASSETS BACKING POLICYHOLDERS' FUNDS 2012 %	YIELD ON INVESTMENT ASSETS BACKING POLICYHOLDERS' FUNDS 2011 %	YIELD ON INVESTMENT ASSETS BACKING SHAREHOLDERS' FUNDS 2012 %	YIELD ON INVESTMENT ASSETS BACKING SHAREHOLDERS' FUNDS 2011 %	TOTAL 2012 %	TOTAL 2011 %
Gross [1]	**4.2**	3.4	**4.4**	2.4	**4.3**	3.1
Net [2]	**4.0**	3.3	**4.2**	2.1	**4.1**	2.9
Gross excluding foreign exchange (loss) gain	**4.3**	2.3	**4.4**	2.4	**4.3**	2.4
Net excluding foreign exchange (loss) gain	**4.1**	2.2	**4.2**	2.1	**4.1**	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 before borrowing costs as a percentage of average investment assets backing policyholders' or shareholders' funds as appropriate.

The allocation of investment income between policyholders' and shareholders' funds is based on the matching of net policyholders' funds with cash, fixed interest securities, equities and properties. The pool of funds held for policyholders in 2012 included equities for the first time. This is consistent with our current investment strategy and approach to managing risk and returns.

Total investments and cash

AS AT 31 DECEMBER	INVESTMENT ASSETS BACKING POLICYHOLDERS' FUNDS 2012 US$M	INVESTMENT ASSETS BACKING POLICYHOLDERS' FUNDS 2011 US$M	INVESTMENT ASSETS BACKING SHAREHOLDERS' FUNDS 2012 US$M	INVESTMENT ASSETS BACKING SHAREHOLDERS' FUNDS 2011 US$M	TOTAL 2012 US$M	TOTAL 2011 US$M
Cash	**1,369**	1,001	**656**	456	**2,025**	1,457
Short-term money	**5,520**	4,569	**2,646**	2,081	**8,166**	6,650
Fixed interest securities and other	**14,319**	13,390	**6,863**	6,100	**21,182**	19,490
Equities	**33**	–	**90**	326	**123**	326
Investment properties [1]	**20**	–	**9**	101	**29**	101
Total investments and cash	**21,261**	18,960	**10,264**	9,064	**31,525**	28,024

1 2011 includes $73 million of property classified as assets held for sale.

Final dividend

Our dividend policy is designed to ensure that we reward shareholders relative to profit and maintain sufficient capital for future investment and growth of the business. The final dividend for 2012 will be 10 Australian cents per share compared with 25 Australian cents per share in 2011, and follows the 2012 interim dividend of 40 Australian cents per share. This represents a payout for the full year of A$593 million or around 81% of net profit after tax, or 59% of cash profit. The calculation of cash profit is shown on page 18.

The dividend will be franked at 100% and is due to be paid on 28 March 2013. The dividend reinvestment programs continue at a discount of 1.5%. Guidance on our dividend policy for 2013 and onward is provided on page 4 in the Chairman's message.

Closing remarks

2012 has been a year of change in the global regulatory and ratings environments in which we operate, requiring us to rebalance the Group's capital position. Our balance sheet and capital ratios were strengthened in 2012, with a continuing upwards trend anticipated for 2013.

QBE has met the challenge of the changing global economic climate with our balance sheet and overall financial flexibility prepared for growth and expected changes. Our strategy and plans for 2013 include a number of initiatives designed to further strengthen and enhance our financial position.

Neil Drabsch
Group Chief Financial Officer

Food security

Once they are sown in the ground, there is never any certainty that crops will make it to harvest time. QBE makes it possible for farmers in the United States to be certain that they will make it to the next planting season if disaster strikes.

Crop insurance is an industry with deep roots in the United States. The importance of crops to the nation's food supply and economy has been recognised for a long time. With private crop insurance companies dating back to the 1880s, the Great Depression saw the introduction of government-sponsored crop insurance with the passing of the Federal Crop Insurance Act in 1938.

In 1980, the private sector and US Government were brought together through the passing of the Federal Crop Insurance Act that saw insurers and the government share underwriting profits and losses through standard agreements that can vary by crop risk and by state.

Today, there are more than 16,000 agents and adjusters in the program and crop insurance is considered the primary safety net for the farming community. Some 85% to 90% of all US cropland is covered by the federal crop insurance program, with corn, soybeans and wheat comprising more than 75% of the insured crops. The remaining 25% is made of up more than 100 different crops.

"Crop insurance stabilises our food supply and rural America," says Greg Deal, NAU Country's President and Chief Executive Officer. "It has become an important risk management tool available for most farmers because it is a public-private partnership that limits taxpayer exposure to risk and helps farmers get back on their feet when disaster strikes."

QBE's NAU Country Insurance is the third largest writer of multi-peril crop insurance in the US, authorised by the US government to protect farmers against weather-related and other unavoidable causes of crop loss.

From regional business to national leader

Acquired by QBE in 2010, the Minnesota-based NAU has grown from a $50 million regional outfit to a $1.6 billion national industry leader. Deal co-founded the company with his father Jim, a former administrator of the Federal Crop Insurance Corporation, in the early 1980s. Crop insurance is now a widely accepted insurance product, partly as a result of NAU's efforts.

Following the acquisition of NAU, QBE purchased Iowa-based crop insurer Agro National later the same year. The Agro acquisition was seen as complementary to NAU as its commitment to the servicing of agents and farmers mirrored that of NAU. Integration occurred in April 2011.

NAU is today one of the top providers of crop insurance in the US, writing business covering nearly 100 different crops, spanning 52 million acres for 107,000 policies. It is also the third largest underwriter and manager of multi-peril crop insurance (MPCI) in the US with an approximate 15% share.

MPCI is a government-sponsored program covering the range of risks that can plague farms and farmers: drought, flood, fire, wind, disease, insects, earthquakes and wildlife. There is also separate coverage for hail. MPCI accounts for more than 90% of NAU's premium ($1.5 billion in 2012).

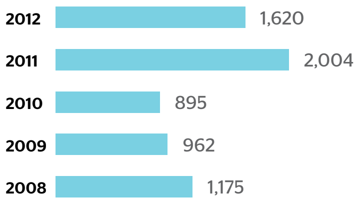
Technology: a key differentiator

Since the government sets crop insurance rates, NAU has differentiated itself in the marketplace on service and, more significantly, on technology.

NAU has been at the forefront of making laptop computers as commonplace on US farms as ground tillers and harvesters. Its service proposition applies proprietary technology to quoting, binding, service delivery, reporting and claims handling processes with advanced, yet simple to use technologies. "Production agriculture can be complicated" says Deal. "We are looking to make reporting and tracking as simple as possible for our policyholders."

NAU was the first MPCI writer to roll out an online loss-adjusting tool to improve the handling of MPCI and hail claims. From the field, claims adjusters enter the details of a loss into their laptops, review it with the insured and obtain the insurer's sign-off.

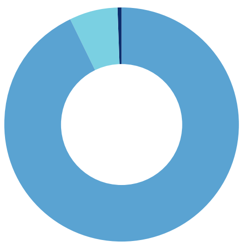
Gross written premium (US$M)



US$1.6billion
Gross written premium

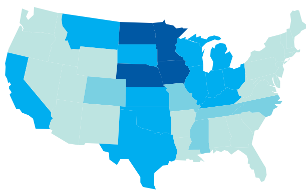
US$1.1billion
Net earned premium

Gross written premium by line of business



- Multi-peril crop insurance
- Hail
- Named peril

Gross written premium geographical mix (US$)



- $0 – 10,000,000
- $10,000,001 – 25,000,000
- $25,000,001 – 100,000,000
- $100,000,001 and above

One unique feature of crop insurance is that just as crop prices can fluctuate from year to year, so does our gross written premium (GWP) on the same number of policies. In the case of corn and soy beans for example, the US Government uses the average futures trading price over February to calculate the premium in the spring and summer when farmers plant their crops and report their acreage. Corn and soy bean farmers must notify the insurer of any changes to their policy on 15 March for their spring crops, locking in their coverage before planting. Insured farmers are not only covered for any material shortfall in crop yields but can also be covered for any material change in crop prices from planting to harvest. This so called revenue type policy enables the farmer to have a greater certainty of their farm revenues before planting season. More than 70% of crop policies have revenue coverage.

"We've continued to invest extensively in loss-adjustment automations that give our adjusters the ability to work claims efficiently and quickly" says Deal.

NAU's mapping software, which is provided to agents and policyholders, predominately utilises aerial imagery and provides farmers with a convenient tool to record planting dates, track tillage, chemical applications, harvest dates and the number of bushels harvested. "The result," says Deal, "is quicker claims service and higher satisfaction among our customers."

Additionally, NAU's information technology group works closely with the US Department of Agriculture so that any changes made in the federal crop insurance program are quickly integrated into NAU's systems.

The unpredictability of nature

Whether heat and drought or rain and flooding, weather has a major influence on crop yield and crop insurers. In 2010, rain and flood accounted for more than 54% of the industry's losses. This compares with 20% in 2008, when the majority of

Applying proprietary technology to quoting, binding, service delivery, reporting and claims handling, NAU has been making laptop computers as commonplace on US farms as ground tillers and harvesters.

claims originated from drought and changes in commodity prices. In 2012, the US Midwest regularly faced triple-digit fahrenheit temperatures and its worst drought conditions in 50 years.

"Uncertainty is a way of life for our farm customers" says Deal. "We can't predict, for example, when a hailstorm will strike. In crop insurance you're always looking out the window or checking the weather forecast."

The drought, combined with higher harvest prices, produced revenue losses for farmers unseen for many years. Some regions had significant yield loss, which contributed to large claims not normally seen in the US Corn Belt. Additionally, hail losses were higher than normal, mostly from storms that hit Minnesota. "We led the industry in processing claims and undertaking adjustment work to close out the season" says Deal.

"Our outstanding claims service should propel further 2013 growth" says Deal, adding that historically NAU has seen a direct correlation of higher volume

Utilising the latest technology, NAU's iPad app, EASYmobility, makes it simple and efficient for our policyholders to manage their policies and keep them up to date.

claims years followed by significant increases in business. "This has been a great opportunity for our claims team to showcase its service excellence" he says.

"Whatever the conditions" Deal says, "NAU is providing peace of mind to farmers through our risk management and our insurance products, as well as the services we provide to ensure that all claims are paid as quickly and accurately as possible – and that's particularly relevant in a year where claims will be significant.

"Today we are well prepared to quickly deliver claim cheques to our farmers that will be hit with lower production from the drought and other perils. We believe the future looks very bright for the growth of crop business at QBE."

While crop performance was impacted by hail storms in 2011 and drought in 2012, the long-term profitability of this business is demonstrated by an average combined operating ratio of 88% over the last 10 years.

Made possible by QBE:

North American Operations

Well connected

QBE is the largest insurer of rural telecommunications companies in the US.

We have been a leader in this area for more than 40 years, and now insure over 600 telephone, cable TV and internet service providers in more than 30 states. Our Farmers Union Insurance subsidiary offers specialised one-policy, multi-peril insurance specifically designed for the telecommunications sector. We have a highly experienced risk control team that regularly helps rural telecommunications providers protect and reduce the likelihood of injury or loss of property and service. Farmers Union Insurance also provides automobile, homeowners, farmowners and small commercial insurance across nine states in the US Midwest and Rocky Mountains.

Protecting a nation's food source

QBE writes 107,000 crop insurance policies in the United States through its NAU Country Insurance business, covering nearly 100 different crops across 52 million acres.

The government sponsored multi-peril crop insurance (MPCI) program covers a range of risks that can affect farms and farmers: droughts, flood, fire, wind, disease, insects, earthquakes and wildlife. QBE is the third-largest MPCI underwriter in the US with an estimated 15% share of the market. MPCI accounts for more than 90% of NAU's premium ($1.5 billion in 2012).

Winter wonderland

Skating in Central Park is a winter tradition for New Yorkers, many of whom have tied their skates for the first time on this ice.

The venue has featured in films such as Love Story and Serendipity, setting visitors beneath the magical New York skyline. QBE provides insurance for the 33,000 square foot rink, which in the summer months is replaced with an amusement park.

Building America

QBE serves 17 of the top 20 homebuilders in the US.

Builders with a licensed agency can offer insurance products directly to their customers. As an alternative to forming a licensed agency, QBE also offers homebuilders arrangements and marketing service agreements which allow home buyers to get coverage quickly so they can close their loans and move in on time.

Four-legged coverage

QBE covers 20% of the insured pets in the US.

We offer a number of products ranging from accident-only coverage to broad, comprehensive all-risks insurance cover. QBE covers costs related to accidents and illnesses for dogs and cats, with rates and coverage eligibility established based on age, breed, and coverage type. We also offer coverage to animal shelters through our Pet Point Shelter Care program, which mostly deals with younger animals. This includes a one month free gift insurance policy to owners of newly adopted pets from shelters.

Keeping shop

QBE provides property insurance for some of the largest retailers in the US. We provide coverage to many familiar retailing brands with hundreds of stores across the US.

Ten pins

QBE is one of North America's largest insurers of independent bowling centres. We offer a comprehensive insurance program that is endorsed by the Bowling Proprietors Association of America.

High-rise paradise

QBE is a major provider of commercial property insurance to apartment buildings located around the coastal areas of southern Florida. One of our primary niches is wind and hail coverage for superior wind-resistive condominiums.

North American Operations business review

> 2012 was a year of consolidation for our North American Operations, including a significant program of remediation of underperforming and run-off portfolios. The resulting upgrade to claims provisions combined with the impacts of the severe US drought and Superstorm Sandy resulted in a disappointing underwriting result.

John Rumpler
President and Chief Executive Officer • North American Operations

Gross written premium US$ million	Net earned premium US$ million	Underwriting result US$ million	Insurance profit US$ million
6,569	3,501	(237)	(170)
↓ 13% from 2011	↓ 13% from 2011	↓ $615M from 2011	↓ $610M from 2011
		Combined operating ratio 106.8% (2011 90.6%)	Insurance profit margin (4.9)% (2011 11.0%)

Competitive landscape

Through recent acquisitions and organic growth, North American Operations has developed a diverse and specialised insurance portfolio which operates in five segments being our Financial Partner Services (FPS) formerly known as QBE FIRST; our US Property & Casualty (US P&C) segment formerly known as intermediary; crop; program and reinsurance. Our FPS segment, which includes lender-placed homeowners insurance (LPI), generates business through its partnerships with banks, mortgage servicers and other financial intermediaries. Historically, crop and US P&C have largely produced business through independent agents. US P&C has expanded its distribution through the establishment of a major brokers unit in 2011, building further distribution capability in 2012. The program segment leverages our managing general agent relationships and the reinsurance segment works primarily with brokers through our global QBE Re operation.

Overall, the US economy was stable in 2012. Gross domestic product (GDP) growth remained modest at around 2% and unemployment remained stubbornly high at 7.8%. The housing market continued to show signs of improvement with stronger new and existing home sales and higher housing prices, though lending still remains somewhat tight, particularly in the residential market. The US Federal Reserve maintained its low federal funds rate target range and implemented various stimulatory monetary policies that have helped keep interest and borrowing rates low.

Current insurance market conditions suggest a moderate improvement in the pricing environment, and we continue to take an uncompromising approach to underperforming portfolios. Although pricing in many segments is modestly to moderately positive, our FPS segment will undergo some reductions in pricing following the recent rate reviews in selected key states. We have agreed to rate reductions estimated to be less than 9% on an annualised basis across the national LPI portfolio. The outlook for this segment remains sound notwithstanding these price reductions.

Underwriting performance

2012 was a difficult year for North American Operations as a severe drought across many parts of the US in combination with Superstorm Sandy provided a challenging backdrop to our business activities. North American Operations generated a combined operating ratio of 106.8%, compared with 90.6% in the prior year. The drought resulted in an unprofitable 102.9% combined operating ratio in our crop segment excluding proportional reinsurance with Equator Re (or 100.8% net of Equator Re recoveries), whilst Superstorm Sandy contributed $117 million of net claims. The underwriting result also reflects a significant upgrade of claims provisions on underperforming and run-off portfolios, primarily in our program segment. We believe that this claims strengthening, coupled with remediation initiatives undertaken over the past two years, position us well for a return to future profitability in our program business.

The underwriting loss for the year resulted in a negative insurance profit margin of 4.9% compared with a positive 11.0% in the prior year, reflecting the aforementioned impacted areas, partially offset by slightly higher investment return on policyholders' funds. Investment returns benefited from realised and unrealised gains in our equity and fixed income portfolios.

Underwriting result

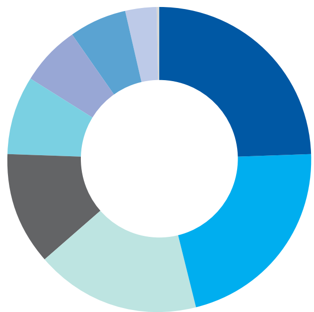
FOR THE YEAR ENDED 31 DECEMBER		2012	2011	2010	2009	2008
Gross written premium	US$M	**6,569**	7,529	4,606	3,648	3,417
Gross earned premium	US$M	**6,978**	7,431	4,563	3,597	3,539
Net earned premium	US$M	**3,501**	4,018	2,555	2,211	2,332
Net incurred claims	US$M	**2,717**	2,622	1,594	1,370	1,417
Net commission	US$M	**221**	264	246	274	429
Expenses	US$M	**800**	754	436	324	343
Underwriting result	US$M	**(237)**	378	279	243	143
Claims ratio	%	**77.6**	65.2	62.4	61.9	60.8
Commission ratio	%	**6.3**	6.6	9.6	12.4	18.4
Expense ratio	%	**22.9**	18.8	17.1	14.7	14.7
Combined operating ratio	%	**106.8**	90.6	89.1	89.0	93.9
Insurance profit margin	%	**(4.9)**	11.0	13.9	14.7	11.6

Premium income

Gross written premium was down 13% to $6,569 million compared with $7,529 million in the prior year, primarily due to reductions in FPS and crop. The benefits of the hardening premium pricing cycle, with average premium rate increases of 6%, were more than offset by reduced revenue from LPI, lower crop prices and reduced income as a result of portfolio remediation initiatives in targeted segments. LPI volumes were impacted by improving economic conditions and the loss of some accounts.

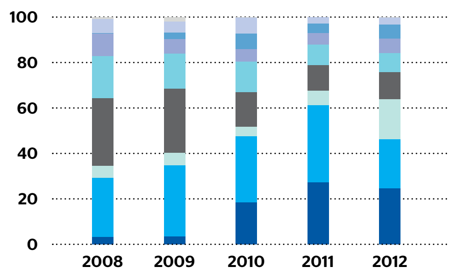
The reinsurance expense ratio increased from 45.9% in 2011 to 49.8% of gross earned premium in 2012. Excluding proportional reinsurance with our captive Equator Re, the reinsurance expense ratio was 19.3%, compared with 18.0% in 2011, the increase due to higher reinsurance costs across all segments, particularly crop.

Gross earned premium by class of business 2012

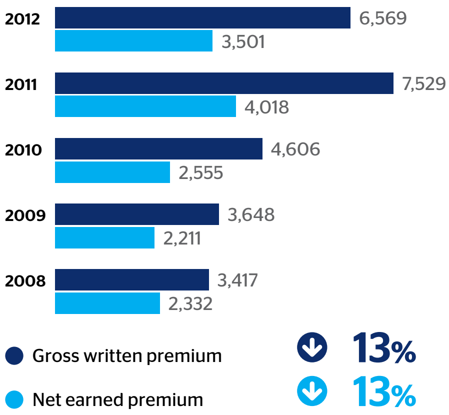


Agriculture & bloodstock	24.5%
Property	21.7%
Householders	17.5%
Motor & motor casualty	12.1%
Public/product liability	8.3%
Workers' compensation	6.4%
Financial & credit	6.1%
Accident & health	3.2%
Other	0.2%

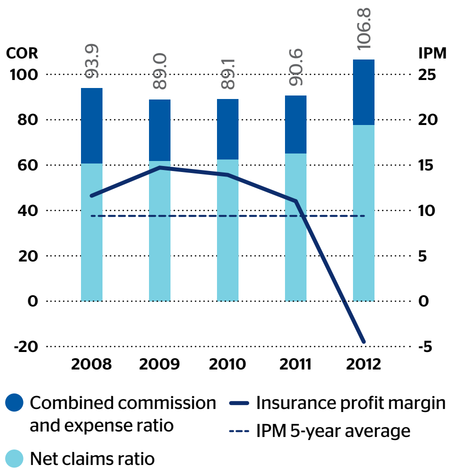
Gross earned premium by class of business (%)



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



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



With effect from 1 January 2012, the intercompany reinsurance pooling arrangements within the US consolidated our 17 licensed companies under a single pool led by QBE Insurance Corporation. In addition to reducing administrative costs, the expanded pooling arrangement facilitates capital management and produces more stable and consistent statutory underwriting results across our insurance entities.

Net earned premium decreased 13% to $3,501 million compared with $4,018 million in the prior year, in line with the reduction in gross written premium.

Claims expense

The net claims ratio increased to 77.6% from 65.2% in the prior year reflecting the impact of Superstorm Sandy and crop claims. Claims costs were also impacted by an upgrade of our claims provisions on underperforming and run-off portfolios as a result of prior accident year claims development, largely relating to our program segment and to a lesser extent our US P&C segment. Based on final reviews for the fourth quarter of 2012, total prior year accident year claims development for the year was $316 million before our Equator Re quota share or $231 million net of quota share.

During 2012 we established a dedicated run-off claims management team to oversee a portfolio of $1.2 billion of gross claims provisions that are in remediation or run-off, applying remediation and run-off protocols that have been successfully applied elsewhere in the Group. Following the material claims strengthening, we are confident that we can run-off these claims in line with our revised expectations.

Commission and expenses

The combined commission and expense ratio increased to 29.2% from 25.4%, primarily driven by a higher expense ratio of 22.9%, up from 18.8%. This was mainly due to reduced premium and increased costs associated with the Balboa acquisition and integration, which more than extinguished early cost savings from our business transformation initiatives. These higher costs were partly offset by a lower commission ratio, down to 6.3% from 6.6%. Commission costs fell primarily due to the mix of business as well as the level of commission income on increased business ceded to Equator Re.

Acquisitions and other developments

2012 was a year of consolidation for North American Operations with a focus in two main areas. Firstly, we substantially completed the consolidation and integration of the Balboa acquisition into our FPS segment and shared services operations. Secondly, we embarked on initiatives which will deliver significantly improved underwriting performance from our core program and US P&C portfolios through segregating remediation and run-off portfolios, strengthening claims provisions and making best use of synergies and cross-selling opportunities within our existing businesses.

"North American Operations benefited from rate increases in 2012 and we expect positive pricing trends to continue across most of our portfolios.

North American Operations
Outlook for 2013

2013 forecast gross written premium: US$6.5billion

FPS US$ million	US P&C US$ million	Crop US$ million
1,200	1,600	1,800
Program US$ million	**Reinsurance US$ million**	
1,500	400	

2013 forecast net earned premium: US$3.2billion

The devastation caused by Superstorm Sandy on top of several years of volatile weather events is driving the US insurance industry to challenge its approach to risk selection, catastrophe modelling and pricing. The combination of adverse claims experience and the continuing low investment yield environment is supporting the moderate firming of premium rates across most property and certain casualty classes in the US. We expect to see premium rate firming of around 5% across the North American property and casualty business in 2013.

Gross written premium for 2013 will continue to come under pressure due to remediation activity on underperforming portfolios and LPI rate reductions, offset by modest US crop premium growth.

The focus of our FPS segment will continue to be on integration, service excellence and operational efficiency. We are committed to enhancing our existing infrastructure and winning new business opportunities, although new business lead times are extensive. We continue to monitor improvements in the housing environment and regulatory developments.

Finally, I must acknowledge the efforts of employees across our North American Operations. Despite the interruptions to our business operations and with many of our people personally affected in the aftermath of Superstorm Sandy, their hard work, dedication and flexibility has been exemplary. We look forward to building upon the business improvement initiatives undertaken in 2012 and to deliver improved profitability in 2013.

Made possible by QBE:

Latin American Operations

Supporting workplace safety in Argentina

QBE covers the health and safety of more than 3,000 employees at Petrobras Argentina. As well as providing insurance, we also work with the energy company to improve overall work conditions.

Petrobras Argentina's operations range from oil and natural gas exploration, pipelines, service stations, refining, fertiliser production to electricity generation. QBE performs annual medical examinations for all Petrobras Argentina employees exposed to occupational disease risk, as well as additional training in first aid, biological risk and alcohol and drug prevention. Our strong collaboration has helped Petrobras Argentina meet its internal safety targets.

A taste of Mexico

QBE provides insurance and risk management services to some of Mexico's leading businesses.

Corn flour forms the base of the tortilla, which is the staple food of the Mexican region. We offer one of Mexico's largest corn flour suppliers a range of risk management services that includes an in-depth analysis of their industrial operations and catastrophe exposures. We also offer the client property, liability and business interruption insurance cover.

No place like it

QBE has worked closely with a leading retailer to increase homeowner insurance take up in the Brazilian state of Espírito Santo.

Home owner insurance is not widespread in Brazil; however, the first 12 months of a distribution agreement between QBE and the retailer saw 25,000 families in the state take a homeowner's policy for the first time. Our policies, which start from as little as $50 a year, cover fire, lightning, explosion, robbery, personal liability and have a home emergency assistance component.

Landmark coverage

QBE provides earthquake and terrorism insurance cover on numerous properties across Colombia.

Properties covered by QBE include several key Colombian office buildings and historic landmarks. QBE also has an agreement with the Colombian National Penitentiary Institute to provide health insurance to the country's prison population.

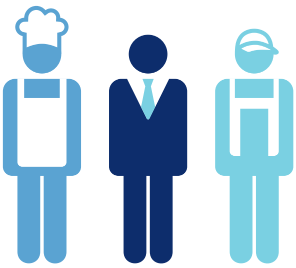
24/7 service

QBE insures the motor and cargo fleet of Argentina's largest industrial group, Techint.

The Argentinian-Italian conglomerate's operations range from engineering, construction, oil and gas exploration, steel making to healthcare. We provide insurance cover for all of Techint's import and export cargo needs and a QBE claims adjuster works exclusively with Techint to assess claims costs. In addition, we provide a 24/7 cargo control service allowing Techint to load and unload cargo at any hour to boost its productivity.

Loss control

QBE provides general liability coverage for nine municipalities in Puerto Rico. We provide loss control services to the 'municipios' including risk surveys which recommend ways to reduce claims and losses.



Job protection

QBE provides unemployment insurance for 280,000 credit card holders of Banco del Pichincha, the largest private bank in Ecuador.

Pick-up cover

QBE provides property cover for Toyota's sole car manufacturing plant in Argentina. We also provide product liability cover for the estimated 70,000 vehicles manufactured at the factory each year, including Hilux pick-ups.

Latin American Operations business review

> 2012 was a demanding year for our Latin American Operations. We completed acquisitions in two countries and undertook significant portfolio restructuring in two other territories. Having laid sound operational foundations as a standalone division, we expect to improve upon the region's solid underlying underwriting performance.

Jose Sojo

Chief Executive Officer • Latin American Operations

Gross written premium US$ million	Net earned premium US$ million	Underwriting result US$ million	Insurance profit US$ million
1,223	1,018	54	121
↑ 59% from 2011	↑ 64% from 2011	↓ 16% from 2011	↑ 20% from 2011
		Combined operating ratio 94.7% (2011 89.7%)	Insurance profit margin 11.9% (2011 16.3%)

Competitive landscape

The competitive environment in Latin America remains unrelenting in terms of pressure on rating levels and reinsurance pricing, fuelled by another year with no significant catastrophe activity in the region's major markets. We expect markets to remain competitive.

Competition is more aggressive in personal lines business, particularly motor which is the largest business line in the region. QBE is the largest writer of motor business in Ecuador and the fourth largest in Argentina. In order to remain ahead of our competitors and to produce acceptable returns in highly competitive market conditions, our focus on strong underwriting and risk selection protocols is imperative.

Commercial insurance, particularly casualty lines, is the more profitable segment of the market. QBE is actively engaged in this market with solid underwriting expertise, above average reinsurance capacity and longstanding distribution relationships. We expect casualty business lines to continue to evolve as the region increases its level of economic development and mandatory coverage requirements, and with the growing sophistication of customer purchasing patterns.

Notwithstanding the economic deceleration in the Latin American region as a whole, we expect local insurance industry growth to outstrip GDP, as is usually the case in emerging economies. The region has experienced significant premium growth in the last decade with the non-life market now representing $89 billion of premium. QBE´s Latin American Operations is well positioned to benefit from this continuing growth trend at margins consistent with the Group's required return on equity.

Underwriting performance

Our combined operating ratio for Latin American Operations deteriorated to 94.7% during 2012 compared with 89.7% in 2011, partly reflecting the acquisition of HSBC Argentina's insurance business. This acquisition had an adverse impact on the region´s net combined operating ratio, despite the acquired portfolios having performed in line with expectations. Since HSBC Argentina was large relative to our business, representing around 30% of our regional net earned premium, the effect of this acquisition has been significant. We are implementing a plan that will improve profitability in these acquired portfolios. Our workers' compensation portfolio in Argentina continues to produce good results.

Underwriting performance in a number of our pre-existing operations was not up to expectations, particularly in Colombia and Ecuador, two very important contributors to our results in recent years. Both these operations underwent significant restructuring of their main portfolios, including cancellation of underperforming business in order to produce better returns going forward.

During 2012, we focused on improving the profitability of our SOAT (compulsory motor cover) in Colombia and our motor portfolio in Ecuador. The relatively lower profit margins in personal lines across the region require us to have significant scale and market presence. We are confident we can produce acceptable returns wherever we write this business, albeit at levels below that for commercial lines.

The acquisition of Optima Insurance in Puerto Rico improved risk diversification during the second half of 2012, although we still have work to do to improve our underwriting result. Our Chilean start-up company wrote almost $10 million in premiums, mainly in the commercial SME space with claims experience and acquisition costs tracking ahead of expectations. Mexico continues to deliver very good results, as it has done every year since we acquired the company in 2007. Brazil's results, while improved, continue to be low compared with our internal hurdles.

Premium income

Our gross written premium in the region grew by 59%, most of it generated by the acquisitions of HSBC Argentina and Optima Insurance in Puerto Rico which were completed during the first half of the year.

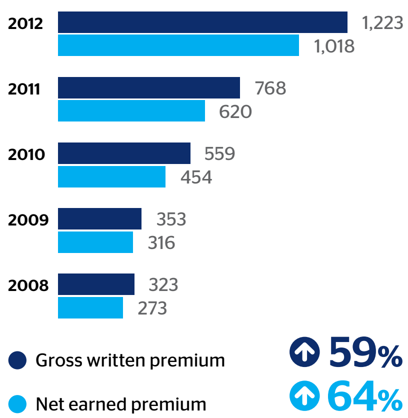
Our organic growth rate was 7% when measured in US dollars and 12% when measured using constant exchange rates. We target a long-term organic growth rate of between 10% and 12% per annum, or approximately two to four points higher than the average industry growth rate. Our 2012 organic growth rate was negatively affected by our portfolio restructuring in Colombia and Ecuador, with Brazil and Mexico contributing higher percentage growth rates.

Claims expense

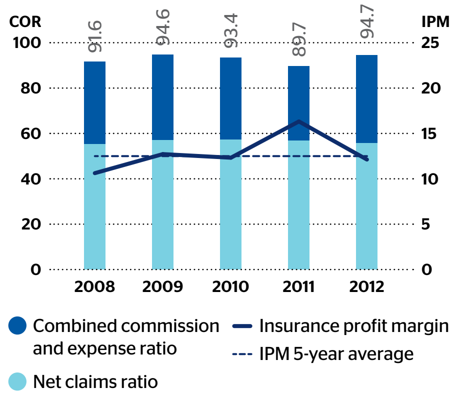
Our claims ratio for the 2012 year of 55.7% was improved compared with 56.7% last year. The business mix has changed significantly with the aforementioned acquisitions and shifts in the relative weighting of countries and business lines.

Our claims development tables suggest that claims experience remains around the same levels as in the past with the exception of the SOAT business in Colombia, where we believe claims experience has significantly deteriorated for the industry as a whole. In 2012, Argentina introduced changes to workers' compensation benefits and we are constantly monitoring these against premium rate increases.

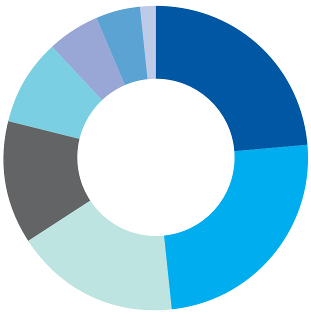
Gross written premium and net earned premium (US$M)



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

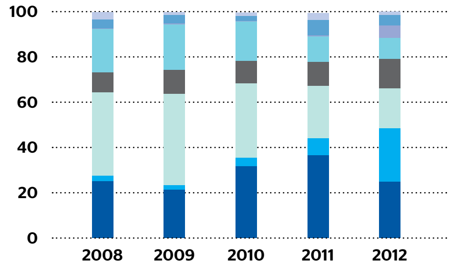


Gross earned premium by class of business 2012



Workers' compensation	24.7%
Motor & motor casualty	23.8%
Accident & health	17.6%
Property	13.0%
Life	9.3%
Other	5.3%
Public/product liability	4.8%
Marine, energy & aviation	1.5%

Gross earned premium by class of business (%)



As a consequence of continuing volatility in inflation and interest rates, we restated our assumptions for claims inflation and discount rates used for our Argentina worker's compensation portfolio. The effect was a net increase of $50 million in the discounted central estimate outstanding claims provision.

Commission and expenses

The combined commission and expense ratio increased from 33.0% of net earned premium in 2011 to 39.0% in 2012, or 35.8% without acquisitions. This ratio was significantly impacted by the acquisition of HSBC Argentina which reported a combined commission and expenses ratio of 46.7% and by the growing premium contribution from Brazil which also carries higher acquisition costs. Whilst integration synergies are beginning to emerge, we do not expect to see an improvement in this ratio in the 2013 financial year due to the full year impact of HSBC Argentina.

Underwriting result

FOR THE YEAR ENDED 31 DECEMBER		2012	2011	2010	2009	2008
Gross written premium	US$M	**1,223**	768	559	353	323
Gross earned premium	US$M	**1,170**	752	554	342	308
Net earned premium	US$M	**1,018**	620	454	316	273
Net incurred claims	US$M	**567**	351	260	180	151
Net commission	US$M	**226**	118	101	82	65
Expenses	US$M	**171**	87	63	37	34
Underwriting result	US$M	**54**	64	30	17	23
Claims ratio	%	**55.7**	56.7	57.3	57.0	55.3
Commission ratio	%	**22.2**	19.0	22.2	25.9	23.8
Expense ratio	%	**16.8**	14.0	13.9	11.7	12.5
Combined operating ratio	%	**94.7**	89.7	93.4	94.6	91.6
Insurance profit margin	%	**11.9**	16.3	12.3	13.0	10.6

Acquisitions and other developments

During 2012, we completed two significant acquisitions. In February 2012, we finalised the purchase of Optima Insurance, Colonial Agency and New Century Finance, a group of companies that make up QBE Puerto Rico. This acquisition came with a very well respected management team with an excellent local market reputation and we have invited Antonio Ortiz, CEO and previous majority owner, to join our senior management team in Latin America.

In May 2012, we also completed the acquisition of HSBC Argentina, now renamed QBE Seguros La Buenos Aires. Our two Argentinean companies are now trading under a single brand and a single management team. QBE became the third largest insurer in Argentina with gross written premium of around $850 million. We believe QBE Seguros La Buenos Aires will become a unique franchise in Argentina, a country where we have had an outstanding track record over the last 10 years. We will operate across all lines of business, building upon our competitive advantage which stems from the strong underwriting skills of our market-leading teams and access to multiple distribution channels.

“We believe having the strongest leadership is the best possible means of maintaining a true long-term competitive advantage. During 2012, we continued to invest heavily in the development of our people and the implementation of an outstanding range of training opportunities for our top talent.

Latin American Operations

Outlook for 2013

2013 forecast gross written premium: **US$1.5billion**

Argentina US$ million	Brazil US$ million	Chile US$ million	Colombia US$ million
850	70	20	300

Ecuador US$ million	Mexico US$ million	Puerto Rico US$ million
160	70	50

2013 forecast net earned premium: **US$1.3billion**

The 2012 acquisitions have significantly increased our size in the region and we expect to write about $1.5 billion in gross written premium in 2013, approximately 2% of the Latin American market. This target assumes full year contributions from our 2012 acquisitions and 11% organic growth, subject to stable exchange rates. Our business in the region is exposed to exchange rate fluctuations, particularly in Argentina, as we are reporting our local results using the official exchange rate.

QBE is relatively small in Brazil and Mexico, the two largest markets in the region, and we believe that there are opportunities for further selective growth in these countries. We remain interested in expanding our business through acquisition, provided that our targets fit our acquisition criteria and business strategy.

Notwithstanding likely further upward pressure on commission expense in 2013, we expect a better performance from our acquisitions (including the emergence of integration synergies) which, coupled with an improved performance in all other countries, underpins our expectation for a slightly improved combined operating ratio in 2013.

Finally, we believe the fundamentals of our business model are sound and we continue to select the segments and markets that we believe produce more attractive returns. Our business has grown significantly over the last few years and our dedicated team of around 1,800 employees in the region believe it is possible to continue to produce market-leading results on a long-term sustainable basis.

Made possible by QBE:

European Operations

Reaching across the seven seas

QBE is a leading provider of insurance to cargo transportation companies and to the energy producers that fuel this trade.

QBE's London-based British Marine subsidiary, which was founded in 1876, protects 12,000 shipping vessels, mostly through its protection and indemnity product. British Marine is also a major insurer of fishing vessels and luxury yachts. Our aviation team insures the fleets of some of the largest cargo and passenger airline operators in the world.

UK emergency services

QBE is a leading insurer of National Health Service ambulance trusts in England, covering 8,300 operational vehicles and 2,160 leased cars.

In 2012, we piloted a cutting-edge telematics system with an ambulance trust involving 50 vehicles and around 1,500 drivers. As a result of the trial, claims are already down by 50% and the trust expects a further reduction in costs associated with fuel consumption and vehicle maintenance. QBE is also a significant insurer of the police and fire authorities in the UK.

Energetic enterprise

Our specialist energy underwriters lead a diverse portfolio of offshore and onshore energy risks worldwide.

In particular, we specialise in offshore insurance for assets located in the North Sea, the Far East, Australia and throughout the Americas. We are one of the top insurers that provide cover for wellheads, refineries and petrochemical plants in the Middle East and Asia.

Transporting London

QBE has signed a five year agreement to provide liability, motor, property, medical liability and commercial crime insurance to Transport for London (TfL).

TfL is the body responsible for London's transit system: buses, the London Underground and Overground, Docklands Light Railway, Victoria Coach Station and London River Services. More than 24 million journeys are made on the TfL network each day.

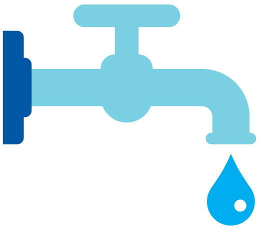
Covering Chernobyl

QBE provides insurance cover to the German company which supplies steel to one of the world's most complex engineering projects, the New Safe Confinement structure at the Chernobyl nuclear plant.

The steel will form part of a 110 metre high structure that will be assembled near the site of the 1986 nuclear accident and then slid in place to cover the remains of the reactor. The 29,000 tonne, 257 metre wide confinement structure will allow for the future dismantling and decommissioning of the damaged reactor.

A modern legend

QBE is the preferred insurer for the 6,500 member Harley-Davidson Club of Denmark. Founded in 1976, the club's goal is to help spread the knowledge of Harley-Davidson in Denmark and help people share their common interest in the iconic motorcycle brand. Their relationship with QBE has developed over the years so that today QBE insures 3,912 Harleys, including classic models from the 1930s.



Precious drop

QBE insures Italy's 21,000 kilometre Acquedotto Pugliese, Europe's largest drinking water network by size and waterflow. QBE provides third party, employers' liability and property cover for the water distributor, which serves around four million customers in the regions of Puglia, Basilicata and Campania.

Peace of mind

QBE is the sole provider of travel insurance products for three of the largest and most prestigious international airlines, protecting thousands of passengers a year. Policies are purchased seamlessly as part of the on-line ticket booking process, with QBE's in-house assistance company, QBE Assist, providing invaluable support with medical emergencies and repatriations on all such policies.

European Operations business review

> Our European Operations completed the year with a stable and slightly improved underwriting result and growth in our premium base across core property, casualty and motor divisions, notwithstanding a prolonged soft market environment.

Steven Burns
Chief Executive Officer • European Operations

Gross written premium	Net earned premium	Underwriting result	Insurance profit
US$ million	US$ million	US$ million	US$ million
5,077	3,331	179	327
↑ 5% from 2011	↑ 6% from 2011	↑ 25% from 2011	↑ 10% from 2011
		Combined operating ratio	Insurance profit margin
		94.6% (2011 95.5%)	9.8% (2011 9.5%)

Competitive landscape

Weak economic conditions, eurozone uncertainty and very competitive UK and European insurance markets prevailed in 2012. Other than for reinsurance, specialist and loss-impacted classes, we have been in the grip of a soft insurance market in our region since 2005. In these circumstances, our core focus has been the retention of quality clients and disciplined underwriting in all portfolios. Nevertheless, we did grow our premium income through the Brit UK retail acquisition and some carefully selected portfolio acquisitions within our core property, casualty and motor divisions.

Due to the challenging economic conditions, we decided it was prudent to temporarily suspend our longer term strategy to grow our mainland European business. We have cut back or exited a number of underperforming portfolios in several countries including property and motor portfolios, principally in France and Germany.

Our overall premium rate increase on renewed business for the year was 2.5%, almost entirely in reinsurance and certain specialty classes, particularly those impacted by specific risk loss activity or the extraordinary catastrophe activity of 2011. The only mainstream class producing rate increases of note was UK motor at almost 5%, albeit this level of increase is still only just covering claims inflation for this sector. Rates within the casualty sector, accounting for around one third of our gross written premium, remained stubbornly flat.

All of our mainstream markets, including Lloyd's, remain characterised by excess capacity and strong competition. This is likely to continue until greater pain is seen in our competitors' reported performance. Our disciplined underwriting, product and geographic diversity and strong risk management continue to hold us in good stead in the face of these challenging market conditions.

Underwriting performance

The combined operating ratio of 94.6% was an improvement compared with 95.5% for 2011. Unlike the unprecedented impact of catastrophes in 2011, we were below our catastrophe and large individual risk allowance for 2012 even after the impact of Superstorm Sandy. Relatively favourable catastrophe experience was offset by a small increase in attritional claims experience, a reduced level of prior year claims provision releases and underlying performance issues in some sectors of our property, motor, aviation and credit portfolios, particularly in mainland Europe.

Compared with the majority of our peers, our underwriting result was solid in the current market environment. Against this challenging backdrop, each of our three underwriting divisions of property casualty & motor, marine energy & aviation and reinsurance generated strong overall underwriting profits through focusing on retaining quality business and applying strict criteria on the pricing of new business.

Premium income

Gross written premium increased by £185 million or 6% in local currency from 2011. On translation to US dollars, gross written premium increased by 5% to $5,077 million. The acquisition of the Brit UK National business in April contributed £120 million to the top line supplemented by modest organic growth in the property casualty & motor division and the continued expansion of the successful European inward reinsurance franchise we acquired through Secura in 2011. Growth was also experienced in a number of underlying specialty products due to rate increases.

Net earned premium was up £133 million or 7% in local currency, or $181 million and 6% on translation to US dollars.

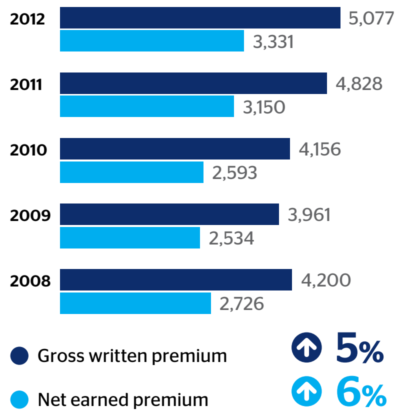
There was no significant change in our outward reinsurance programs for 2012 in terms of coverage and cost. Most of our business continues to benefit from the Group's comprehensive global reinsurance program provided by Equator Re and high quality external providers. Reinsurance spend as a percentage of gross earned premium was 31.4% compared with 32.0% in 2011. Excluding proportional reinsurance with Equator Re, the reinsurance expense ratio was materially unchanged at 19.3% compared with 19.4% in 2011.

Claims expense

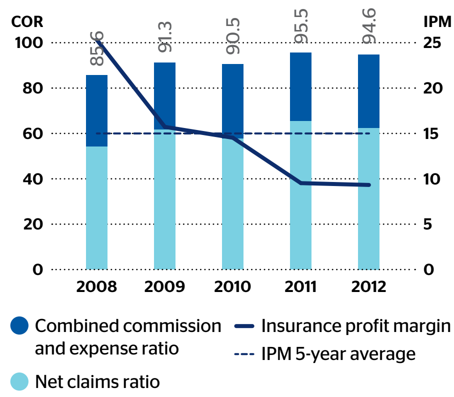
Our claims ratio was 62.4%, an improvement on 65.3% in 2011. The impact of Superstorm Sandy is expected to be around $80 million net (inclusive of reinsurance reinstatement premiums and net of recoveries from Equator Re). Net incurred claims from large individual risk and catastrophe events in 2012 were down significantly compared with 2011.

As previously noted, we saw a slight increase in claims attrition in some portfolios, although it remains stable across most of our business. We also experienced reduced prior accident year claims provision releases.

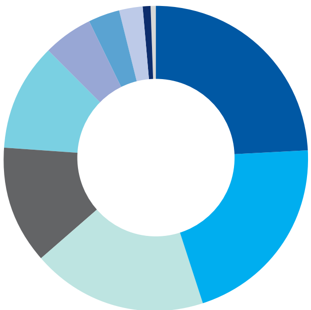
Gross written premium and net earned premium (US$M)



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

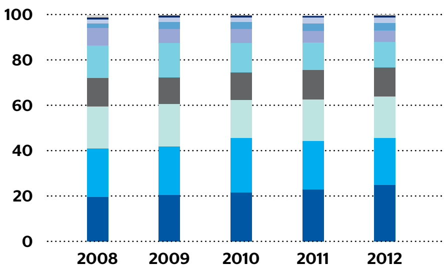


Gross earned premium by class of business 2012



Property	24.8%
Marine energy & aviation	20.7%
Public/product liability	18.4%
Motor & motor casualty	12.6%
Professional indemnity	11.3%
Workers' compensation	5.2%
Financial & credit	3.3%
Accident & health	2.4%
Agriculture & bloodstock	0.7%
Other	0.6%

Gross earned premium by class of business (%)



Underwriting result

FOR THE YEAR ENDED 31 DECEMBER		2012	2011	2010	2009	2008
Gross written premium	US$M	**5,077**	4,828	4,156	3,961	4,200
Gross earned premium	US$M	**4,854**	4,635	4,008	3,892	3,984
Net earned premium	US$M	**3,331**	3,150	2,593	2,534	2,726
Net incurred claims	US$M	**2,078**	2,054	1,498	1,563	1,477
Net commission	US$M	**567**	536	437	421	450
Expenses	US$M	**507**	417	412	331	405
Underwriting result	US$M	**179**	143	246	219	394
Claims ratio	%	**62.4**	65.3	57.7	61.6	54.2
Commission ratio	%	**17.0**	17.0	16.9	16.6	16.5
Expense ratio	%	**15.2**	13.2	15.9	13.1	14.9
Combined operating ratio	%	**94.6**	95.5	90.5	91.3	85.6
Insurance profit margin	%	**9.8**	9.5	14.5	15.7	25.3

We continue to work very hard to remediate the underperforming portfolios highlighted above. Indeed, we believe in constant improvement throughout the business, even in our most profitable classes. Whilst our Secura reinsurance acquisition in Belgium has been a major success, our European insurance business has disappointingly suffered from a high frequency of large claims in its property and motor portfolios, principally in France and Germany, leading to an underwriting loss in the year. In contrast, our Central and Eastern European business has remained profitable despite the difficult economic conditions. European Operations' claims provisions remain strong overall compared with 2011.

Commission and expenses

The combined commission and expense ratio was 32.2% compared with 30.2% in 2011.

The commission ratio of 17.0% remained flat compared with 2011 despite changes in the business mix and a general increase in commission rates in several of the specialty portfolios, such as energy.

The expense ratio increased by 2.0% to 15.2%, in line with expectations. The 2011 expense ratio benefited from some one-off factors, including higher profit commission receivable from external names on our majority-owned Lloyd's syndicate 386 following an exceptionally good result last year. The level of expenses incurred in 2012 includes costs associated with the Brit UK acquisition, the completion of our IT transformation project and further costs in respect of Solvency II compliance preparation, some of which will be non-recurring.

Other developments

In the first half of 2012, our IT transformation program was successfully completed. This three year project included decommissioning a number of legacy policy administration systems, the implementation of a central claims management system and outsourcing elements of IT support. The expected benefits are being realised through swifter claims settlement, more robust data management and greater transparency in reporting. This project has positioned us well to implement Solvency II as and when it is formally adopted.

In the second half of 2012, QBE Group launched QBE Re as the Group's global reinsurance franchise bringing together our Lloyd's, European company and US underwriting capability into a single underwriting and management team led in Europe. This project included a merger of our existing European company reinsurance platforms into a single reinsurer, QBE Re (Europe) Limited, with capital of over €600 million.

> Our disciplined underwriting, product and geographic diversity and strong risk management continue to hold us in good stead in the face of challenging market conditions.

European Operations
Outlook for 2013

2013 forecast gross written premium: US$5.0billion

Property casualty & motor	Marine energy & aviation	Reinsurance & credit
US$ million	US$ million	US$ million
3,200	1,000	800

2013 forecast net earned premium: US$3.6billion

Gross written premium for 2013 is expected to be at least $5.0 billion, or £3.2 billion in local currency using budgeted rates of exchange. Overall, we anticipate nominal rate increases. We will therefore continue the defensive and disciplined underwriting strategy described above. Organic growth opportunities will be limited in these market conditions and there are no material acquisitions planned.

We will strive to ensure that as many individual portfolios as possible continue to exceed our 15% return on equity hurdle and will persist with our relentless remediation of underperforming business.

The recruitment and retention of people of the highest quality will remain at the top of our agenda, as well as seeking to create a work environment where our staff can thrive and fulfil their potential. During 2012, we committed to a number of programs around staff engagement, flexible working practices and diversity. We will build on this in 2013, particularly through a program of workshops to roll out the Group's refreshed vision and values so that this cultural change is embraced by all staff across the division.

Our dedicated UK and European staff have again produced a commendable result in difficult market conditions. Management is indebted to them and greatly appreciates their hard work, commitment and support over the past year.

Made possible by QBE:

Australian & New Zealand Operations

A resourceful partner

QBE is a major insurer of the mining sector in Australia, from leading global players to specialist service providers and smaller operations.

We insure more than 75 companies, ranging from coal miners in the Queensland Bowen Basin and New South Wales Hunter Valley to the iron ore mines of Western Australia's Pilbara. QBE's involvement in the mining sector includes industrial special risk, business interruption and liability insurance for mobile plant and equipment. This industry accounts for more than 6% of Australia's GDP, contributing $121 billion a year including $35 billion in new capital investment.

Formidable power

QBE is a major player in New Zealand's energy sector, insuring a number of top energy generators and suppliers.

These companies in turn supply hundreds of thousands of New Zealand businesses and domestic customers with their daily power needs. From traditional power generation to low fuel-cost hydro dams and geothermal power fields, QBE insures the power stations, dams and fields producing the power and the substations and transmission pipelines which deliver power into major industries, businesses and homes.

Play it safe

QBE offers sports insurance designed to protect the members of sports clubs and associations if they are injured while participating in, training in or officiating at club activities.

We insure the whole Australian rugby union community, which covers more than 90,000 registered players from 770 clubs including the national team, the Wallabies. QBE provides the travel insurance for all of Australia's representative rugby teams when they tour overseas. We also provide personal accident insurance to professional jockeys across Australia who, according to the Medical Journal of Australia, are members of one of the country's most dangerous professions.

The sky is the limit

QBE is Australia and New Zealand's largest aviation insurer, providing a range of products, including hull and liability cover.

We have been involved with the aviation industry for more than 50 years and our team includes pilots, engineers and aircraft owners who have vast experience in underwriting, claims handling and providing value added service and safety support to the aviation industry.

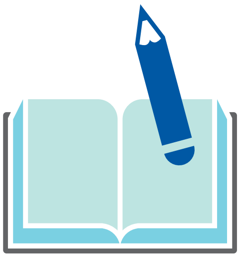
A national icon

QBE is proud to provide insurance to Surf Life Saving Australia (SLSA), the country's major water safety and rescue authority.

SLSA has more than 165,000 members and 500 affiliated surf life saving entities. QBE insures around 1,100 motor vehicles and 700 vessels on behalf of clubs nationwide. We also offer property, equipment and machinery breakdown and workers' compensation to SLSA.

Sydney Swans

QBE has been the Principal Partner of the Sydney Swans for 27 years. Our commitment to the Swans reflects our business philosophy of creating and growing long-term, mutually rewarding partnerships. Recognised as one of the most enduring relationships in Australian sport, we've been behind the Swans through the highs and lows, providing support when required and celebrating fantastic achievements, including their successful 2012 AFL Premiership.



Studious

QBE provides insurance to a range of education institutions, from primary and secondary schools to universities. We insure around 400 education institutions, catering for 500,000 students.

Superyachts

QBE is a leader in underwriting specialist superyacht builders in New Zealand. The country's superyacht sector is worth around $200 million annually, building 40-50 metre super-large sailing yachts and motor yachts, as well as 30 metre high-tech composite construction vessels. New Zealand is renowned for its engineering and construction of racing yachts.

Australian & New Zealand Operations business review

“ The Australian & New Zealand Operations return to profitability in 2012 was commendable given the challenges of declining investment yields, a slowing economy and unusual patterns of catastrophe activity. Our commitment to planning and scenario analysis enables us to maintain pricing discipline throughout the cycle.

Colin Fagen

Chief Executive Officer • Australian & New Zealand Operations

Gross written premium US$ million	Net earned premium US$ million	Underwriting result US$ million	Insurance profit US$ million
4,987	4,123	388	779
↑ 6% from 2011	↑ 7% from 2011	↑ $371M from 2011	↑ 222% from 2011
		Combined operating ratio 90.6% (2011 99.6%)	Insurance profit margin 18.9% (2011 6.3%)

Competitive landscape

Economic conditions in Australia reflected the weak global economic environment with interest rates declining during the year. This has led to ongoing caution in the community, particularly seen through lower retail sales. GDP growth remained positive but reliant on the mining sector. The Australian insurance sector benefited from higher pricing, particularly in property related classes, resulting from the catastrophe events in 2011 and subsequent higher reinsurance costs impacting all insurers. Competition remains strong in the industry. 2012 was a relatively benign catastrophe year and this resulted in increased competition in property classes as the year progressed. QBE continues to focus on retaining profitable and high quality business.

Underwriting performance

Our operations performed well throughout 2012, achieving a strong combined operating ratio of 90.6% and an insurance profit margin of 18.9% compared with 99.6% and 6.3% respectively in 2011. Although declining interest and discount rates proved challenging, detailed scenario planning undertaken in early 2012 ensured that timely underwriting and pricing action was taken to maintain profitability, particularly in long tail classes. Personal lines and short tail classes experienced material rate increases, although the corporate market flattened slightly after June 2012. We continue to focus on only retaining profitable and high quality business and alliances with a diverse range of intermediaries.

It was pleasing to see that our renewal retention held steady compared with previous years, notwithstanding QBE taking a leading position on price in the market. The combination of strong retention, accurate pricing, superior service and market-leading relationship management provided the foundation for an excellent result.

Premium income

Gross written premium increased by 6% to $4,987 million, driven by rate increases, particularly in short tail classes as well as property risks in New Zealand. New business in our lenders' mortgage and workers' compensation portfolios exceeded expectations whilst intermediary distribution faced pressure from a competitive market. Retention remained strong at around 80%, an excellent result considering premium increases averaged over 8% in 2012.

Net earned premium increased 7% to $4,123 million, driven by increased gross written premium and no outward reinstatement premiums. The reinsurance expense ratio reduced to 14.0% of gross earned premium compared with 15.0% in 2011, benefiting from the absence of reinstatement premiums and the more benign levels of catastrophe activity.

Strongly performing business units in terms of premium growth included New Zealand, lenders' mortgage, financial institutions, direct, aviation, travel and Elders.

Claims expense

The net claims ratio was 60.3%, representing a significant improvement compared with 69.2% in 2011. This was due to a reduction in the attritional claims ratio and more favourable catastrophe frequency and severity. Catastrophe claims totalled $63 million or 1.5% of net earned premium in 2012 compared with $235 million or 6.1% in 2011. There has been an increased propensity for large individual risk claims across both long tail and short tail classes. Individual products with net claims ratios underperforming against expectations included builders' warranty, engineering, personal accident, surety and professional liability.

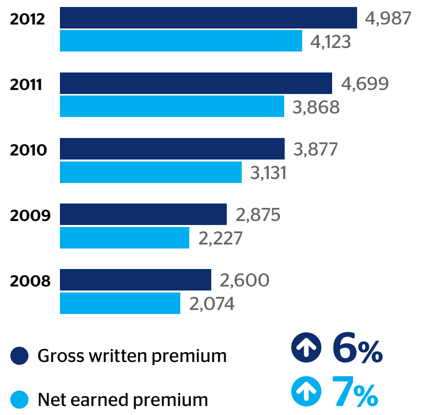
Claims ratios in other products decreased reflecting rate increases, improved risk selection and the maintenance of strong underwriting controls. Claims costs also benefited from the ongoing application of the global claims leakage program. Over 97% of claims relating to the 2011 natural catastrophes in Australia have been settled.

The significantly lower yields on government bonds used to discount outstanding claims increased the net claims ratio by approximately 1.8%. There was a net overall release in prior accident year undiscounted central estimates.

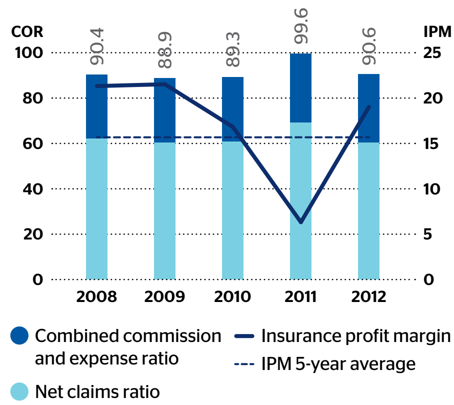
Commission and expenses

The combined commission and expense ratio was 30.3%, down slightly from 30.4% in 2011. Higher profit commissions, short-term employee incentives and fire service levies were more than offset by the benefits of our wholly-owned agencies and workers' compensation service businesses. Stable controllable expenses due to the ongoing operational efficiency program on an increased net earned premium benefited overall expense ratios. Disciplined expense management will continue to be a priority throughout 2013.

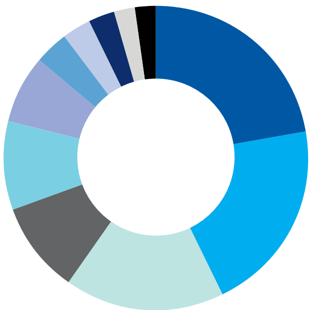
Gross written premium and net earned premium (US$M)



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

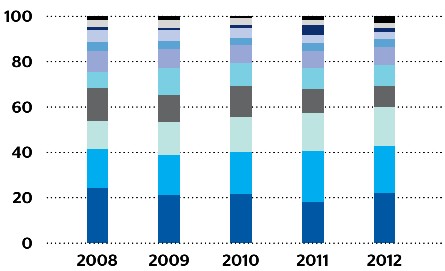


Gross earned premium by class of business 2012



Property	22.2%
Motor & motor casualty	20.5%
Householders	17.0%
Public/product liability	9.6%
Financial & credit	9.2%
Workers' compensation	7.9%
Marine, energy & aviation	3.4%
Professional indemnity	3.1%
Other	2.9%
Agriculture & bloodstock	2.1%
Accident & health	2.1%

Gross earned premium by class of business (%)



Underwriting result

FOR THE YEAR ENDED 31 DECEMBER		2012	2011	2010	2009	2008
Gross written premium	US$M	**4,987**	4,699	3,877	2,875	2,600
Gross earned premium	US$M	**4,794**	4,551	3,892	2,729	2,496
Net earned premium	US$M	**4,123**	3,868	3,131	2,227	2,074
Net incurred claims	US$M	**2,487**	2,674	1,899	1,344	1,286
Net commission	US$M	**557**	516	335	255	253
Expenses	US$M	**691**	661	562	381	336
Underwriting result	US$M	**388**	17	335	247	199
Claims ratio	%	**60.3**	69.2	60.7	60.3	62.0
Commission ratio	%	**13.5**	13.3	10.7	11.5	12.2
Expense ratio	%	**16.8**	17.1	17.9	17.1	16.2
Combined operating ratio	%	**90.6**	99.6	89.3	88.9	90.4
Insurance profit margin	%	**18.9**	6.3	16.8	21.5	21.3

Other developments

In 2012, QBE won the NIBA 'General Insurer of the Year' award for the 11th consecutive year, reflecting superior service, claims management and the strong relationship between our teams and our intermediaries.

In June, QBE combined the Australian and New Zealand operations to form a single division, benefiting from similar legislative environments and broker relationships across both countries as well as geographic proximity. Functional integration between the operations is underway as are various initiatives to enhance trans-Tasman commercial opportunities.

Throughout the year, our workplace strategy program was implemented across Australia, with our Melbourne, Perth and Adelaide offices being significantly upgraded. A newly constructed office was opened in Parramatta (NSW) and is now our largest Australian premises. Further upgrades to our Brisbane and Sydney offices are planned over the next two years. Considerable investment has been made to ensure that we provide our employees with a working environment and policies which support our "Make it happen" culture.

In late December, employees voted on our new Enterprise Agreement which provides modernised and flexible employment terms and conditions. This will assist with ongoing improvements to the diversity of our workforce and attractiveness as an employer in the global market.

In the final quarter of the year, we launched our new set of global vision, values and strategic priorities, positioning us for ongoing evolution in 2013 and beyond. This provides a common platform for the future global focus of QBE.

“Recent changes to the management of the underlying portfolios are delivering results and we are well positioned to produce ongoing positive results in a competitive market.

Australian & New Zealand Operations

Outlook for 2013

2013 forecast gross written premium: **US$5.0billion**

Intermediary distribution	Corporate partners & direct	Lenders' mortgage insurance
US$ million 2,300	US$ million 1,870	US$ million 405
Credit & Surety	**New Zealand**	
US$ million 150	US$ million 260	

2013 forecast net earned premium: **US$4.0billion**

The pleasing return to profitability in 2012 reflects the underlying strength of our underwriting portfolios and our commitment to maintaining a robust risk to reward profile. We will build on work undertaken in 2012 to improve our operational effectiveness and look to leverage opportunities from our global scale.

Our financial plan for 2013 is to outperform our internal benchmark return on equity of 15%, despite an anticipated decrease in investment returns and uncertain economic growth expectations. We plan to deliver gross written premium growth above GDP growth and are targeting a slightly improved combined operating ratio.

We expect further reductions in interest and discount rates in line with underlying inflation, and will continue to price our products in accordance with these expectations.

Our 2012 result represents a pleasing return to profitability and is the result of forward planning, hard work and the dedication of our teams throughout the year. Our result was also assisted by a benign catastrophe season. We thank our intermediary partners for their support and look forward to working with them in 2013 and beyond. I would also like to particularly thank our teams for their efforts resulting in these improved results and their personal contributions to making QBE a great place to work.

Made possible by QBE:

Asia Pacific Operations

All types of transport, on road and rail

QBE is one of the main insurers of transport in Hong Kong.

QBE provides project workers' compensation and public liability insurance to MTR, the operator of Hong Kong's mass transit system which carries 5.3 million passengers each weekday. We have been the insurer of one of Hong Kong's main bus companies, Citybus, for more than 10 years, insuring their fleet of around 1,000 buses. Up to one quarter of the registered motorcycles in Hong Kong are insured with QBE and we are a leading private car insurer in the territory.

Star attractions

Some of Singapore's most iconic attractions and events are insured by QBE.

QBE provides coverage to some of Singapore's key tourist landmarks and pieces of infrastructure. We also insure several major sporting events in Singapore. Despite the slowdown in the global economy, tourism has been one of the city-state's most successful industries in recent years. The number of international arrivals in Singapore grew 36% to a record 13.2 million in the two years to 2012.

Indian trade route

QBE offers a range of specialty marine products through its Indian joint venture, Raheja QBE.

Raheja QBE offers port and terminal operators' liability and multimodal transit operators' liability insurance to some of the largest port and container terminal companies in India.

A city of lights

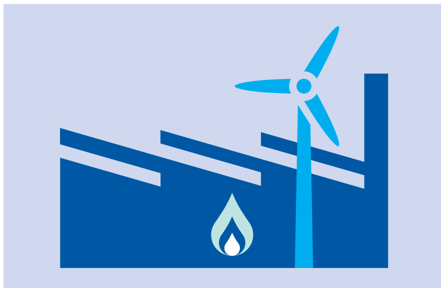
QBE plays a key role in helping to insure the backbone of the Macau economy – casinos.

Some of the territory's main landmarks have industrial special risks insurance with QBE. We have also provided coverage to some of Macau's main construction projects.

Powering up Asia

QBE provides coverage to some of Southeast Asia's major electricity providers.

We provide insurance to operators of gas-powered power plants throughout Southeast Asia. QBE also offers coverage to companies which generate solar, biomass and wind-generated electricity in the region. Renewable energy is expected to play an increasingly important role in the region where the demand for energy is expected to nearly double by 2030.



A healthy future

We are the lead insurer of New Caledonia's largest non-mining project – the Koutio multi-medical centre. The $400 million project, which is covered by a QBE construction all risks (CAR) and maintenance insurance contract, will include a medical research centre and New Caledonia's main hospital. QBE is also the lead CAR insurer of the project to upgrade New Caledonia's main international airport.

Luxury

QBE insures all the merchandise and equipment for several luxury brand stores in Jakarta. We also provide property all risks insurance for a major shopping mall in the Indonesian capital.

Vital connection

QBE insures one of the Philippines' main arterial roadways, the 84 kilometre North Luzon Expressway (NLEx). Operated by the Manila North Tollways Corporation, the NLEx upgrade was completed in 2005, making it one of the most modern toll roads in the region. The redevelopment of the NLEx is seen as a major element in the economic regeneration of the central and northern part of the Philippines' most populous island, Luzon.

Asia Pacific Operations business review

> QBE remains focused on understanding local market conditions and carefully selecting those products and geographies where we can achieve a reasonable return for our shareholders.

John Neal

Acting Chief Executive Officer • Asia Pacific Operations

Gross written premium	Net earned premium	Underwriting result	Insurance profit
US$ million	US$ million	US$ million	US$ million
578	415	59	66
↑ 24% from 2011	↑ 22% from 2011	↑ 37% from 2011	↑ 10% from 2011
		Combined operating ratio	Insurance profit margin
		85.8% (2011 87.4%)	15.9% (2011 17.6%)

Competitive landscape

Asia Pacific consists of a broad range of geographically and culturally diverse countries at various stages of economic and market development. Although there has been a slowdown in the overall rate of growth over the past 12 months, the region still offers significant opportunities when compared with the more developed markets of Europe and North America. This is especially the case in developing countries, which continue to attract strong competition from local insurers as well as global players seeking growth opportunities. As a result, a surplus of capacity exists in the region in many lines of business as new entrants compete with existing carriers for profitable business.

This has led to keen competition on rates, as a number of players focus on top line opportunities with the expectation of increased profitability at some time in the future. QBE's approach is to understand local market conditions, allowing us to select carefully those products and geographies where we can achieve a reasonable return for our shareholders.

Whilst diverse regulatory regimes still exist across the region, authorities are monitoring progress on European and US initiatives on solvency, risk management, governance and disclosure, and are gradually moving towards more sophisticated regulatory regimes.

The high incidence of natural catastrophes in 2011 has not only driven up reinsurance prices but has also facilitated a better understanding of the real risks in the region.

Pricing across the Asia Pacific region has fluctuated based on exposure to natural catastrophes. Premium rate increases of above 10% have been achieved in some countries whilst rates remain relatively flat in countries that don't have an historical exposure to natural catastrophes.

Underwriting performance

Our operations across the region performed extremely well in 2012, achieving a strong combined operating ratio of 85.8% compared with 87.4% in 2011 and an insurance profit of 15.9%, down from 17.6% last year. This greatly improved underwriting result demonstrates the benefits of portfolio remediation actions taken after the adverse catastrophe experience of 2011 to ensure premium rates, deductibles and terms and conditions appropriately reflect the underlying risks inherent in specific countries across Asia Pacific.

Following the catastrophe events of 2011, property reinsurance costs in the region increased significantly which reflected in higher premium rates in many markets, especially in property classes. We believe further rate increases are needed for property premiums to accurately reflect the level of risk and underlying catastrophe exposure that exists in the region.

We continue to focus on only retaining profitable, high quality business, particularly where we can work with our intermediary partners and their clients to mitigate potential risk exposures.

Underwriting result

FOR THE YEAR ENDED 31 DECEMBER		2012	2011	2010	2009	2008
Gross written premium	US$M	**578**	467	431	402	396
Gross earned premium	US$M	**545**	457	415	383	375
Net earned premium	US$M	**415**	341	322	283	285
Net incurred claims	US$M	**176**	149	139	128	115
Net commission	US$M	**94**	73	65	61	59
Expenses	US$M	**86**	76	68	61	60
Underwriting result	US$M	**59**	43	50	33	51
Claims ratio	%	**42.4**	43.7	43.2	45.1	40.3
Commission ratio	%	**22.7**	21.4	20.2	21.6	20.7
Expense ratio	%	**20.7**	22.3	21.1	21.6	21.1
Combined operating ratio	%	**85.8**	87.4	84.5	88.3	82.1
Insurance profit margin	%	**15.9**	17.6	20.5	13.4	23.2

Premium income

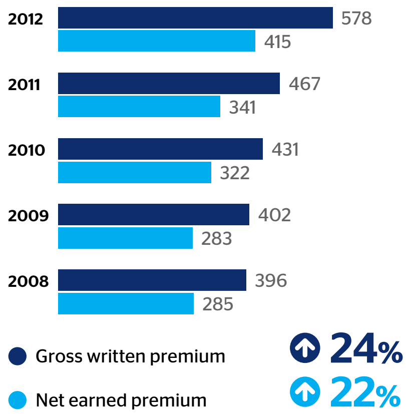
Our gross witten premium in 2012 grew by 24% to $578 million. A healthy organic growth rate of 18% was bolstered by acquisitions in both Asia and the Pacific as outlined below. All countries recorded growth in local currency terms when measured against 2011, with the exception of Macau, French Polynesia and Vietnam where the economic downturn impacted both renewals and new business opportunities.

Hong Kong, Singapore and Malaysia comprise 82% of our gross written premium in Asia and each country produced strong underwriting results with very good support from the Philippines. We are a true specialist in marine and liability classes which comprise 29% of gross written premium in Asia, with a strong track record of market-leading profitability.

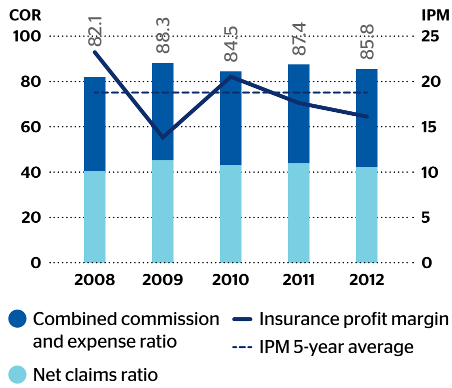
Our Pacific Islands businesses wrote $113 million of gross written premium with particularly strong results in Papua New Guinea, New Caledonia and the Solomon Islands.

We have excellent working relationships with agents, local brokers and major broking houses across the region. Our bancassurance model in Hong Kong was augmented in 2012 through an exclusive distribution relationship with Hang Seng Bank.

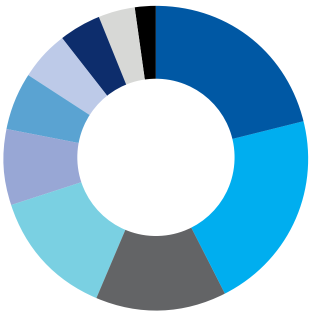
Gross written premium and net earned premium (US$M)



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

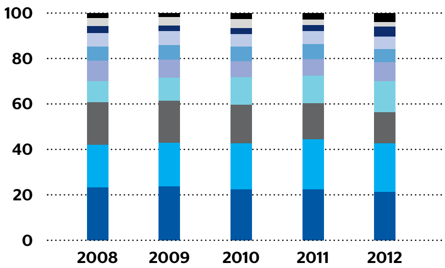


Gross earned premium by class of business 2012



Property	21.3%
Marine energy & aviation	21.3%
Motor & motor casualty	13.8%
Workers' compensation	13.6%
Accident & health	8.3%
Public/product liability	5.9%
Professional indemnity	5.5%
Householders	4.2%
Other	3.9%
Financial & credit	2.2%

Gross earned premium by class of business (%)



Claims expense

Our net claims ratio of 42.4% improved from the 43.7% experienced in 2011, which was impacted by the flood event in Thailand. Fiji had a particularly challenging year with flood losses early in the year followed by the extensive damage caused by Cyclone Evan in December. Typhoon Vicente brought with it some marine claims when it hit Hong Kong in late July.

Nevertheless, 2012 was a much more benign year for claims, resulting in improvements in both our catastrophe and attritional claims ratios.

Commission and expenses

The combined commission and expense ratio of 43.4% was higher than planned owing to higher reinsurance costs which depressed net earned premium. We remain committed to our ongoing investment in technology and people to ensure that the growth ambitions of the business are ably supported.

Acquisitions and other developments

In July 2012, we completed the acquisition of the Hang Seng Insurance Company from Hang Seng Bank. This was complemented by a 10-year bancassurance agreement wherein QBE became the exclusive provider and underwriter of bancassurance general insurance products to Hang Seng Bank's customers in Hong Kong and mainland China. The distribution agreement provides increased penetration into the Hong Kong market and the opportunity to advance our interest in exploring mainland China through the bank's strong operations in that country.

In the Pacific region, we completed a small acquisition in Vanuatu. In January 2013, we have made a further acquisition in Papua New Guinea, which will strengthen our leadership position in that market.

Developing a strategy for QBE Asia

The non-life insurance market in Asia is estimated to generate approximately $220 billion in gross written premium, representing around 20% of the global market. The market is forecast to grow at 8% compound over the next decade driven by strong GDP growth and increasing penetration of insurance products. We believe that Asia will represent a growing proportion of global GDP.

QBE's Asia footprint is relatively modest and, recognising the scale and also the complexity of the opportunity, we have further refined our strategy for the region. This will see a largely organic focus on areas where QBE can build market leadership, in particular around speciality and commercial business in Singapore, Hong Kong and Malaysia, leveraging specialist underwriting expertise available elsewhere in the Group.

This increased focus will require us to build on and broaden our current underwriting capabilities, as well as investing in a technology solution to support our long-term business ambitions.

“We recognise Asia as the growth engine for global insurance. In 2012, we therefore developed a five year strategic plan to support profitable growth.

Asia Pacific Operations
Outlook for 2013

2013 forecast gross written premium: US$690million

Asia	Pacific	2013 forecast net earned premium:
US$ million 565	US$ million 125	US$525million

QBE is pleased to announce the appointment of Mr David Fried as Chief Executive Officer, QBE Asia Pacific. With nearly 30 years industry experience, most of which was gained in Asia, David will join QBE on 8 April 2013 and will initially be based in Singapore where he will be responsible for the implementation of the regional growth strategy.

The outlook for our Asia Pacific division in 2013 and beyond is bright due to expected economic growth in Asia and QBE's solid business franchise. Our aim is to continue the strong focus on underwriting fundamentals whilst delivering our profitable growth ambitions across the region.

The platform for profitable growth will also be enhanced through the development of our insurance licence in China coupled with a focused approach to growth in our Indian joint venture business.

We expect markets to remain competitive. We will continue to focus on achieving a minimum 15% return on equity whilst growing our business through the delivery of our strategic plans, particularly in Asia.

We have a strong distribution network across the region with QBE's specialist teams working closely through intermediaries and the Hang Seng Bank in Hong Kong. In 2013, we will enhance this capability with the addition of specialist underwriting team members who will be strategically located across the region to ensure we take advantage of, and build on, the strong relationships that already exist.

QBE would like to particularly thank our intermediary partners across the region for their continued support of our Asia Pacific team. We look forward to future support as we roll out new initiatives to improve service offerings over the next 12 months.

My thanks and congratulations also go out to our hardworking staff for a superb result in 2012, and for their continued efforts to set a solid foundation for future growth.

Equator Re business review

> Equator Re is QBE's wholly-owned captive reinsurer providing excess of loss and proportional reinsurance protection to QBE's operating divisions. The captive's 2012 result reflects an overall improved underwriting and insurance profit compared with 2011. However, the result disappointed against our expectations mainly due to adverse prior accident year claims development.

Des Fogarty
President • Equator Re

Gross written premium US$ million	Net earned premium US$ million	Underwriting result US$ million	Insurance profit US$ million
3,710	3,410	10	139
↓ 3% from 2011	↑ 1% from 2011	↑ $161M from 2011	↑ $195M from 2011
		Combined operating ratio 99.7% (2011 104.5%)	Insurance profit margin 4.1% (2011 -1.7%)

Competitive landscape

General economic and insurance market conditions were challenging for the various operating divisions and resulted in an overall reduction in Equator Re's proportional reinsurance premium income for 2012. While excess of loss premium rates were generally flat in 2012, property catastrophe reinsurance rates in Australia and Asia Pacific increased significantly following the unprecedented level of catastrophe loss activity in the region in 2010 and 2011, resulting in increased revenue to Equator Re.

The difficult global economic conditions and government actions taken to stimulate economies have resulted in a further reduction in yields on cash and fixed interest investments.

Underwriting performance

The 2012 combined operating ratio was disappointing at 99.7%, but an improvement on 104.5% reported last year. This year's result was impacted by a number of factors including claims from Superstorm Sandy, deterioration of prior accident year catastrophe provisions, adverse claims development on the non-US casualty book, crop losses due to the severe drought in the US and claims provision strengthening on a number of portfolios in the US.

The overall net loss to Equator Re from Superstorm Sandy was $114 million after reinstatements and reinsurance recoveries.

Insurance profit improved to $139 million compared with a loss of $56 million in 2011 and the insurance profit margin also improved to 4.1% compared with a negative margin of 1.7% last year.

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2 Business review
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4 Directors' report
5 Financial report
6 Other information

There was a significant improvement in investment income on policyholders' funds which increased from $95 million to $129 million due to gains on the fixed income portfolio, largely reflecting a narrowing of credit spreads during the year.

Premium income

Gross written premium by source

FOR THE YEAR ENDED 31 DECEMBER		2012	2011	2010	2009	2008
North American Operations	US$M	**2,269**	2,218	1,335	979	817
Latin American Operations	US$M	**24**	39	36	–	–
European Operations	£$M	**621**	607	540	517	399
Australian & New Zealand Operations	A$M	**318**	454	214	200	325
Asia Pacific Operations	US$M	**100**	105	76	57	43
Total	US$M	**3,710**	3,807	2,479	1,994	1,870

Gross written premium fell by 3% to $3,710 million from $3,807 million last year. The fall in premium income was mainly due to reduced premiums from Australian & New Zealand Operations due to lower reinstatement income as a result of the more benign catastrophe claims environment and no requirement for back-up catastrophe covers in 2012.

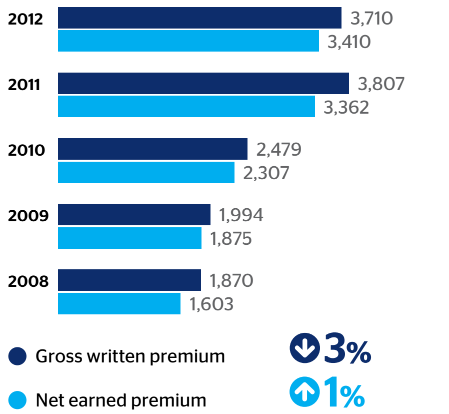
Net earned premium rose by just over 1% to $3,410 million, up from $3,362 million in 2011. The outward reinsurance expense ratio fell to 8.1% of net earned premium compared with 9.1% for 2011 due to the decision to purchase additional catastrophe reinsurance cover in 2011 following especially severe catastrophe experience in the first half of that year. The underlying reinsurance protections purchased in 2011 and 2012 were broadly similar.

The company operates within the Group's overall risk appetite and maximum event limits and pricing is benchmarked against open market rates. Equator Re supports the management of aggregate exposures to any one individual risk or catastrophe event and assists in optimising the levels of capital held within the Group. No external business is written.

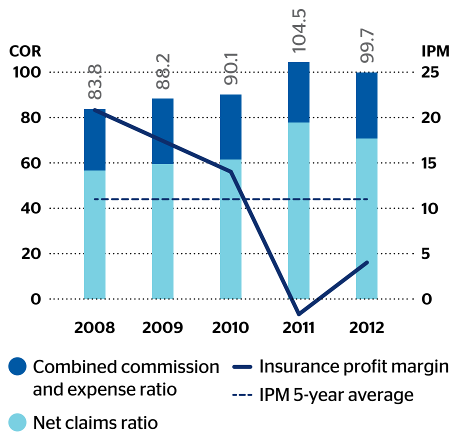
Claims expense

The net claims ratio was 70.5% compared with 77.8% last year and reflects a lower frequency of catastrophe claims in 2012 compared with 2011. The claims ratio was negatively impacted by a number of large casualty claims, adverse prior accident year catastrophe claims development and a general provision strengthening in a number of the insurance portfolios in North America. Reinsurance recoveries from our global reinsurance arrangements were $234 million compared with $381 million last year.

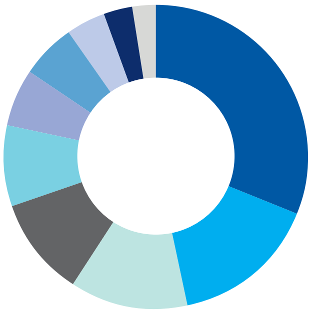
Gross written premium and net earned premium (US$M)



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

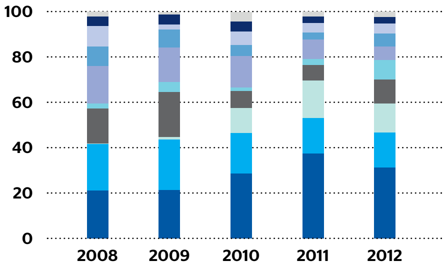


Gross earned premium by class of business 2012



Property	31.2%
Public/product liability	15.5%
Agriculture & bloodstock	12.7%
Motor & motor casualty	10.5%
Householders	8.6%
Marine, energy & aviation	6.0%
Workers' compensation	5.8%
Financial & credit	4.3%
Professional indemnity	3.0%
Accident & health	2.4%

Gross earned premium by class of business (%)



Commission and expenses

The combined commission and expense ratio was 29.2% compared with 26.7% last year. The increase was due to a change in the mix of business (proportional premium increased as a percentage of total net earned premium due to reduced excess of loss reinstatement premium income) and reflects the higher commissions payable on the proportional business written by Equator Re.

Underwriting result

FOR THE YEAR ENDED 31 DECEMBER		2012	2011	2010	2009	2008
Gross written premium	US$M	**3,710**	3,807	2,479	1,994	1,870
Gross earned premium	US$M	**3,712**	3,697	2,363	1,918	1,658
Net earned premium	US$M	**3,410**	3,362	2,307	1,875	1,603
Net incurred claims	US$M	**2,403**	2,616	1,417	1,113	908
Net commission	US$M	**895**	784	575	440	344
Expenses	US$M	**102**	113	87	100	92
Underwriting result	US$M	**10**	(151)	228	222	259
Claims ratio	%	**70.5**	77.8	61.4	59.4	56.6
Commission ratio	%	**26.2**	23.3	24.9	23.5	21.4
Expense ratio	%	**3.0**	3.4	3.8	5.3	5.8
Combined operating ratio	%	**99.7**	104.5	90.1	88.2	83.8
Insurance profit margin	%	**4.1**	(1.7)	14.0	17.4	20.8

Other developments

During 2012, Equator Re carried out a major review of its operating model with a view to providing optimal support for the QBE Group strategy. This involved benchmarking operations against peers and aligning Equator Re's organisation, governance and operating model with "best practice" for a captive reinsurer.

As a result, Equator continues to operate as a Class 3a reinsurer under Bermuda Monetary Authority regulations with an enhanced position in the Group and new office space in Hamilton, Bermuda. A number of functions have been strengthened including risk management, internal audit and financial modelling capability and a number of claims, underwriting and actuarial roles were enhanced. A new catastrophe modelling and portfolio analysis role was also created.

“Equator Re aims to be QBE's reinsurer of choice. Its role is to optimise the Group's management of risk and capital.

Equator Re

Outlook for 2013

2013 forecast gross written premium: US$3.5billion

2013 forecast net earned premium: US$3.3billion

2013 gross written premium income is expected to reduce slightly to around $3.5 billion while net earned premium is expected to be around $3.3 billion.

Equator Re continues to work closely with the Group's operating divisions to identify further opportunities to grow the business and deliver reinsurance solutions which meet the needs of the underlying business units. For 2013, the retentions on a number of the divisional catastrophe and per risk programs have been increased further, thereby reducing Equator Re's risk exposure, particularly in areas where there has been increased frequency and severity in claims in recent years. We have purchased additional reinsurance covers and changed the structure of reinsurance contracts in 2013 to provide a broader cover to the Group against a frequency of catastrophe claims. We continue to use external benchmarking to ensure that the various reinsurance contracts are priced on an arms-length basis in line with the open market.

I would like to thank all of the Equator Re staff for their commitment, dedication and support over the past year as we implemented a transformation program to meet the future needs of the business.

The QBE Foundation:
Supporting work, education and work-ready initiatives

The QBE Foundation is QBE's major corporate responsibility initiative. Through the Foundation, we encourage individuals and groups to live more independently and successfully by overcoming disadvantage.

In 2012, we consolidated the work of the Foundation through a co-ordinated approach to grants, matching employee giving and volunteer work. Formal programs for these initiatives were implemented across the six divisions through which we operate. Employee volunteering almost tripled, while employee-matched giving and fundraising doubled over the year.

AUSTRALIA & NEW ZEALAND

Changing lives

Mel* is one of the many young people helped through the *Youth Off The Streets (YOTS)* Street Walk program, which is supported by QBE Foundation workplace giving. Convinced that no one believed in her, Mel was sleeping on the streets and using drugs. A *YOTS* Street Walk team met Mel and supported her through an intensive drug rehabilitation program, reunited her with her family and she is now attending TAFE.† Over the past 12 months, 65 QBE employees have volunteered with *YOTS*. One *YOTS* volunteer, Nicki Proberts, Senior Partnership Manager in QBE LMI, said: "I'm in awe of how much *YOTS* does to help kids at that crucial stage – they turn their lives around."

LATIN AMERICA

Fostering work-readiness

Junior Achievement Argentina (JA) is an organisation that fosters entrepreneurship in young people. *JA* runs programs that improve the work-readiness and financial literacy skills of young people across Argentina. A QBE Foundation grant funded the implementation of educational programs, educational events and development of new programs. QBE employees volunteered more than 1,000 hours for *JA* including QBE Argentina CEO, Gonzalo Delger, who sits on the *JA* board. Pictured here, students from the Nuestra Señora del Buen Consejo college in Buenos Aires eagerly await customers for the bath relaxation sets they developed, produced and marketed themselves.

* Not their real names   † TAFE is a vocational and education and training provider

"We believe corporate responsibility extends beyond monetary support. We encourage all of our employees to contribute in some way to the communities in which they work and support them through volunteer leave, matched fundraising, employee donations and grants.

Jenni Smith Chair QBE Foundation Group Committee

NORTH AMERICA

Sponsoring career advice

15 QBE senior leaders took part in a volunteer opportunity in Harlem, New York, as part of the *Boys & Girls Clubs of America*'s (BGCA) CareerLaunch program. The QBE Foundation supports the *BGCA* on a national level, while also directly impacting the CareerLaunch program at 10 local clubs across the country. Devin Cobb, lead learning and development partner (left), listens to the specific interests of the program participants and offers career advice.

EUROPE

Assisting skills development

The QBE Foundation used its association with rugby to help disadvantaged young people engage in sport while getting skills and qualifications to find employment through a grant spread across the *Rugby Football Foundation*, *Wooden Spoon* and *The Prince's Trust*.

ASIA PACIFIC

Providing quality education

16 year old Sera* (left) missed out on several years of appropriate teaching. With the QBE Foundation paying her school and boarding fees at the *Gospel School for the Deaf* in Suva in Fiji, she is now excelling in some subjects. Nine year old Jone* (right) has improved dramatically in his four years at the school, especially with his language skills. QBE Foundation funding enables him to continue at the school.

Risk: Our business

QBE is in the business of managing risk. Our ability to satisfy our customers' risk management needs is at the heart of what we do. We aim to generate wealth and maximise returns for our shareholders by pursuing opportunities that involve risk. Our people have the responsibility to ensure that the key risks are managed and controlled on a day-to-day basis. We aim to use our ability to properly manage risk to provide more certainty and improved outcomes for all of our stakeholders.

QBE seeks to only take on risks that fall within the Group's stated risk appetite and aims to manage them in a way to achieve an optimal return overall. The Group's risk management framework is designed to support this approach and enhance decision making by our people. A strong approach to risk management informs our decision making and enables us to measure and judge our risk exposures. Ultimately, this gives us greater confidence and expands our capacity to take on risks to improve our returns.

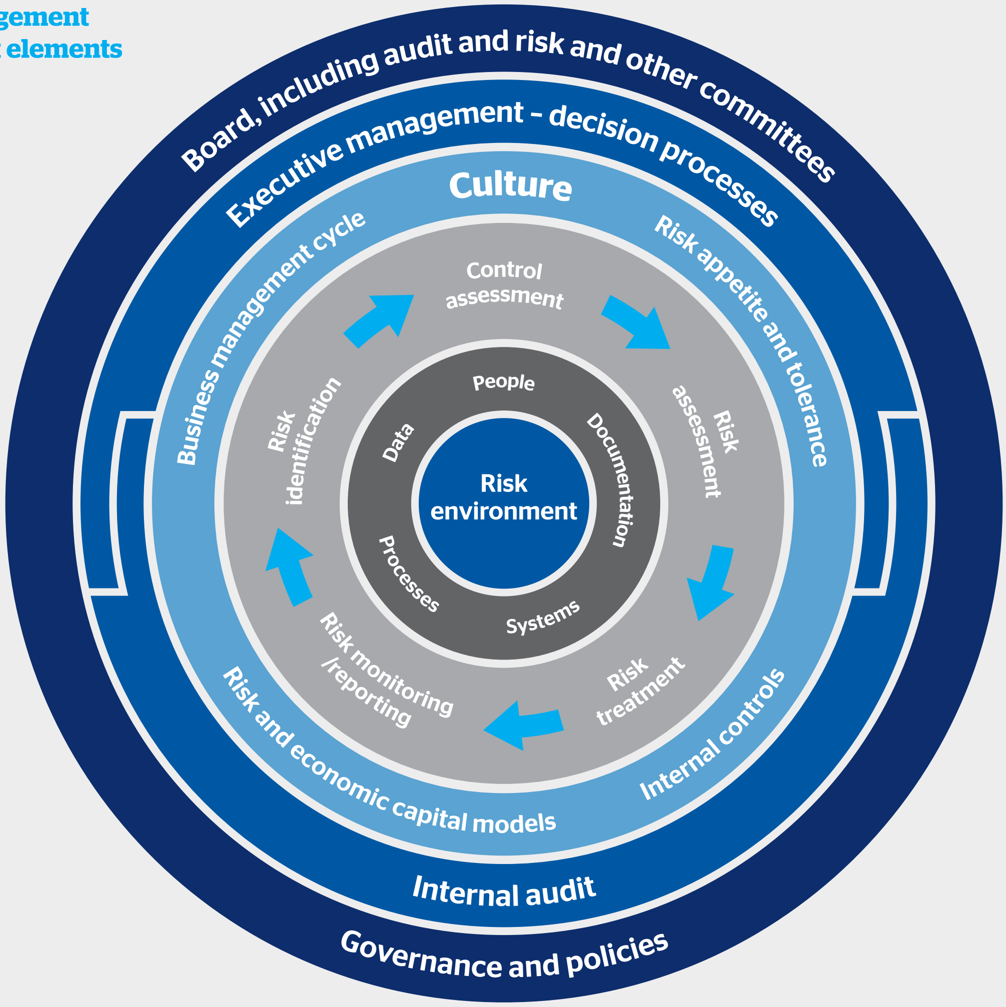
Our risk management framework aims to ensure that decisions across all categories of risk are conscious and transparent across the Group. The framework seeks to provide a support network to ensure our employees' decisions are in the best interests of all QBE stakeholders.

Risk management involves good governance and ensuring that the decisions QBE makes are founded on solid risk assessment. This means clearly identifying the different types of risks and assessing them against clear appetites and tolerances for each type of risk.

Following a record level of catastrophes in 2011, 2012 saw a much lower level of catastrophe claims. QBE experienced some deterioration in estimates of 2011 catastrophe claims, primarily related to the devastating Christchurch earthquakes and Thai floods. Multiple seismic events and changes in building codes and associated costs have made estimation difficult for Christchurch and the widespread impact and last quarter timing of the Thailand floods resulted in some late reporting of claims. The largest 2012 year claims came from the crop business in the US caused by the worst drought in decades and Superstorm Sandy on the US East Coast during the fourth quarter.

The underwriting risk management in place in QBE's crop business, combined with reinsurance designed to cap underwriting losses at just below break even, operated

Risk management framework elements



as expected in the extreme drought conditions, resulting in only a small underwriting loss for the year. The exposure management in place to control the impact of a large North Eastern US windstorm also worked as expected in the case of Superstorm Sandy, and QBE's early announcement of an estimated cost has been robust as market loss estimates have gradually moved up to our initial view of an industry loss of more than $20 billion.

Proactive management action to cease underwriting business which does not meet risk-adjusted return targets resulted in the cancellation of significant portions of business across the Group over the last few years. 2012 saw a further tightening of this process around run-off business management, particularly in the US. As a result, management increased the level of claims provisions to reflect the potential for future increases in claims settlements.

Embedding a risk assessment mindset in business planning and management processes assists in keeping focus on the key objectives and identifying metrics required to monitor portfolio performance and improvement initiatives. This remains a key focus in 2013.

> **If we can assess our risk parameters accurately, then this will give us a real competitive advantage and ensure we maximise the return on our capital.**
>
> **John Neal**
> Group Chief Executive Officer

The investment team continued to manage risk exposure proactively during the year, realising investment gains during the first half to further increase credit quality in the portfolio. Strong management through some periods of significant volatility delivered a result well above initial target.

The Group recognises that risk management is only effective if it is entrenched in the culture of its people. An emphasis on strong risk management helps embed the ownership and accountability for risk across our entire workforce. It is the responsibility of every QBE employee to adopt a rigorous approach to managing risks and to adhere to QBE's risk management policy.

The QBE Board is responsible to shareholders for the performance of the Group and, as such, takes a critical role in ensuring that an effective risk management strategy is established and maintained.

Key risk management information has been provided to the former Group Audit and Risk Committee or Board to enable them to fulfil their governance responsibilities. Appropriate reporting is also maintained within each division, aligned to the relevant organisational structure, including each division's audit and/or risk committee.

The following table provides some examples of the types of risk QBE faces, drivers of these risks and mitigation

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.	• Changes in the external environment including competitive landscape, customer behaviour and distribution models. • Business strategy and change, investment strategy and corporate governance. • Risks related to acquisitions and capital management.	• Considering strategic options in light of the impact on return volatility 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 at the time of underwriting. This includes underwriting, catastrophe claims concentration and claims estimation risks.	• Natural or man-made catastrophic events. • Pricing of individual insurance contracts. • Insurance claims.	• Maintaining historical pricing and claims analysis. • Setting a tolerance to concentration risk. • Ensuring consistency of provisioning practices across all divisions. • Monitoring and performance review. • Reinsurance. • In-house and external actuarial review of claims provisions independent of underwriting teams.
Credit risk The risk of not recovering amounts owed to QBE.	• Reduction or delay in repayments or interest payments from the default of a counterparty such as a bond issuer, policyholder or reinsurer.	• 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 derivative positions. • Maximising placement of reinsurance with highly-rated and regarded counter parties and limiting concentration of exposures.
Market risk The risk of variability of the value of, and returns on, investments and the variability of interest rates, foreign exchange rates and economy-wide inflation on both assets and liabilities, excluding insurance liabilities.	• 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.	• Active asset management and hedging in business units. • Tactical asset allocation. • Diversified portfolio. • Hedging of net asset exposures.
Liquidity risk The risk of insufficient liquid assets being available to meet liabilities as they fall due to policyholders and creditors.	• 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.	• Stress testing of liquidity needs relative to major catastrophe events. • Holding a minimum percentage of consolidated investments and cash 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.	• Systems errors or failure in information that impacts delivery of services. • Failure of key processes and controls resulting in losses.	• 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 procedures.

One ERM

One key initiative during the year was to further align and harmonise the Chief Risk Officer (CRO) functions across the Group. As part of this process, we are also refining our approach to enterprise risk management (ERM) to streamline and enhance risk management globally.

As part of the ongoing improvement of our risk management processes, QBE introduced a new Group-wide risk management software system called infoRM during 2012. The system represents a significant investment in QBE's risk management capability and allows the Group to assess its risk parameters more accurately and hence make more informed decisions.

The system supports sharing of leading practices and knowledge across all of QBE's divisions and geographies.

QBE's Group CRO has primary responsibility for developing and maintaining the risk management framework and strategy. In turn, the CRO Forum, comprised of the Group and divisional CROs, supports the overall risk management strategy and specific initiatives of the Group.

The risk management framework

QBE's risk management framework reflects the 'three lines of defence' approach to risk management. This defines risk management responsibilities across QBE. The first line will typically generate most of the risk exposures and has responsibility for identifying, managing and owning risks. The second line provides frameworks, policies, tools and processes to support the first line in delivering their responsibilities and also has oversight of the effective execution of those responsibilities. The third line of defence provides independent assurance over the first and second lines to delivery of their responsibilities and the adequacy of the internal control environment.

Given the changing nature of the environment in which we operate, it is imperative that our risk management continues to evolve and adapt. We take a forward looking approach to managing risk and continually monitor our exposures against our stated risk appetites.

Within the three lines of defence, independent assurance on the management of risk is gained in several ways. These include regular and comprehensive internal audit reviews; the Group's outstanding claims provision being reviewed by internal actuarial staff who provide independent views separate from management; external actuarial review of QBE's central estimate claims provision; QBE's Audit Committee review of the internal audit and risk functions of the Group; and the external auditor's opinion on the Group's accounts and the level of regulatory compliance of QBE's APRA licensed insurance entities.

Newly acquired businesses are required to be substantially compliant with the QBE risk management framework within 12 months of acquisition or as approved by the Group Chief Executive Officer based on the complexities of the arrangement.

Risk appetite and tolerance

Risk appetite is the level of risk that the Board and management are willing to take in pursuit of the Group's strategic objectives. At Group level, risk appetite is assessed:

- through Board-approved risk appetite statements and risk tolerances for each of the QBE risk categories, including the Group's maximum tolerance of risk;
- through the business plan objectives, including return on risk-adjusted capital, in terms of capital adequacy and through detailed risk limits;
- within the delegation of authority from the Board to the Group Chief Executive Officer; and
- within Group policies covering key risk areas.

The Group's risk appetite statements and tolerance for risk are reviewed by senior management at least once a year and approved by the Board.

Allocation of capital

QBE uses an economic capital model (ECM) to help assess risk and calculate the appropriate level of risk-based capital to allocate to all the risks to which the Group is exposed. This capital allocation is used in determining the required returns on equity for QBE's incentive schemes. The allocation of risk-based capital helps ensure that the risk taken by the Group is commensurate with required returns and is within the Board's risk appetite and tolerance. Risk-based capital enables QBE to make decisions which involve quantitative risk reward trade-offs.

Regulatory developments

The insurance regulatory environment in which QBE operates can be highly dynamic. QBE takes a proactive approach to managing and mitigating insurance regulatory risk globally.

We believe that there is a material commercial benefit in adopting a "best practice before" rather than a "meet minimum after" approach to regulation. A proactive approach better enables QBE to develop practices which are suited to our business.

Regular discussions with third parties such as ratings agencies and insurance regulators from various jurisdictions indicate a positive view of QBE's general management approach and risk framework.

QBE is subject to more than 30 different local insurance regulatory capital requirements and various "whole-Group" requirements around the world.

In Australia, following a two year long Life and General Insurance Capital (LAGIC) review, APRA released final standards in 2012 which, from 1 January 2013, change the calculations of required regulatory capital, now known as the prescribed capital amount (PCA) and the prudential capital requirement (PCR).

Despite differences in the insurance regulatory frameworks across many jurisdictions, QBE's regulatory strategy remains consistent in providing assurance to senior management, the Group Executive and the Board regarding Group compliance with regulatory requirements; minimising regulatory burden and cost across the Group; and, supporting the efficient use of capital in line with regulatory requirements.

George Thwaites
Group Chief Risk Officer

Skills, experience & knowledge

Belinda Hutchinson AM

BEC, FCA, FAICD

Chairman

Age 59

Belinda Hutchinson was appointed as an independent non-executive director of QBE in September 1997 and became Chairman in July 2010. Belinda is a member of the Audit, Investment, Remuneration and Risk and Capital Committees.

Belinda is a director of AGL Energy Limited and St Vincent's Health Australia. Belinda is also a member of the Salvation Army Eastern Territory Advisory Board and Chancellor of the University of Sydney.

Duncan Boyle

BA, FCII, FAICD

Independent director

Age 61

Duncan Boyle was appointed as an independent non-executive director of QBE in September 2006. Duncan is Chairman of the Audit Committee and a member of the Remuneration Committee.

Duncan is a director of Clayton Utz lawyers and Stockland Trust Group and has 40 years experience in the insurance industry in Australia, New Zealand and the UK.

John Graf

BA

Independent director

Age 53

John Graf is based in the US and was appointed as an independent non-executive director of QBE in August 2012. John is a member of the Audit, Investment and Risk and Capital Committees.

John is the chairman, president and chief executive officer of the financial services company Forethought Financial Group, Inc. John has over 31 years experience in the US financial services industry including senior executive positions with AXA Financial Inc., American General Corporation, Conseco Inc. and John Hancock Financial Services.

John M Green

B JURIS/LLB, FAICD, SF FIN

Independent director

Age 60

John M Green was appointed as an independent non-executive director of QBE in March 2010. John is Chairman of the Risk and Capital Committee and a member of the Investment and Remuneration Committees.

John is a non-executive director of WorleyParsons Limited, a member of the Takeovers Panel in Australia, a book publisher at Pantera Press, a novelist and a business writer. As an executive director at Macquarie Bank and before that as a partner at two major law firms, John advised numerous insurance and financial services companies.

Isabel Hudson

MA, FCII

Independent director

Age 53

Isabel Hudson is based in the UK and was appointed as an independent non-executive director of QBE in November 2005. Isabel is Chairman of the Remuneration Committee and is a member of the Audit Committee.

Isabel is Chairman of the National House Building Council and a director of MGM Advantage, Phoenix Group Holdings and the Pensions Regulator in the UK. She is also an ambassador of the UK charity Scope. Isabel has 32 years experience in the insurance industry in the UK and mainland Europe.

Charles Irby

FCA (England & Wales)

Independent director

Age 67

Charles Irby is based in the UK and was appointed as an independent non-executive director of QBE in June 2001. Charles is a member of the Investment Committee and the European Operations' Audit Committee.

Charles is a director of Great Portland Estates Plc and North Atlantic Smaller Companies Investment Trust Plc. Charles is also a trustee and governor of King Edwards VII's Hospital Sister Agnes.

Irene Lee

BA, Barrister-at-law

Independent director

Age 59

Irene Lee is based in Hong Kong and was appointed as an independent non-executive director of QBE in May 2002. Irene is Chairman of the Investment Committee and is a member of the Audit and Risk and Capital Committees.

Irene is the executive Chairman of Hysan Development Limited. Irene is a director of Cathay Pacific Airways Limited, CLP Holdings Limited, Sydney Symphony Limited and Noble Group Limited. She is also a member of the advisory council of JP Morgan Australia.

John Neal

Group Chief Executive Officer

Age 48

John Neal joined QBE in 2003 and was appointed Group Chief Executive Officer on 17 August 2012. Prior to his current role, John held the position of Chief Executive Officer of Global Underwriting Operations and prior to that held several leadership positions in QBE's European Operations, most recently as Chief Underwriting Officer.

John has over 25 years experience in the insurance industry and before joining QBE, John was the Chief Executive of Ensign, a Lloyd's managing agent. John developed Ensign to become the UK's leading commercial motor insurance brand. QBE acquired Ensign in 2003.

Making it happen

John Neal

Group Chief Executive Officer

Age 48

John Neal joined QBE in 2003 and was appointed Group Chief Executive Officer on 17 August 2012. Prior to his current role, John held the position of Chief Executive Officer of Global Underwriting Operations and prior to that held several leadership positions in QBE's European Operations, most recently as Chief Underwriting Officer.

John has over 25 years experience in the insurance industry and before joining QBE, John was the Chief Executive of Ensign, a Lloyd's managing agent. John developed Ensign to become the UK's leading commercial motor insurance brand. QBE acquired Ensign in 2003.

Steven Burns

FCA

Chief Executive Officer, European Operations

Age 54

Steven Burns joined QBE through its acquisition of Limit Underwriting in 2000 and was appointed Chief Executive Officer, European Operations in 2004. Prior to his current role, Steven was Chief Executive Officer, Lloyd's Division.

Steven has extensive experience in the insurance industry. He joined Janson Green, a Lloyd's managing agent, in 1987 and became Finance Director prior to the agent's acquisition by Limit Underwriting.

Steven was a member of the Council of Lloyd's, between 2003 and 2005 and a non-executive director of the Lloyd's Franchise Board.

Neil Drabsch

FCA, FAICD, FCIS

Group Chief Financial Officer

Age 64

Neil Drabsch joined QBE in 1991 and was appointed Group Chief Financial Officer in 1994. Prior to his current role, Neil was Group Company Secretary.

Neil has more than 46 years experience in insurance and reinsurance management, finance and accounting, including 24 years as a practicing chartered accountant.

Neil is a fellow of the Institute of Chartered Accountants, the Australian Institute of Company Directors and the Institute of Chartered Secretaries and Administrators. He also participates in a number of representative committees for the Insurance Council in relation to finance and industry matters and the development of Australian accounting standards for general insurance.

Colin Fagen

B COM, MBA

Chief Executive Officer, Australian & New Zealand Operations

Age 46

Colin Fagen joined QBE in 1998 and was appointed Chief Executive Officer, Australian Operations in 2011. This was expanded to include New Zealand Operations in 2012. Prior to his current role, Colin was the Executive General Manager, Intermediary Distribution for Australian Operations.

Colin has 22 years experience in the general insurance industry, having held a variety of operational roles. Colin is a director of the Australian and New Zealand Institute of Insurance and Finance and is also a director of the Insurance Council of Australia.

John Rumpler

FFIN, FAIEX

President and Chief Executive Officer, North American Operations

Age 52

John Rumpler joined QBE in 1997 and was appointed President and Chief Executive Officer, North American Operations in 2009. Prior to his current role John led the development of the Group's international credit and surety businesses and was a member of the Australian Operations' executive team.

John has more than 31 years experience in the banking, government and insurance industries. John is a fellow of the Australian Institute of Banking and Finance, a member of the Australian Institute of Company Directors and was the president of the International Credit and Surety Association from 2006 to 2008.

Jenni Smith

MBA

Group Executive Officer, People and Communications

Age 50

Jenni Smith joined QBE in 2003 and holds the role of Group Executive Officer, People and Communications. Jenni is also the Chair of the QBE Foundation.

Jenni has substantial international experience having held executive roles in the UK advertising and television industry. Before joining QBE, Jenni held the position of General Manager Human Resources, International at Telstra Corporation.

Jose Sojo

B BUS, M ECON/POL. SCIENCE

Chief Executive Officer, Latin American Operations

Age 41

Jose Sojo joined QBE in 2001 and was appointed Chief Executive Officer, Latin American Operations in 2011. Prior to his current role, Jose was General Manager, Latin America where he was responsible for QBE´s expansion from a one country operation to the current business in seven countries in Latin America.

Jose currently chairs the Group´s Underwriting and Distribution Forum, working on several global initiatives for QBE. Jose has been involved in the insurance industry for 17 years, gaining underwriting and management experience at Gen Re and HIH Argentina. It was QBE's acquisition of HIH Argentina in 2001 that brought Jose to QBE.

George Thwaites

B ENG (HONS), ACA

Group Chief Risk Officer

Age 47

George Thwaites joined QBE in 1999 and was appointed Group Chief Risk Officer in 2005. Prior to his current role, George was Financial Controller for QBE's Asia Pacific Operations.

George has been involved in the insurance industry for over 17 years and previously worked in the accounting profession. George has gained extensive global experience advising financial institutions across the UK, Canada and Australia.

Corporate governance statement

QBE places importance on corporate governance and being a good corporate citizen. The Group has a vision and six ONE QBE values that recognise its customers, people, shareholders and the community. QBE believes that a culture that rewards transparency, integrity and performance will promote its long-term sustainability and the ongoing success of its business.

This corporate governance statement aims to disclose in summary form as clearly and objectively as possible QBE's corporate governance standards and practices so that they can be readily understood by our shareholders, policyholders and other stakeholders. QBE also continues to focus on other equally important issues such as the strength of its outstanding claims provision and the quality of its reinsurance protections.

The ASX Corporate Governance Council (ASX CGC) has issued eight principles and, as part of them, made 30 recommendations. Each principle is discussed below.

ASX CGC principle 1: lay solid foundations for management and oversight

Board functions

In accordance with its charter, the Board:

- oversees corporate governance;
- selects and supervises the Group Chief Executive Officer;
- provides direction to management;
- approves the strategies and major policies of the Group;
- monitors performance against plan;
- considers regulatory compliance;
- monitors people-related strategies (including people development and succession planning); and
- reviews information technology and other resources.

The Board ensures it has the information it requires to be effective including, where necessary, independent professional advice. A non-executive director may seek such advice at the company's cost with the consent of the Chairman. All directors would receive a copy of such advice. Non-executive directors may attend relevant external training courses at QBE's cost with the consent of the Chairman.

Strategic issues and management's detailed budgets and three year business plans are reviewed at least annually by the Board. The Board receives updated forecasts during the year. Visits by non-executive directors to the Group's offices in key locations are encouraged. To help the Board to maintain its understanding of the business and to effectively assess management, directors have regular presentations by the divisional Chief Executive Officers and other senior managers of the various divisions on topics, including budgets, three year business plans and operating performance. They have contact with senior employees at numerous times and in various forums during the year. The Board meets regularly in Australia and, due to QBE's substantial overseas operations, usually spends five days in the UK and the US each year. Meetings are held in other overseas offices as and when the Board considers it appropriate. This year, the Board met in Hong Kong. Each meeting normally considers reports from the Group Chief Executive Officer and the Group Chief Financial Officer, together with other relevant reports. The Board regularly meets in the absence of management. The Chairman and Group Chief Executive Officer in particular, and board members in general, have substantial contact outside Board and Committee meetings.

The Board delegates responsibility to the Group Chief Executive Officer for management of the business on a day to day basis.

Committees

The Board is supported by several committees which meet regularly to consider the audit and risk management processes, investments, remuneration and other matters. The main committees of the Board were the Audit and Risk Committee, the Investment Committee and the Remuneration Committee. Committees operate under a written charter approved by the Board. Any non-executive director may attend a committee meeting. The committees have free and unfettered access to QBE's senior managers during their meetings and may consult external advisers at QBE's cost, including requiring their attendance at committee meetings. Committee membership is reviewed regularly. The Chairman of the Remuneration Committee changed in October 2012 following Mr Bleasel's retirement.

In addition, the Board has established for 2013 a Risk and Capital Committee to replace the previous Funding Committee. Both of these committees comprise Mr JM Green (Chairman), Mr JA Graf, Ms BJ Hutchinson AM and Ms IYL Lee. This new committee will usually meet four times a year.

As a consequence, in 2013, the Audit and Risk Committee will become the Audit Committee.

A report on each committee's last meeting is provided to the next Board meeting. The Company Secretary acts as secretary to all committees. Details of directors' attendance at board and committee meetings are outlined in the table of meeting attendance set out in the directors' report on page 82.

Delegated authorities

QBE has operated under an extensive written system of delegated authorities for many years. In particular, a written delegated authority with specified limits is approved by the Board each year to enable the Group Chief Executive Officer to conduct the Group's business in accordance with detailed budgets and business plans. This authority deals with topics such as underwriting, reinsurance protection, claims, investments, acquisitions and expenses. The Group Chief Executive Officer delegates his authority to management throughout the Group on a selective basis taking into account expertise and past performance. Compliance with delegated authorities is closely monitored by management and adjusted as required for actual performance, market conditions and other factors. Management and the Group's internal audit teams review compliance with delegated authorities and any breach can lead to disciplinary procedures, including dismissal in serious cases.

Evaluating senior executives

The Remuneration Committee receives information on the performance of the Group Executive, being the senior executives as defined by the ASX CGC (namely those employees who have the opportunity to materially influence the integrity, strategy, operation and financial performance of the QBE Group).

A performance development plan (PDP) involves a meeting between the relevant member of the Group Executive, the Group Chief Executive Officer and the Group Executive Officer, People and Communications to:

- review past performance;
- discuss career opportunities; and
- consider areas of further development.

PDPs occur periodically in accordance with the process above, and several took place in 2012. In addition, the Board continually monitors the performance of the Group Executive through regular contact and reporting.

ASX CGC principle 2: structure the Board to add value

Board of directors

Directors are selected to achieve a broad range of skills, experience and expertise complementary to the Group's insurance activities. Details of individual directors are included on pages 70 and 71 and can also be found on the QBE website at www.qbe.com. The Board currently comprises eight directors including an independent Chairman, the Group Chief Executive Officer and six independent non-executive directors applying the "independence" definition of the ASX CGC. Applying this definition, the Board has determined that a non-executive director's relationship with QBE as a professional adviser, consultant, supplier, customer or otherwise is not material unless amounts paid under that relationship exceed 0.1% of revenue.

The roles of Chairman and Group Chief Executive Officer are not exercised by the same individual.

The period for which a director has served on a board is not part of the ASX CGC's independence definition. Nevertheless, as a general guide, the Board has agreed that a non-executive director's term should be approximately 10 years. The Board considers that a mandatory limit on tenure would deprive the Group of valuable and relevant corporate experience in the complex world of international general insurance and reinsurance. Ms BJ Hutchinson AM has been a non-executive director since September 1997 and Chairman since July 2010. She was re-elected as a director at the 2012 AGM. QBE's other directors believe that Ms Hutchinson AM continues to exercise independent judgment and, through her QBE experience, makes an important contribution. They also believe that the Chairman's experience gained from directorships in other businesses provides an advantage to QBE.

Similar reasons apply to Mr CLA Irby and Ms IYL Lee who joined the Board in June 2001 and May 2002 respectively. Mr Irby was re-elected as a director at the 2011 AGM, while Ms Lee was re-elected at the 2012 AGM. Mr Irby will retire from the Board on 31 March 2013.

The Chairman oversees the performance of the Board, its committees and each director. The Board regularly reviews its performance. The Chairman reports the overall result to the Board and it is discussed by all directors. Recommendations for either improvement or increased focus are agreed and then implemented. For the first time, the board review procedure was facilitated by an independent consultant. The procedure included written answers and questions completed confidentially by each director, the Group Executive and QBE's company secretaries together with interviews. The consultant discussed her findings with the Chairman and Group Chief Executive Officer and then with the Board as a whole. Recommendations for either improved or increased focus were agreed and are being implemented. This review procedure is a precursor to other directors determining whether to support, via the notice of meeting, a non-executive director for re-election at an AGM. The last board review was completed in accordance with the process above in February 2013, ahead of nominating Mr JA Graf for election and Messrs DM Boyle and JM Green for re-election at the 2013 AGM. The last board review included the Audit and Risk, Investment and Remuneration Committees as the main committees of the Board. The review concluded that each committee was operating soundly and meeting the terms of its charter.

QBE's constitution provides that no director, except the Group Chief Executive Officer, shall hold office for a continuous period in excess of three years or past the third AGM following a director's appointment, whichever is the longer, without submission for re-election at the next AGM. Under QBE's constitution, there is no maximum fixed term or retirement age for non-executive directors.

Directors advise the Board on an ongoing basis of any interest they have that they believe could conflict with QBE's interests. If a potential conflict does arise, either the director concerned may choose not to, or the Board may decide that he or she should not, receive documents or take part in board discussions whilst the matter is being considered.

Board selection process

The Board believes that its composition, including selection, appointment, renewal and retirement of members, is of such importance that it is the role of the Board as a whole to review. As a result, all directors are members of the nomination committee.

The Board believes that orderly succession and renewal contributes to strong corporate governance and is achieved by careful planning and continual review. Directors consider the size and composition of the Board regularly and at least once a year as part of the board review procedure. The Board has a skills matrix covering the competencies and experience of each member. When the need for a new director is identified, the required experience and competencies of the new director are defined in the context of this matrix and any gaps that may exist. Generally a list of potential candidates is identified based on these skills required and other issues such as geographic location and diversity criteria. External consultants may be employed where necessary to search for prospective board members. Candidates are assessed against the required skills and on their qualifications, backgrounds and personal qualities. In addition, candidates are sought who have insurance experience, a proven track record in creating shareholder value, utmost integrity, a commitment to corporate governance, the required time to commit to the position, a strategic mindset, a preparedness to constructively question and challenge and an independence of mind. The Board has adopted non-executive director nomination guidelines.

During the year, Mr LF Bleasel AM retired as a director, Mr JA Graf was appointed as a director, Mr FM O'Halloran retired as Group Chief Executive Officer and Mr JD Neal succeeded him.

ASX CGC principle 3: promote ethical and responsible decision making

Group guidelines

The Group has adopted a code of conduct for Australian Operations, Group head office and Group Investment division which forms the basis for the manner in which these employees perform their work involving both legal obligations and the reasonable expectations of stakeholders. The code of conduct requires that business be carried out in an open and honest manner with our customers, shareholders, employees, regulatory bodies, outside suppliers, intermediaries and the community at large. The code also deals with confidentiality, conflicts of interest and related matters. The non-executive directors have adopted a code of conduct for themselves which is substantially the same as the code above.

Other divisions have developed codes of conduct based on the Group code above, with some differences to allow for the requirements of the particular countries in which the division operates.

There are other Group policies covering anti-discrimination, employment, harassment, QBE values and behaviours, health and safety, privacy, whistle-blowing and many other business practices. These policies, like the code of conduct, are underpinned by the Group's vision and values statements. The vision and values statements form part of the induction information given to new employees.

QBE in Australia follows the general insurance code of practice, a self-regulated code developed by the Insurance Council of Australia (ICA) relating to the provision of products and services to customers of the general insurance industry in Australia. A revised code of practice commenced in July 2012. The code is currently being reviewed by an independent consultant for the ICA. The consultant's recommendations are expected by mid 2013.

QBE in Australia is a member of the Financial Ombudsman Service, an Australian Securities and Investment Commission (ASIC) approved external dispute resolution body which deals with general insurance disputes between consumers and insurers.

Corporate governance statement CONTINUED

Similar insurance practice rules apply to the Group in certain other countries outside Australia.

Details of indemnification and insurance arrangements are included in the directors' report on page 81.

The following documents are available either in the corporate governance area of QBE's website or on request from a company secretary:

- board charter;
- role of non-executive directors;
- Audit, Investment, Remuneration and Risk and Capital Committee charters;
- non-executive director nomination guidelines;
- code of conduct for non-executive directors;
- code of conduct for Australian Operations, Group head office and Group Investment division;
- trading policy for dealing in securities of QBE Insurance Group Limited or other entities by directors and senior Group executives;
- workforce diversity policy;
- continuous disclosure guidelines;
- shareholder communication guidelines; and
- QBE's constitution.

Diversity

The Group aims to create a workplace that is fair and inclusive in order to attract and retain the best people to do the job. QBE in Australia has been assessed as compliant with the Workplace Gender Equity Act (for locally-based employees) for 2012.

In 2010, QBE considered changes to the ASX CGC's Principles and Recommendations with regard to gender diversity. These changes were integrated into the workforce diversity policy that was first approved by the Remuneration Committee in December 2010 under its charter from the Board. The policy has been communicated to employees across the Group to promote awareness and proactive management practices regarding workplace diversity and inclusion. The Group embraces diversity, including differences in ethnic background, gender, age, sexual orientation, religion and disability.

Divisional CEOs manage divisional diversity and inclusion plans aligned to the objectives in this policy.

Specific objectives include:

- reasonable participation of women in senior leadership roles;
- participation of women in accelerated talent programs that provide development focused on attainment of leadership roles;
- regular monitoring and management of pay equity between women and men within job families in each region;
- improved awareness of options for flexible working arrangements and family support programs available in each region; and
- availability of employee education specific to the benefits of work force diversity and manager education, focusing on work force diversity management, including role redesign to encourage flexible working arrangements.

In order to make diversity and inclusion integral to the culture of QBE, QBE has established a Group Workforce Diversity Committee which is responsible for reviewing and making recommendations to the Remuneration Committee on the Group's workforce diversity and inclusion practices and objectives. The Remuneration Committee monitors progress of the Workforce Diversity Committee. Most recently, the committee suggested actively promoting flexible work arrangements around the Group. This activity yielded global flexible work principles communicated by the Group Chief Executive Officer to employees in 2012 and a goal to launch formal flexible work policies in Group head office and all divisions during 2013.

Diversity measurement

QBE is committed to creating a culture of diversity and inclusion around the Group. To ensure this expectation is consistently met, measurable objectives for fostering inclusive, diverse workgroups have been added to performance objectives to people leaders at the top three levels of the organisation.

Additionally, QBE has set specific targets to ensure gender diversity across the Group. The Remuneration Committee in December 2010 set a target for 25% of all senior head office roles and 20% of all senior roles within the divisions to be held by females by December 2012. A summary of women's roles at QBE is provided below:

DIVERSITY OBJECTIVE	31 DECEMBER 2012	31 DECEMBER 2011
Women in workforce	**56%**	57%
Group Board positions	**37.5%**	37.5%
Executive positions	**9%**	7%
Senior executive positions (Group head office)	**24%**	17%
Senior executive positions (divisions)	**19%**	17%

QBE is considering restating its targets of improving the number of women in senior executive positions now that the targets are close to being achieved. When the diversity targets were initially established, the focus was on gender; as we look forward, the organisation is also considering how to widen the diversity agenda throughout QBE.

Insurance and other regulation

General insurance and, to a lesser extent, reinsurance are heavily regulated industries. In addition to accounting, legal, tax and other professional teams, QBE has personnel who focus on regulatory matters. Regulators in Australia include ASIC, the Australian Competition and Consumer Commission, APRA, the Australian Privacy Commissioner and relevant state authorities for compulsory third party motor insurance and workers' compensation insurance. These regulatory bodies enforce laws which deal with a range of issues, including capital requirements and consumer protection. Similar local laws and regulations apply to the Group's operations outside Australia.

Share trading policy

QBE revised its policy in 2013 for directors and senior Group executives relating to the purchase and sale of QBE securities. This is in addition to the insider trading provisions of the *Corporations Act 2001*. In particular, the policy states that directors and senior Group executives should:

- never actively trade the company's securities;
- not hedge unvested entitlements as well as not hedge vested entitlements counting towards an executive's minimum shareholding requirement; and
- notify any intended transaction to nominated people within the Group, including notification of any hedging.

QBE will disclose any hedging in the remuneration report.

The policy identifies set periods during which directors or senior Group executives may buy or sell QBE's securities, being one to 30 days after each of the release of QBE's half year results, the release of QBE's annual report and the date of the AGM, and also one day after the issue of any prospectus until the closing date. Any QBE share dealings by directors are promptly notified to the ASX.

ASX CGC principle 4: safeguard integrity in financial reporting

Audit Committee

The membership of the Audit Committee may only comprise non-executive directors. This committee normally meets four times a year. The Chairman must be a non-executive director who is not the Chairman of the Board. The current members are Mr DM Boyle (Chairman), Mr JA Graf, Ms IF Hudson, Ms BJ Hutchinson AM and Ms IYL Lee.

The role of the Audit Committee is to oversee the credibility of QBE's financial reporting process. This includes review of:

- the financial reporting to APRA, ASIC, the ASX and shareholders;
- financial reporting risks;
- the Group's accounting policies, practices and disclosures; and
- the scope and outcome of external and internal audits.

This committee's scope includes reviewing the financial statements (including items such as the outstanding claims provision, and reinsurance recoveries), internal controls, financial reporting, tax compliance and significant changes in accounting policies.

Other non-executive directors normally attend Audit Committee meetings which consider the 30 June and 31 December financial reports. Meetings of this committee usually include, by invitation, the Group Chief Executive Officer, the Group Chief Financial Officer, the Group Chief Actuary, the Group Chief Risk Officer, the Group Head of Internal Audit and the external auditor. As appropriate, other relevant senior managers also attend.

The Audit Committee has free and unfettered access to the external auditor. The external auditor, the Group Head of Internal Audit and the Group Chief Actuary have free and unfettered access to this committee.

External auditor independence

QBE firmly believes that the external auditor must be, and must be seen to be, independent. The external auditor confirms its independence in relation to the 30 June and 31 December financial reports and the Audit Committee confirms this by separate enquiry. The Audit Committee has contact with the external auditor in the absence of management in relation to the 30 June and 31 December financial reports and otherwise as required. The external auditor normally confers with the Audit Committee in the absence of management as part of each meeting.

QBE has issued an internal guideline on external auditor independence. Under this guideline, the external auditor is not allowed to provide the excluded services of preparing accounting records, financial reports or asset or liability valuations. Furthermore, it cannot act in a management capacity, as a custodian of assets or as share registrar.

The Board believes some non-audit services are appropriate given the external auditor's knowledge of the Group. QBE may engage the external auditor for non-audit services other than excluded services subject to the general principle that fees for non-audit services should not exceed 50% of all fees paid to the external auditor in any one financial year. External tax services are generally provided by an accounting firm other than the external auditor.

The external auditor has been QBE's auditor for many years. As a diverse international group, QBE requires the services of one of a limited number of international accounting firms to act as auditor. It is the practice of QBE to review from time to time the role of the external auditor. The *Corporations Act 2001*, Australian professional auditing standards and the external auditor's own policy deal with rotation and require rotation of the lead engagement partner after five years. In accordance with such policy, the lead engagement partner of the external auditor rotated in 2009 and will again in 2014.

Actuarial review

It is a longstanding practice of the directors to ensure that the Group's insurance liabilities are assessed by actuaries. The Group's outstanding claims provision is reviewed by experienced internal actuarial staff. Actuarial staff are involved in forming an independent view, separate from management, of the central estimate and the probability of adequacy of the outstanding claims provision and premium liabilities, premium rates and related matters. Around 96% of QBE's central estimate is also reviewed by external actuaries. External actuaries are generally from organisations which are not associated with the external auditor.

CEO/CFO certificates

The Group Chief Executive Officer and Group Chief Financial Officer provide the Board with certificates in relation to risk management and internal control as recommended by the ASX CGC and on the financial reports as required by the *Corporations Act 2001*.

Internal audit

A global internal audit function is critical to the risk management process. QBE's internal audit function reports to senior management and the Audit Committee on the monitoring of the Group's worldwide operations. Internal audit provides independent assurance that the design and operation of the controls across the Group are effective. The internal audit function operates under a written charter from the Audit Committee. Other governance documents include a reporting protocol, internal audit manual, internal audit issue rating system, internal audit opinion levels and internal audit timetables. A risk-based internal audit approach is used so that higher risk activities are reviewed more frequently. The Group's internal audit teams work together with the external auditor to provide a wide audit scope.

Investment Committee

The membership of the Investment Committee may only comprise non-executive directors. The Investment Committee normally meets four times a year. The Chairman must be a non-executive director who is not the Chairman of the Board. The current members are Ms IYL Lee (Chairman), Mr JA Graf, Mr JM Green, Mr CLA Irby and Ms BJ Hutchinson AM. Meetings of the Investment Committee usually include, by invitation, the Group Chief Executive Officer, the Group Chief Investment Officer and the Group Chief Financial Officer. As appropriate, other relevant senior managers also attend.

The role of the Investment Committee is to oversee QBE's investment activities. This includes review of:

- investment objectives and strategy;
- investment risk management;
- currency, equity and fixed interest exposure limits;
- credit exposure limits with financial counterparties; and
- Group treasury.

The Investment Committee's scope includes review of economic and investment conditions as they relate to QBE and overseeing investment performance, including the performance of any defined benefit superannuation funds sponsored by QBE.

Corporate governance statement CONTINUED

ASX CGC principle 5: make timely and balanced disclosure

Continuous disclosure

ASX Listing Rule 3.1 requires QBE to inform the ASX immediately once QBE is or becomes aware of any information concerning it that a reasonable person would expect to have a material effect on the price or value of QBE's shares. Procedures are in place to ensure that items which potentially require announcement to the ASX are promptly notified to Group head office for assessment and released as required. Depending upon content, either the Board or the Group Chief Executive Officer is responsible for authorising market releases. All market releases are posted promptly to the Group's website.

QBE takes the spirit of its continuous disclosure obligations very seriously and issues frequent market releases during the year to satisfy those obligations. A list of the material releases made since 1 January 2012 is included on page 180.

ASX CGC principle 6: respect the rights of shareholders

Communication with shareholders

The *Corporations Act 2001* no longer requires QBE to distribute an annual report to all shareholders except to those who elect to receive it. QBE also produces a half year report which is sent to all shareholders who elect to receive it. Both reports are available on the QBE website. The website also contains historical and other details on the Group. Shareholders can discuss their shareholding with either the shareholder services department or the share registrar, both located in Sydney.

The AGM is held in Sydney each year, usually in April; however, in 2013, it will be held on 27 March. Shareholders are encouraged to attend the AGM in person or by proxy. Most resolutions in the notice of meeting have explanatory notes. During the AGM, shareholders may ask questions of either the Chairman or the external auditor.

Communications with analysts, investors, media, rating agencies and others

The Group Chief Executive Officer, Group Chief Financial Officer, Group Chief Risk Officer, General Counsel and Company Secretary, Head of Investor Relations, divisional chief executives and divisional finance officers generally deal with analysts, investors, media, rating agencies and others, taking account of regulatory guidelines including those issued by the ASX on continuous disclosure. The presentations on the 30 June and 31 December results and other major presentations are sent to the ASX before the presentations commence and are available promptly on the Group's website. The 30 June and 31 December presentations are also webcast live and subsequently archived on the Group's website.

ASX CGC principle 7: recognise and manage risk

Risk management

QBE's core business is the underwriting of risk. The Group's successful performance over many years clearly establishes its substantial risk management credentials.

It is QBE's policy to adopt a rigorous approach to managing risk throughout the Group. Risk management is a continuous process and an integral part of quality business management. QBE's approach is to integrate risk management into the broader management processes of the organisation. It is QBE's philosophy to ensure that risk management remains embedded in the business and that the risk makers or risk takers are themselves the risk managers.

Diversification is used as a tool to reduce the Group's overall insurance risk profile by spreading exposures, thereby reducing the volatility of results. QBE's approach is to diversify insurance risk, both by product and geographically. Product diversification is achieved through a strategy of developing strong underwriting skills in a wide variety of classes of business. A combination of core and speciality products under the control of proven employees skilled in such products allows QBE to lead underwrite in many of the markets in which we operate. Geographic diversification is achieved by operating in 48 countries.

QBE has a global risk management framework that defines the risks that QBE is in business to accept and those that we are not, together with the material business risks that QBE needs to manage and the framework and standards of control that are needed to manage those risks.

The foundation of our risk management is the obligation and desire to manage our future and create wealth for our shareholders by maximising profitable opportunities through:

- achieving competitive advantage through better understanding of the risk environment in which we operate;
- optimising risk and more effectively allocating capital and resources by assessing the balance of risk and reward;
- adequate pricing of risk;
- avoiding unwelcome surprises by reducing uncertainty and volatility, such as by controlling aggregate exposures and maintaining sound reinsurance arrangements;
- complying with laws and internal procedures; and
- improving resilience to external events.

The Group has established internal controls to manage material business risks in the key areas of exposure relevant to QBE. The broad risk categories are strategic and business risk, insurance risk, credit risk, market risk, liquidity risk and operational risk. Internal controls and systems are designed to provide reasonable assurance that the assets of the Group are safeguarded, insurance and investment exposures are within desired limits, reinsurance protections are adequate, counterparties are subject to security assessment and foreign exchange exposures are within predetermined guidelines.

The Board approves a comprehensive risk management strategy (RMS) and reinsurance management strategy (REMS) annually, both of which are lodged with APRA. The RMS outlines the principles, framework and approach to risk management adopted by the Group, deals with all areas of significant business risk to the Group and outlines the Group's risk appetite. The REMS covers topics such as the Group's strategy in respect of the selection, approval and monitoring of all reinsurance arrangements. The Group's reinsurance management framework is made up of the Group Reinsurance Forum (determines risk appetite and reinsurance strategy), the Group Security Committee (assesses reinsurer counterparty security), the Group Aggregate Management Committee (monitors aggregate accumulation), the Group Technical Committee (controls the adequacy of reinsurance coverage) and finally the Group Commutations Committee (facilitates Group commutation opportunities). The committees meet regularly throughout the year and report as required to the Group Reinsurance Forum.

While the RMS and REMS are approved by the Board, QBE believes that managing risk is the day to day responsibility of the Group head office and the business units, and that all staff need to understand and actively manage risk. The business units are supported by risk management teams, compliance teams and by senior management. Further information on risk management is provided on pages 66 to 69 of the annual report and in note 5 to the financial statements.

Management has reported to either the former Audit and Risk Committee (and will report to the Risk and Capital Committee or the Board on the effectiveness of QBE's management of its material business risks.

Environmental risk management

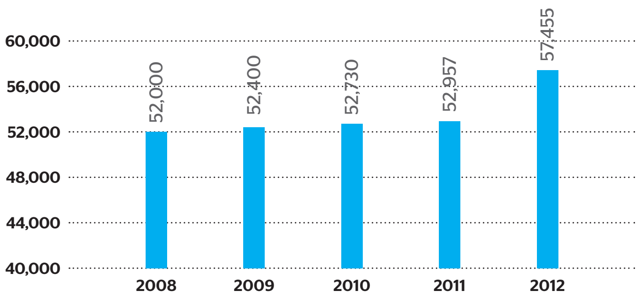
QBE is a corporation involved in an industry that seeks to play a role, in conjunction with governments, individuals and organisations, in managing and reducing environmental risk. In an initiative to collaborate with the United Nations Environment Program, QBE, together with a number of other major international insurers, is a signatory to a statement of environmental commitment by the insurance industry.

The Group Chief Risk Officer is responsible for monitoring and managing ongoing risks and opportunities relating to climate change in order to mitigate any adverse effect on QBE's businesses and to protect shareholders' funds. Reports have been provided to the former Audit and Risk Committee.

Measurement of the Group's environmental impact to date has focused on two key carbon emission metrics, being business air travel and electricity usage. Based on these key metrics, the Group's estimated carbon emissions (CO2e) for 2012 were 57,455 tonnes (2011 52,957 tonnes), an increase of 8.5%. This can be summarised as:

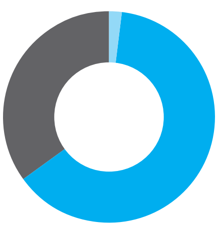
- 1,160 tonnes of scope 1 direct greenhouse emissions due to natural gas and oil consumption used for heating (2011 1,306 tonnes);
- 36,396 tonnes of scope 2 indirect greenhouse emissions from electricity consumption (2011 36,541 tonnes); and
- 19,899 tonnes of scope 3 other indirect greenhouse emissions, defined as emissions relating to travel (2011 15,110 tonnes).

Group carbon emissions (CO2e) (tonnes)



8.5%

Carbon emissions by scope



Scope 1 1,160 tonnes 2%
Direct greenhouse emissions due to natural gas and oil consumption used for heating

Scope 2 36,396 tonnes 63%
Indirect greenhouse emissions from electricity consumption

Scope 3 19,899 tonnes 35%
Indirect greenhouse emissions defined as emissions relating to travel

QBE is a participant in the annual Carbon Disclosure Project (CDP) survey. The CDP is an independent, not-for-profit organisation which acts as an intermediary between shareholders and corporations on all climate change related issues, providing climate change data from the world's largest corporations to the global market place.

QBE's response to the latest CDP questionnaire, CDP2012, was published in October 2012 and is available on our website in the investor information section.

ASX CGC principle 8: remunerate fairly and responsibly

Remuneration Committee

The membership of the Remuneration Committee may only comprise non-executive directors. The Remuneration Committee normally meets four times a year. The Chairman must be a non-executive director who is not the Chairman of the Board. The current members are Ms IF Hudson (Chairman), Mr DM Boyle, Mr JM Green and Ms BJ Hutchinson AM. Meetings of the Remuneration Committee usually include, by invitation, the Group Chief Executive Officer and the Group Executive Officer, People and Communications.

QBE's governance of remuneration focuses on aligning the remuneration and reward strategy and frameworks with robust risk management practices and strong governance principles.

The role of the Remuneration Committee is to oversee QBE's major remuneration practices. The Remuneration Committee, in particular, assesses the appropriateness of remuneration frameworks and practices in order to fairly and responsibly reward the Group Chief Executive Officer and other members of the Group Executive. The Remuneration Committee ensures rewards are commensurate with performance and that remuneration levels are competitive in the various markets in which QBE operates. The Remuneration Committee has access to detailed external research from independent consultants.

The Remuneration Committee's scope includes:

- recommendations on the total remuneration (fixed and at-risk) of the Group Chief Executive Officer and executives reporting to him;
- review of short-term and deferred incentives such as equity-based plans;
- review of superannuation;
- review of performance measurement criteria, succession plans and other major human resource practices;
- monitoring of PDPs for the Group Executive and other senior positions;
- recommendations on non-executive director remuneration to the Board;
- review of reward structures (including incentive schemes) for employees of APRA regulated entities (such as risk and financial control employees) in accordance with the requirements of APRA prudential standards relating to the governance of remuneration; and
- review of workplace diversity.

The Remuneration Committee recognises that the key to achieving sustained performance is to motivate and retain quality employees and align executive reward with changing shareholder wealth. The Remuneration Committee has the discretion to reduce deferred equity awards to the Group Executive where financial results subsequently deteriorate.

QBE has operations and staff in 48 countries with differing laws and customs. QBE's remuneration policy therefore reflects the fact that QBE is a global organisation, whilst also taking into account local remuneration levels and practices.

Details of remuneration

Details of remuneration of executives and non-executive directors, such as employee entitlements under the Employee Share and Option Plan, deferred equity awards and superannuation are included in the remuneration report on pages 84 to 104 and in notes 30 and 31 to the financial statements.

Directors' report

FOR THE YEAR ENDED 31 DECEMBER 2012

Your directors present their report on QBE Insurance Group Limited and the entities it controlled at the end of or during the year ended 31 December 2012.

Directors

The following directors held office during the whole of the financial year and up to the date of this report:

DM Boyle
JM Green
IF Hudson
BJ Hutchinson AM (Chairman)
CLA Irby
IYL Lee

Mr JD Neal was appointed as a director on 17 August 2012.

Mr JA Graf was appointed as a director on 20 August 2012.

Mr FM O'Halloran was a director from the beginning of the financial year until his retirement on 17 August 2012.

Mr LF Bleasel AM was a director from the beginning of the financial year until his retirement on 30 September 2012.

At the 2013 annual general meeting (AGM), Messrs Boyle and Green will retire by rotation and offer themselves for re-election and Mr Graf will offer himself for election.

Details of the directors and their qualifications are provided on pages 70 and 71.

Consolidated results

	2012 US$M	2011 US$M
Gross written premium	**18,434**	18,291
Unearned premium movement	**(93)**	(451)
Gross earned premium revenue	**18,341**	17,840
Outward reinsurance premium	**(2,360)**	(2,592)
Deferred reinsurance premium movement	**(183)**	111
Outward reinsurance premium expense	**(2,543)**	(2,481)
Net earned premium	**15,798**	15,359
Net claims incurred	**(10,428)**	(10,466)
Net commission	**(2,560)**	(2,291)
Underwriting and other expenses	**(2,357)**	(2,108)
Underwriting result	**453**	494
Net investment income on policyholders' funds	**809**	591
Insurance profit	**1,262**	1,085
Net investment income on shareholders' funds	**407**	185
Financing and other costs	**(324)**	(275)
Share of net profits of associates	**3**	6
Amortisation of intangibles and impairment of goodwill/intangibles	**(407)**	(133)
Profit before income tax	**941**	868
Income tax expense	**(161)**	(149)
Profit after income tax	**780**	719
Net profit attributable to non-controlling interests	**(19)**	(15)
Net profit after income tax	**761**	704

Profit

Net profit after income tax for the year ended 31 December 2012 was $761 million, up 8% from $704 million last year. The underwriting result decreased by 8%, mainly due to an increase in the commission and expense ratio, which was partly offset by the lower net claims ratio. Net profit after tax benefited from stronger investment income due to an increase in realised and unrealised gains on our fixed interest and equity portfolios. Net profit after tax was impacted by an increase of $274 million in the amortisation and impairment of intangibles following our detailed review of the carrying values of intangible assets at the balance date. Details are provided in note 19 to the financial statements.

Dividends

The directors announce a final dividend of 10 Australian cents per share, down from 25 Australian cents per share last year. The dividend will be franked at 100%. The total dividend payout is A$593 million compared with A$956 million in 2011. The bonus share and dividend reinvestment plans continue with a discount of 1.5%.

Activities

The principal activities of QBE during the year were underwriting general insurance and reinsurance risks, management of Lloyd's syndicates and investment management.

Presentation currency

The Group has presented this financial report in US dollars, consistent with our reporting in 2011. The US dollar is considered to be more relevant for measuring performance given that over 50% of annualised gross written premium is derived in US dollars.

Operating and financial review

Information on the operations (including the results of those operations) and financial position of the Group is set on pages 9 to 63 of this annual report. These pages also deal with the Group's business strategies and prospects for future financial years.

Further information on the Group's business strategies and prospects for future financial years has not been included in this annual report because the directors believe it would be likely to result in unreasonable prejudice to the Group.

Outstanding claims provision

The net central estimate of outstanding claims is determined by the Group Chief Actuary after consultation with internal and external actuaries. The assessment takes into account the statistical analysis of past claims, allowance for claims incurred but not reported, reinsurance and other recoveries, future interest and inflation factors.

As in previous years, the directors consider that substantial risk margins are required over the actuarial central estimate to mitigate the potential for uncertainty in the central estimate. The probability of adequacy of the outstanding claims provision at 31 December 2012 was 87.5% compared with 86.3% last year. The APRA prudential standards provide a capital credit for outstanding claims in excess of a probability of adequacy of 75%.

Group indemnities

Article 115 of the company's constitution provides that the company indemnifies past and present directors, secretaries or other officers against any liability incurred by that person as a director, secretary or other officer of the company or its controlled entities. The indemnity does not apply to any liability (excluding legal costs):

- owed to the company or its controlled entities (e.g. breach of directors' duties);
- for a pecuniary penalty or compensation order under the *Corporations Act 2001*; or
- which did not arise out of conduct in good faith.

The indemnity extends to legal costs other than where:

- in civil proceedings, an exclusion above applies;
- in criminal proceedings, the person is found guilty;
- the person is liable for civil remedies in proceedings brought by the Australian Securities and Investments Commission, a corresponding regulator in another jurisdiction or a liquidator (unless as part of the investigation before proceedings are commenced); or
- the court does not grant relief after an application under the *Corporations Act 2001* or corresponding legislation in another jurisdiction that the person acted honestly and having regard to all the circumstances ought fairly to be excused for negligence, default, breach of trust or breach of duty in civil proceedings.

During the year, a deed of access and indemnity was entered into with Mr Graf.

Directors' and officers' insurance

QBE pays a premium each year in respect of a contract insuring directors, secretaries, senior managers and employees of the Group together with any natural person who is either a trustee or a member of a policy committee for a superannuation plan established for the benefit of the Group's employees against liabilities past, present or future. The officers of the Group covered by the insurance contract include the directors listed on pages 70 and 71, the secretary, DA Ramsay, and deputy secretary, P Smiles.

In accordance with normal commercial practice, disclosure of the amount of premium payable under, and the nature of liabilities covered by, the insurance contract is prohibited by a confidentiality clause in the contract.

No such insurance cover has been provided for the benefit of any external auditor of the Group.

Significant changes

There were no significant changes in the Group's state of affairs during the financial year.

Likely developments and expected results of operations

Likely developments in the Group's operations in future financial years and the expected results of those operations have been included in the review of operations on pages 9 to 63 of this annual report.

Further information on likely developments in the operations of the Group and the expected results of operations has not been included in this annual report because the directors believe it would be likely to result in unreasonable prejudice to the Group.

Environmental regulation

The Group's operations are not subject to any significant environmental regulations under either Commonwealth, State or Territory legislation.

Directors' report CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2012

Meetings of directors

	FULL MEETINGS OF DIRECTORS[1]	MEETINGS OF NON-EXECUTIVE DIRECTORS	MEETINGS OF COMMITTEES			
			AUDIT AND RISK	FUNDING[2]	INVESTMENT	REMUNERATION
Number of meetings held	10	9	4	2	4	4
Number attended						
LF Bleasel AM	8	7	3	–	–	2
DM Boyle	10	9	4	–	–	4
JA Graf	3	3	1	1	2	–
JM Green	10	9	–	2	4	4
IF Hudson	10	9	4	–	–	4
BJ Hutchinson AM	10	9	4	2	4	4
CLA Irby	9	9	–	–	3	–
IYL Lee	10	9	4	2	3	–
JD Neal[3,4]	3	–	–	1	2	–
FM O'Halloran[5]	7	–	–	1	2	–

1 Included a one day review meeting in Hong Kong and a five day review meeting in the UK and the US.
2 Reconstituted as the Risk and Capital Committee in 2013.
3 Mr Neal attended Audit and Risk and Remuneration Committee meetings by invitation, not being a member of these committees.
4 Similar to other committees, Mr Neal is no longer a member of the Investment Committee from 2013, although he will attend meetings by invitation.
5 Mr O'Halloran attended Audit and Risk and Remuneration Committee meetings by invitation, not being a member of these committees.

During the April, May and June board meetings in 2012, the Board also met as the nomination committee. Further meetings occurred during the year, including meetings of the Chairman and Group Chief Executive Officer and meetings of the directors with management. From time to time, directors attend meetings of committees of which they are not currently members.

Directorships of listed companies held by the members of the Board

From 1 January 2010 to 26 February 2013, the directors also served as directors of the following listed entities:

	POSITION	DATE APPOINTED	DATE CEASED
DM Boyle			
Stockland Trust Group	Director	7 August 2007	–
JM Green			
WorleyParsons Limited	Director	11 October 2002	–
IF Hudson			
Phoenix Group Holdings plc	Director	18 February 2010	–
BJ Hutchinson AM			
AGL Energy Limited	Director	22 December 2010	–
CLA Irby			
Great Portland Estates plc	Director	1 April 2004	–
North Atlantic Smaller Companies Investment Trust plc	Director	10 December 2002	–
IYL Lee			
Cathay Pacific Airways Limited	Director	13 January 2010	–
CLP Holdings Limited	Director	15 October 2012	–
Hysan Development Company Limited	Chairman[1]	9 March 2011	–
Keybridge Capital Limited	Chairman	26 October 2006	4 April 2012
Noble Group Limited	Director	1 March 2012	–

1 Ms Lee became non-executive chairman in May 2011 and executive chairman in March 2012.

Qualifications and experience of company secretaries

DA Ramsay B COMM, LLB, LLM, ANZIIF(FELLOW), FCIS

Mr Ramsay is General Counsel and Company Secretary of QBE Insurance Group Limited. His legal career commenced in March 1986 with Freehills, where he worked in the general commercial and litigation areas. In June 1993, he joined QBE as General Counsel. Since May 2001, he has acted as General Counsel and Company Secretary for the Group. He is also a director or secretary of a number of QBE controlled entities and acts as chairman of the policy committee for, and a trustee of, QBE sponsored superannuation plans in Australia and New Zealand respectively.

P Smiles LLB, MBA, ACIS

Mr Smiles is Deputy Company Secretary of QBE Insurance Group Limited and a company secretary of various QBE subsidiaries in Australia. He has 21 years insurance experience, which includes 16 years as a corporate lawyer. Prior to commencing employment with QBE in 2002, Mr Smiles worked for the NRMA Insurance Group in various corporate roles. In addition to his current company secretarial duties, he acts as a corporate lawyer advising QBE Group head office departments and Asia Pacific offices.

Directors' interests and benefits

(A) Ordinary share capital

Directors' relevant interests in the ordinary share capital of the company at the date of this report are as follows:

DIRECTOR	2012 NUMBER	2011 NUMBER
DM Boyle	**19,019**	17,617
JA Graf	**15,100**	–
JM Green	**37,258**	35,856
IF Hudson	**11,737**	11,737
BJ Hutchinson AM	**105,148**	94,646
CLA Irby	**22,889**	22,889
IYL Lee	**26,749**	26,749
JD Neal	**138,258**	52,382

(B) Options and conditional rights

At the date of this report, Mr Neal had 136,763 (2011 187,322) options over ordinary shares of the company and 283,338 (2011 217,895) conditional rights to ordinary shares of the company. Details of the schemes under which these options and rights are granted are provided in the remuneration report and in note 30 to the financial statements.

The names of all persons who currently hold options granted under the Employee Share and Option Plan (the Plan) and conditional rights to ordinary shares of the company are entered in the registers kept by the company pursuant to section 168 of the *Corporations Act 2001* and the registers may be inspected free of charge.

(C) Loans to directors and executives

Information on loans to directors and executives are set out in note 31(C) to the financial statements.

(D) Related entity interests

Details of directors' and executives' interests with related entities are provided in note 31 to the financial statements.

Remuneration report

To our shareholders

Contents

As the recently appointed Chair of the Remuneration Committee, I am pleased to present the 2012 remuneration report. This report has been approved by the Board and is intended to present this complicated subject in as transparent and easily understood a manner as possible whilst complying with our statutory reporting obligations. The executive summary sets out key information, including a table of actual remuneration paid in 2012, information on performance hurdles in 2012 and the ROE hurdles agreed for 2013. I hope you find this both informative and helpful.

2012 performance

2012 was a disappointing year in terms of financial performance with an underwriting loss in our North American Operations and adverse claims development on prior accident years. As a result, the majority of executives and employees in North American Operations, Equator Re and Group head office received no or substantially reduced short-term incentives and deferred equity awards. These reduced payments reflect the "at risk" nature of our incentive arrangements.

There were no fundamental changes to our remuneration structure and arrangements during the year, and only modest salary increases in line with inflation. QBE sets itself challenging ROE hurdles for remuneration purposes compared with many of our peers. Annual incentive arrangements for 2012 were based on Group head office employees achieving ROE targets in the range of 12% - 19% and 10% - 28% for the divisions based on the capital allocated to those divisions. The Remuneration Committee reviewed the ROE hurdles for each division. As a result of this review, some were reduced to reflect the lower investment income environment in which we are now operating while others were increased to reflect the higher risk/reward equation of operating in certain regions. The ROE used for remuneration is calculated on a slightly different basis to our statutory numbers. The definition of ROE on a management basis is set out on page 103.

The Group ROE for remuneration purposes was 9.2%, below the minimum 12% ROE needed to trigger a short-term cash payment to Group head office employees. In previous years when interest rates were higher, the minimum ROE target was 14%.

With the exception of the disappointing results from our North American Operations and Equator Re, each division exceeded minimum ROE targets and therefore both short-term cash payments and deferred equity awards were made to those divisions.

The average cash award paid out for the current divisional executives was 55% of the maximum opportunity.

Grants under the 2012 LTI plan will be made in March 2013. Based on financial results to date, LTI awards granted in 2010 and 2011 are projected to pay out no more than 50% of the maximum award.

We believe that the remuneration outcomes for 2012 demonstrate that there is a close alignment of shareholders' interests and executive incentive rewards, with the executive only rewarded for the delivery of superior financial performance.

Arrangements for 2013

For 2013, the same remuneration framework will apply as in previous years, although the Group head office ROE hurdle will be reduced to a range of 9% – 16%, consistent with our business plans for 2013. This reflects a variety of market conditions, in particular the significant reduction in investment returns already referred to and which all insurers are experiencing. No changes are being made to divisional ROE targets but there will be a higher allocation of capital to the divisions, reflecting the more onerous regulatory and rating agency capital charges we are experiencing under our risk-based capital allocation model. This will make divisional ROE targets more challenging to achieve.

There are no planned changes to the deferred equity award or LTI plan for 2013.

The fees paid to the Chairman and the non-executive directors for 2013 will not increase. You will see that, at the forthcoming AGM, a resolution is proposed to increase the overall fee cap for the Board from A$2.7 million to A$3.3 million. This is to ensure that the Board has the flexibility to appoint additional non-executive directors during 2013, as appropriate, and to allow for fees to be paid to the new Risk and Capital Committee.

Executives have been awarded either zero (for the Group CEO and the President and Chief Executive Officer, North American Operations) or modest salary increases for 2013. The one exception is the Chief Executive Officer, Latin American Operations whose role has changed significantly as a result of the recent acquisitions in Argentina and Puerto Rico.

Looking beyond 2013, the Remuneration Committee has commissioned a comprehensive review of our remuneration arrangements. The appointment of a new Group CEO and the review of the Group's strategy make this an opportune time to review remuneration. The objective of this review is not to increase packages but to ensure that at-risk pay operates as intended, motivates our management while supporting our strategy and the creation of shareholder value, and has due regard to regulatory and other market developments.

I look forward to presenting the findings of that review to you in next year's report.

Change in key management personnel

Three executives, including the former Group CEO, Frank O'Halloran, left the Group in 2012. These departures were managed in line with the provisions set out in the relevant executive's employment contract and current termination benefits legislation in Australia.

We will be seeking shareholder approval at the 2013 AGM for the payment of a retirement allowance of A$2,340,000 gross (equal to one year's annual fixed remuneration) to Frank O'Halloran, together with the normal resolutions to approve his 2011 and 2012 LTI awards. The retirement allowance is a contractual obligation which has been disclosed previously in annual reports and was also set out in the ASX market release we made last August.

Summary

We remain confident that our approach to remuneration is in line with our business strategy and aims to ensure that we attract quality executives and adequately reward and incentivise our key personnel. I trust you will agree that the Remuneration Committee has acted responsibly in the steps it has taken on your behalf to align remuneration to the long-term success of all our shareholders.

Isabel Hudson
Chairman, Remuneration Committee

> **"We have taken some important steps to improve the transparency of our remuneration arrangements for you, our shareholders. I hope you find this both informative and helpful.**

Remuneration report CONTINUED

1. Executive summary

In line with our reporting obligations, this report provides significant detail on the remuneration structures and practices impacting the key management personnel (KMP) of the QBE Insurance Group. In 2012, KMP included the Group CEO, executives and non-executive directors.

QBE's remuneration strategy is to provide a market competitive remuneration structure that motivates and retains our executives while aligning their remuneration with the creation of sustained shareholder value. Our approach to achieving this is set out in detail in this report which describes the fixed remuneration paid, the short-term cash incentives, the three and five year deferred equity awards and the five year LTI plan. A detailed description of these schemes can be found on page 92.

Changes made to remuneration in 2012

QBE's longstanding ROE-based remuneration structure was maintained in 2012; however, the opportunity was taken to make some changes within this structure.

The Group head office ROE incentive scale for short-term cash payments was adjusted down from a range of 14% – 21% to 12% – 19%. This change was made to reflect a number of factors but, in particular, to reflect the lower investment income environment in which we are now operating.

Over the past four years, we have witnessed a significant reduction in investment yields, particularly for our cash and fixed interest portfolios. The low yields are expected to continue for the immediate future with a significant negative impact on the Group's reported profit and ROE.

The Remuneration Committee believes that, in the current operating environment, the 12% – 19% ROE scale remained a challenging target for management in 2012, both as an absolute target and relative to our peers.

Divisional ROE target ranges, which are based on allocated capital, remained the same in 2012 with the exception of:

- Australian Operations: maximum ROE target was reduced from 24% to 22% for the same reasons as Group head office.
- Asia Pacific Operations and Latin American Operations: maximum ROE target ranges were increased from 24% to 28% and 26% to 28% respectively to reflect the higher risk of operating in these regions.

Details of the ROE ranges for the divisions can be found on page 92.

Remuneration paid in 2012

As is clear elsewhere in this annual report, 2012 was a difficult year and produced a disappointing financial result.

We could highlight many factors which impacted our performance but, in particular, we continued to experience challenging economic conditions which impacted our investment income compared with previous years. We were hit by Superstorm Sandy which cost $335 million and we strengthened our claims provisions by $464 million due to adverse prior year claims development.

Against the background of these challenges, management has continued to focus on the underlying quality of our insurance business.

Short-term cash incentives and deferred equity awards

The Group ROE was 9.2%, below the minimum 12% ROE needed to trigger a short-term cash payment to Group head office executives. As a result, and for the second year running, no cash payments under our incentive plans were made for short-term performance to Group head office executives. As the three and five year deferred equity awards are contingent on the payment of a short-term incentive, there were, again for the second year running, no deferred equity awards for Group head office executives.

Each division has its own ROE targets which use a capital allocation based on the requirements for a Standard & Poor's A+ credit rating. With the exception of North American Operations and Equator Re, each division met or exceeded its minimum ROE target and therefore both short-term cash payments and deferred equity awards will be made. The disappointing outcome in North America resulted in a divisional ROE of 1.9%, well below the threshold of 15%, and no cash or deferred equity awards were made to the President and Chief Executive Officer, North American Operations.

The average cash award paid out for the current divisional CEOs was 55% of the maximum opportunity.

Long-term incentives

The five year long-term incentives awarded in 2010 and 2011 are currently projected to pay out no more than 50%. The 50% of the LTI which is based on diluted EPS increasing by a compound average of 7.5% per annum over five years is currently not being achieved; however, the 50% of the LTI award which is based on the Group's average ROE and COR for five years being in the top 10% of the 50 largest global insurers and reinsurers is being achieved, reflecting the competitive performance of the Group when measured against our peers.

> “QBE's remuneration strategy is to provide a market competitive remuneration structure that motivates and retains executives while aligning their remuneration with sustained shareholder value.

Actual remuneration outcomes in 2012

The table below sets out total remuneration realised by executives in office as at 31 December 2012, including the accrued QIS-cash award and deferred equity values vested during the financial year. The deferred equity value realised in the year has been determined based on the conditional rights and options that vested during 2012 by reference to the closing share price on the vesting date. Options vested were in accordance with the legacy 2006 LTI plan terms and conditional rights vested were in accordance with the legacy 2008 Deferred Compensation Plan (DCP). Award vesting was subject to a tenure hurdle which was achieved by each executive.

Remuneration details in accordance with Australian accounting standards for current and former executives are contained on page 96 of the remuneration report.

	REMUNERATION EARNED IN 2012		OTHER	DEFERRED EQUITY OUTCOMES IN 2012	
CURRENT EXECUTIVES	FIXED REMUNERATION[1] US$000	QIS-CASH AWARD[2] US$000	US$000	CONDITIONAL RIGHTS VESTED[3] US$000	TOTAL REMUNERATION REALISED IN 2012 US$000
John Neal[4]	1,623	–	380	1,080	3,083
Steven Burns	1,477	1,542	30	2,023	5,072
Neil Drabsch	1,093	–	252	458	1,803
Colin Fagen	915	1,048	89	77	2,129
John Rumpler	1,040	–	188	106	1,334
Jenni Smith	695	–	58	212	965
Jose Sojo	479	193	34	108	814
George Thwaites	688	–	35	199	922

1 As determined by the Remuneration Committee. For a definition of fixed remuneration see page 103.
2 Payable in March 2013 for performance in 2012.
3 The value of conditional rights has been determined by reference to the closing share price of $12.27 (A$11.85) on the vesting date of 5 March 2012.
4 John Neal was appointed to the role of Group CEO on 17 August 2012. On this date, his fixed remuneration increased from A$1,248,000 to A$2,100,000.

Key remuneration changes for 2013

As we turn to 2013, we continue to look at how executive remuneration appropriately motivates our management while reflecting and supporting our strategy and the creation of shareholder value. With a new Group CEO appointed in August 2012, a wide ranging review of QBE's strategy is being undertaken. The Remuneration Committee will work with management to ensure that the remuneration structure is aligned with the new strategy and reflects ongoing market and regulatory developments.

We are intending to undertake a thorough review of all our remuneration and reward frameworks globally during 2013, with a view to implementing appropriate changes from 2014 onwards. In the meantime, the following changes are being made to the 2013 remuneration framework:

- Group CEO fixed remuneration remains unchanged at A$2.1 million. The average increase for our executives is 3.2%, with some receiving no increase. The exception is the Chief Executive Officer of Latin American Operations whose increase of 15% reflects the significant change in role due to recent acquisitions.
- In 2014, we are aligning all fixed remuneration reviews to 1 April. As a result, the 2013 remuneration review covers a 15 month period.
- Short-term cash incentive ROE ranges for Group head office are being reduced from 12% – 19% to 9% – 16% to align the remuneration targets with the business plan agreed by the non-executive directors and our published targets for 2013. In order to meet the minimum ROE of 9%, the Group still needs to achieve a market competitive COR of around 94%.
- There are no changes to the divisional ROE targets but the allocation of capital to the divisions is being increased, in part reflecting higher regulatory capital requirements.
- There are no changes to the QIS Deferred Equity Award (QIS-DEA) or the LTI plan.
- Fees paid to the Chairman and other non-executive directors will not be increased; however, the new Risk and Capital Committee Chairman and its members (excluding the Chairman) will receive fees from 1 January 2013.

Remuneration report CONTINUED

2. Remuneration explained

The information presented in the 2012 remuneration report has been prepared and audited in accordance with the disclosure requirements of the *Corporations Act 2001*. The report sets out remuneration details of the KMP of QBE Insurance Group. In 2012, KMP included the Group Chief Executive Officer, divisional and head office executives and non-executive directors.

NAME	POSITION	COUNTRY OF RESIDENCE	TERM AS KMP IN 2012
Current KMP executives			
John Neal [1]	Group Chief Executive Officer	Australia	1 January – 31 December
Steven Burns	Chief Executive Officer, European Operations	United Kingdom	1 January – 31 December
Neil Drabsch	Group Chief Financial Officer	Australia	1 January – 31 December
Colin Fagen	Chief Executive Officer, Australian & New Zealand Operations	Australia	1 January – 31 December
John Rumpler	President and Chief Executive Officer, North American Operations	America	1 January – 31 December
Jenni Smith	Group Executive Officer, People and Communications	Australia	1 January – 31 December
Jose Sojo	Chief Executive Officer, Latin American Operations	Argentina	16 January – 31 December
George Thwaites	Group Chief Risk Officer	Australia	1 January – 31 December
Former KMP executives			
Gary Brader [2]	Group Chief Investment Officer	Australia	1 January – 1 May
Des Fogarty [2]	President, Equator Re	Ireland/Bermuda	1 January – 1 May
Duncan Ramsay [2]	Group General Counsel and Company Secretary	Australia	1 January – 1 May
KMP executives who left during 2012			
Michael Goodwin [3]	Chief Executive Officer, Asia Pacific Operations	Singapore	1 January – 27 July
Blair Nicholls [4]	Group Chief Actuarial Officer and Head of Reinsurance	Australia	1 January – 1 May
Frank O'Halloran [5]	Group Chief Executive Officer	Australia	1 January – 17 August
Non-executive directors			
Duncan Boyle	Non-executive director	Australia	1 January – 31 December
John Graf [6]	Non-executive director	America	20 August – 31 December
John Green	Non-executive director	Australia	1 January – 31 December
Isabel Hudson	Non-executive director	United Kingdom	1 January – 31 December
Belinda Hutchinson AM	Chairman, non-executive director	Australia	1 January – 31 December
Charles Irby	Non-executive director	United Kingdom	1 January – 31 December
Irene Lee	Non-executive director	Hong Kong	1 January – 31 December
Non-executive directors who left during 2012			
Len Bleasel AM [7]	Non-executive director	Australia	1 January – 30 September

1 John Neal was appointed to the role of Group Chief Executive Officer on 17 August 2012. From 1 January to 16 August 2012, John Neal held the role of Chief Executive Officer, Global Underwriting Operations.
2 Gary Brader, Des Fogarty and Duncan Ramsay ceased being KMP on 1 May 2012 as a result of the Group Executive restructure.
3 Michael Goodwin ceased being a KMP on 27 July 2012. His secondment to Singapore was concluded on 27 January 2013.
4 Blair Nicholls ceased being a KMP on 1 May 2012. His position was made redundant on 31 October 2012.
5 Frank O'Halloran retired from the role of Group Chief Executive Officer on 17 August 2012. In accordance with his notice period, Frank O'Halloran's termination was effective 28 August 2012.
6 John Graf was appointed to the position of non-executive director on 20 August 2012.
7 Len Bleasel retired from his position of non-executive director on 30 September 2012.

What is the role of the Remuneration Committee?

The Remuneration Committee has overall governance responsibility for executive remuneration structures and outcomes to ensure that remuneration frameworks are aligned with robust risk management practices and strong guiding principles. The Remuneration Committee annually reviews the Group remuneration policy to ensure that fixed remuneration is appropriately positioned relative to the market and at-risk rewards remain linked to QBE's financial targets, investment performance targets and strategic business objectives.

In addition, the Remuneration Committee oversees the remuneration and incentive scheme structures for employees of APRA regulated entities (such as risk and financial control employees) in accordance with its governance prudential standard CPS 510.

The key responsibilities of the Remuneration Committee are summarised below:

- reviewing and recommending for approval to the QBE Group Board:
  - remuneration strategy and framework for the executives and non-executive directors
  - contractual arrangements for the Group CEO and other executives
  - fixed remuneration and at-risk reward for the Group CEO
  - Group remuneration policy
- reviewing and approving:
  - contractual arrangements for executives not involving remuneration
  - executive termination payments
  - reward structures and incentive schemes in line with APRA's prudential standard on remuneration
  - major human resources policies relating to incentive schemes, equity schemes and superannuation plans
- overseeing and monitoring:
  - the executive succession planning framework
  - compliance with statutory remuneration reporting disclosures

Further details on the role and scope of the Remuneration Committee are set out in the QBE Remuneration Committee charter (published on www.qbe.com).

> “The Committee has overall governance responsibility for executive remuneration structures and outcomes to ensure that remuneration frameworks are aligned with robust risk management practices and strong guiding principles.

Remuneration report CONTINUED

2. Remuneration explained CONTINUED

How is executive remuneration structured?

Our approach to remuneration recognises that the successful achievement of the Group's business strategy and our ongoing performance depends on the quality and motivation of our executives. Our fixed remuneration and at-risk reward structure recognises the significant influence executives have on achieving QBE's financial results.

We aim to provide market competitive remuneration and transparent at-risk reward structures that motivate, retain and align our executives to deliver sustained shareholder value.

2012 REMUNERATION FRAMEWORK

		COMPONENTS	GUIDING PRINCIPLES	DELIVERY
Fixed remuneration	**Base salary & guaranteed annual benefits**	• all guaranteed pay – base (cash) salary, superannuation and other guaranteed benefits (such as the value of motor vehicles, health insurance, life assurance, personal accident insurance, allowances, expatriate benefits and the applicable taxes thereon) • excludes deemed interest on employee share loans and long service leave accruals	• retention and attraction – market competitive, benchmarked against Australian listed companies in the financial services sector and global insurers • positioned at a level that reflects the contribution and value to the Group • recognises capability, expertise and performance of the executive • designed to provide a predictable 'base' level of remuneration	• cash salary and benefits in accordance with terms and conditions of employment
At-risk reward	**QIS-cash**	• cash award for delivering short-term performance over a 12 month period based on ROE targets on allocated capital	• rewards performance over a short-term period • links to performance – achievement of financial targets based on Group and divisional performance, giving clear alignment with shareholders • ROE is a solid measure of profit which executives can be evaluated against • retain and motivate – executives are encouraged to increase profit and the value of QBE shares	• cash payment in March 2013
At-risk reward	**QIS-DEA**	• deferred equity award of conditional rights, subject to a three and five year tenure hurdle • enhanced deferred equity award subject to a three year tenure hurdle for exceeding ROE targets in the year prior to grant for divisional CEOs only	• rewards performance over a long-term period • retains and motivates – executives are encouraged to increase profit and the value of QBE shares • equity awards are subject to a clawback for material deterioration of the relevant entity's ROE • shareholder alignment – executives are exposed to the performance of QBE shares over three and five years	• March 2013 – grant of conditional rights • March 2016 – 50% of QIS – DEA vests • March 2018 – 50% of QIS – DEA vests
At-risk reward	**LTI plan**	• a deferred equity award of conditional rights, subject to a five year vesting period and achievement of future performance hurdles – EPS, ROE and COR	• rewards performance over a long-term period • executive reward designed to encourage profitable business growth (EPS) and maintain focus on operating performance (ROE and COR) • equity awards are subject to a clawback for material deterioration of the relevant entity's ROE • shareholder alignment – executives are exposed to the performance of QBE shares over five years	• March 2013 – grant of conditional rights • annual testing of performance hurdles – EPS, ROE & COR (2013 – 2018) • March 2018 – 50% of LTI vesting based on EPS hurdle • March 2018 – 50% of LTI vesting based on ROE and COR hurdle

Total remuneration and reward mix

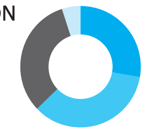
The mix of total remuneration and reward is reflective of an executive's ability to influence QBE's financial results, therefore the range is varied. The diagrams below show the 2012 potential total reward mix assuming maximum at-risk incentives. The majority of reward mix for executives is weighted towards 'at-risk' components (QIS-cash, QIS-DEA and LTI).

Group CEO potential total reward mix

FIXED REMUNERATION	%
FIXED REMUNERATION	26
QIS-CASH	35
QIS-DEA	26
LTI	13

Average current executive potential total reward mix

FIXED REMUNERATION	%
FIXED REMUNERATION	28
QIS-CASH	35
QIS-DEA	32
LTI	5



Fixed remuneration – assessing what is 'competitive'

Fixed remuneration considers the diversity, complexity and expertise required of individual roles. To assess competitiveness of fixed remuneration, the Remuneration Committee considers market data and published recognised survey tools and/or undertakes external market reviews to inform the setting of competitive fixed remuneration levels.

A defined comparator group of companies as set out in the table below also serves as a guide in setting fixed remuneration levels. This comparator group is unchanged from 2011.

EXECUTIVES	COMPARATOR GROUP
Australian-based	Generally ASX listed companies that are 50% to 200% of QBE's market capitalisation based on the most recent 12 month average market value to smooth volatility, as well as applying judgment to determine what is appropriate to the individual and the role. For those executive roles where there is insufficient market data, the sizing criteria are expanded to 25% to 400% of market capitalisation. Executive roles that have a global reach are also reviewed against comparable international insurers.
Overseas-based	Market data is gathered from relevant external surveys. A similar benchmarking approach, with the emphasis on a comparative group of a similar size to the relevant operations, is used to filter survey data for overseas executives.

How is reward linked to QBE's performance?

Our reward frameworks are directly linked to the key financial profit drivers that encourage achievement of Group business plans and create shareholder value over the long-term.

Creation of shareholder value can be influenced positively by the following measures which are aligned with our executive reward framework:

- achievement of COR targets;
- growth and increased profitability, particularly insurance profit and investment income performance;
- achievement of ROE targets; and
- consistency of earnings, particularly EPS.

The table below summarises several key performance indicators of QBE's results in the last five years.

FINANCIAL RESULTS		2008	2009	2010	2011	2012
Combined operating ratio	%	88.5	89.6	89.7	96.8	**97.1**
Earnings						
Net profit after income tax (NPAT)	US$M	1,558	1,532	1,278	704	**761**
Diluted earnings per share	cents	172.2	149.9	119.6	61.3	**61.6**
Return on equity (ROE)						
Return on average shareholders' funds [1]	%	22.3	18.0	13.1	6.8	**7.0**
Return on equity [2]	%	22.6	20.2	15.9	7.4	**9.2**
Return to shareholders						
Dividend per share	Australian cents	126.0	128.0	128.0	87.0	**50.0**
Share price at 31 December	A$ per share	25.81	25.62	18.15	12.95	**10.90**
Underwriting result	US$M	1,069	981	1,168	494	**453**

1 ROE on a statutory basis.
2 ROE on a management basis is used for Group QIS-cash awards.

Remuneration report CONTINUED

2. Remuneration explained CONTINUED

Our 2008 to 2012 net profit after tax has been significantly impacted by the unusual global claims environment and challenging economic conditions which reduced investment income.

Over the period from 2008 to 2012:

- QBE's underwriting profit decreased by a compound annual average 19% per annum;
- QBE's NPAT decreased by a compound annual average 16% per annum;
- diluted EPS decreased by a compound annual 23% per annum; and
- dividend per share decreased by a compound annual average of 21% per annum.

During the same period, average executive remuneration (fixed remuneration and QIS-cash) reduced by a compound annual average of 5.3% per annum reflecting lower at-risk remuneration (based on same incumbents) demonstrating an alignment with shareholder expectations.

Rationale for selection of financial targets

The achievement of ROE targets is the primary performance measure of QBE's success in the context of at-risk reward. It represents shareholders' "rate of return" and is well understood. ROE is an absolute measure of profitability. It shows how much income the Group is earning for each dollar of capital allocated. It is a strong objective measure of value created.

The divisional at-risk rewards are based on achieving a minimum ROE on allocated capital using QBE's economic capital model based on the requirements of a Standard & Poor's rating of A+.

For the purpose of Group QIS awards, ROE is reported on a management result basis as a percentage of opening allocated capital adjusted for dividend and capital movements in the year. For the purpose of divisional QIS awards, the ROE is determined on a management basis using NPAT as a percentage of opening allocated capital.

The Group Board approve a comprehensive delegated authority for the Group CEO, which is an integral part of QBE's risk management process. There are no at-risk incentives solely based on top line growth. Executives are required to adhere to a range of Group-wide policies to ensure risk taking is well managed, strong governance structures are in place and high ethical standards are maintained. These policies are communicated to all employees throughout the Group.

Executive performance is evaluated annually by the Group CEO, and by the Chairman in respect of the Group CEO, through formal business review assessments to ensure financial performance targets are achieved. This is generally followed by a formal personal development plan (PDP) process. The PDP process provides feedback to an executive on their overall performance against their role profile, demonstrated QBE values and an assessment of current capability and future potential.

How did QBE's performance affect rewards in 2012?

The incentive structure and financial targets are approved annually by the Remuneration Committee. The achievement of ROE outcomes has been the primary measure for at-risk reward purposes, demonstrating an alignment of revenue growth over time and actual QIS-cash awards for our executives.

QIS-cash

The QIS-cash award is a performance-based incentive delivered in the form of an annual cash payment for a performance measurement period of 12 months. The table below shows the 2012 financial performance targets, incentive opportunity and awards achieved by executives in office as at 31 December 2012. The different cash award percentage levels reflect an executive's relative influence on organisational performance and the different ROE ranges reflects market factors.

		FINANCIAL TARGET				ACTUAL ACHIEVED	
		ROE		QIS-CASH[1]		ROE	QIS-CASH[1]
CURRENT EXECUTIVES	PERFORMANCE MEASURE	MINIMUM %	MAXIMUM %	MINIMUM %	MAXIMUM %	%	US$000
Group head office							
John Neal[2]	Group ROE	12	19	20	135	9.2	–
		12	19	20	133	9.2	–
Neil Drabsch	Group ROE	12	19	20	117	9.2	–
Jenni Smith	Group ROE	12	19	20	110	9.2	–
George Thwaites	Group ROE	12	19	20	110	9.2	–
Divisional							
Steven Burns	European Operations ROE	10	22	–	133.34	19.4	1,542
Colin Fagen[3]	Australian & New Zealand Operations ROE	15	22	20	125	21.3	1,048
John Rumpler	North American Operations ROE	15	22	39.9	133	1.9	–
Jose Sojo	Latin American Operations ROE	15	28	20	125	17.5	193

1 The QIS-cash award is calculated as a percentage of fixed remuneration as at 31 December 2012.

2 John Neal was appointed to the Group CEO role effective 17 August 2012. From 1 January to 16 August 2012, his maximum QIS-cash award was 133%.

3 Colin Fagen assumed responsibility for New Zealand on 2 May 2012, in addition to his previous CEO Australian Operations role. His QIS-cash award was based on the ROE of the combined division.

QIS deferred equity award

The QIS-DEA provides executives with the opportunity to acquire equity in the form of conditional rights to fully paid QBE shares without payment. A QIS-DEA is delivered only if a cash award is earned for the financial year.

The maximum QIS-DEA is determined as the lesser of 80% of the QIS-cash award earned for the financial year or 100% of fixed remuneration as at 31 December, and will be recognised by the executive as follows:

- conditional rights to the value of 50% of the equity award will convert to shares after three years; and
- conditional rights to the value of 50% of the equity award will convert to shares after five years.

The share price upon which the 2013 grant of conditional rights is calculated is the volume weighted average sale price of QBE shares over the five trading days on the ASX from 26 February 2013 (being the date on which QBE's annual result is announced to the ASX).

A tenure hurdle is attached to the QIS-DEA. Shares will vest if the individual has remained in service throughout the three or five year vesting period. Notional dividends, payable in the form of QBE shares, accrue on the conditional rights during the vesting period.

The vesting of the conditional rights is also contingent on no material deterioration of the 2012 ROE during the vesting period (see page 94 on "How does clawback work?").

The Remuneration Committee has the discretion to pay cash in lieu of shares in certain circumstances such as death, disability, redundancy or retirement if the executive is not subject to disciplinary proceedings or notice to terminate employment on that date.

The table below shows the basis of calculation of the QIS-DEA conditional rights based on 2012 performance.

	QIS-CASH			QIS-DEA[3]				
					THREE YEAR CONDITIONAL RIGHTS		FIVE YEAR CONDITIONAL RIGHTS	
CURRENT EXECUTIVES	FIXED REMUNERATION US$000	PERCENTAGE OF FIXED REMUNERATION	PAYMENT (MARCH 2013) US$000	MAXIMUM AWARD[1] US$000	US$000	SHARES[2] NUMBER	US$000	SHARES[2] NUMBER
Group head office								
John Neal	1,623	–	–	–	–	–	–	–
Neil Drabsch	1,093	–	–	–	–	–	–	–
Jenni Smith	695	–	–	–	–	–	–	–
George Thwaites	688	–	–	–	–	–	–	–
Divisional								
Steven Burns	1,477	104	1,542	1,028	617	49,977	617	49,977
Colin Fagen	915	115	1,048	838	419	33,966	419	33,966
John Rumpler	1,040	–	–	–	–	–	–	–
Jose Sojo	479	40	193	154	77	6,245	77	6,245

1 Based on the lesser of 80% of QIS-cash award or 100% of fixed remuneration, with the exception of Steven Burns whose QIS-DEA is based on the lesser of 66.67% of QIS-cash or 100% of fixed remuneration. Steven Burns' QIS-DEA is determined as 60% of the maximum for each of the three and five year awards.

2 For indicative purposes, the closing share price at 31 January 2013 of A$11.92 ($12.43) has been used.

3 Australian accounting standards require deferred equity awards earned under the QIS and the LTI to be measured at fair value at the date of grant and expensed over the relevant performance period, regardless of the value which is ultimately realised by the executive.

Enhanced QIS-DEA (divisional CEOs only)

From 1 January 2008, divisional CEOs are eligible to benefit from an enhanced QIS-DEA. The first award was made in March 2009. It provides the opportunity to acquire additional equity without payment in the form of conditional rights if divisional ROE targets are exceeded.

The value of the conditional rights allocated varies for each CEO, ranging from 3% – 15% of fixed remuneration or base salary as appropriate, except for Steven Burns whose award ranges from 0% – 50% of the QIS-cash award.

To calculate the number of conditional rights, the award value is divided by the volume weighted average sale price of QBE shares over the five trading days on the ASX from 26 February 2013 (being the date on which QBE's annual result is announced to the ASX).

A three year tenure hurdle is attached to enhanced QIS-DEA. Shares will only vest if the individual has remained in service throughout the vesting period. Notional dividends, payable in the form of QBE shares, accrue on the conditional rights during the vesting period.

The vesting of the conditional rights is also contingent on no material deterioration of the division's 2012 ROE during the vesting period (see page 94 on "How does clawback work?").

The Remuneration Committee has the discretion to pay cash in lieu of shares in certain circumstances such as death, disability, redundancy or retirement if the individual is not subject to disciplinary proceedings or notice to terminate employment on that date.

Remuneration report CONTINUED

2. Remuneration explained CONTINUED

The divisional ROE hurdles, the minimum and maximum awards and the actual award for the 2012 financial year are shown in the table below.

		ENHANCED DIVISIONAL ROE HURDLES	ENHANCED QIS-DEA AS A % OF FIXED REMUNERATION		
DIVISIONAL EXECUTIVES	DIVISION	MINIMUM & MAXIMUM %	MINIMUM & MAXIMUM %	ACTUAL AWARD %	AWARD VALUE US$000
Steven Burns [1]	European Operations	22 - 32	0-50	–	–
Colin Fagen	Australian & New Zealand Operations	23 - 27	3-15	–	–
John Rumpler	North American Operations	23 - 27	3-15	–	–
Jose Sojo	Latin American Operations	29 - 32	3-15	–	–

1 Steven Burns' award is determined as a percentage of the QIS cash award.

How does clawback work?

From 2010, the Remuneration Committee introduced a discretionary clawback provision to enable awards under the QIS-DEA to be reduced during the retention period for any material adverse development which results in the ROE used to determine the original grant being overstated. "Material" at Group level is defined as profit for the relevant financial year being overstated by 10% or more. For divisions, a material adverse development is defined as profit for the relevant accident year being overstated by 20% or more.

In considering whether to exercise discretion to reduce unvested awards under the QIS-DEA, the Remuneration Committee will consider the quantum of the reduction in profit.

Clawback may also occur if the relevant ROE is affected by fraud.

What happens when there is a 'change in control of QBE'?

In accordance with the QIS-DEA rules, should a change in organisational control occur, the holder of an unvested conditional right may require the conversion of the conditional right to QBE shares during the time declared for such conversion by the Remuneration Committee.

Long-Term Incentive plan

The LTI plan comprises an award of conditional rights to fully paid shares without payment by the executive, subject to a five year tenure hurdle, with vesting contingent upon the achievement of two future performance hurdles as follows:

1. 50% of the award granted will be contingent on QBE's diluted EPS increasing by a compound average 7.5% per annum over the five year vesting period; and
2. 50% of the award granted will be contingent on QBE's average ROE and combined operating ratio being in the top 10% of the top 50 largest global insurers and reinsurers as measured by net earned premium for the five year vesting period.

The award relating to the 2012 financial year will be granted in March 2013 and, subject to achievement of the above performance hurdles, will vest in March 2018. To calculate the number of conditional rights to be granted, the award value is divided by the volume weighted average sale price of QBE shares over the five trading days from 26 February 2013 (being the date on which QBE's annual result is announced to the ASX).

The vesting of the conditional rights is also contingent on there being no material deterioration in QBE's ROE during the vesting period.

The Remuneration Committee has the discretion to accelerate LTI awards or allocate a pro-rata amount in cash in lieu of shares in certain circumstances such as death, disability, redundancy or retirement.

For indicative purposes, the closing share price at 31 January 2013 of A$11.92 ($12.43) has been used in the table below.

	LTI GRANT – CONDITIONAL RIGHTS		
CURRENT EXECUTIVES	MAXIMUM AWARD AS A % OF FIXED REMUNERATION	MAXIMUM AWARD US $000	INDICATIVE NUMBER OF SHARES
Group head office			
John Neal	50	811	65,727
Neil Drabsch	25	273	22,143
Jenni Smith	15	104	8,442
George Thwaites	15	103	8,361
Divisional			
Steven Burns	15	222	17,942
Colin Fagen	15	137	11,125
John Rumpler	15	156	12,636
Jose Sojo	15	72	5,826

Performance hurdles are measured annually over the five year vesting period. The table below details LTI performance hurdles for conditional rights granted under the LTI plan that are in progress and have been measured during 2012.

PERFORMANCE YEAR	LTI GRANT	PERFORMANCE HURDLE	ACHIEVED	% OF PLAN MEASURED	VESTING DATE
2010	March 2011	1. Compound average EPS	×	40%	March 2016
		2. Average ROE & COR ranking	✓		
2011	March 2012	1. Compound average EPS	×	20%	March 2017
		2. Average ROE & COR ranking	✓		

Future performance conditional rights

At the discretion of the Remuneration Committee, future performance conditional rights may be awarded to executives subject to specific performance criteria and tenure conditions. Details of future performance conditional rights awarded to executives in 2012 and prior years are detailed on page 99 of this report.

Keeping executives and shareholders' interests aligned

Minimum shareholding

In keeping with our remuneration philosophy to align at-risk reward with the achievement of returns for shareholders in terms of dividends and growth in share price, an executive minimum shareholding requirement was introduced from 31 March 2008.

The minimum shareholding requirement encourages executives to build their shareholding and ensures they have significant exposure to QBE's share price and, by doing so, confirms their long-term interests are aligned with shareholders.

Under the requirement, all executives must accumulate a minimum vested shareholding in QBE equivalent to one year's fixed remuneration by 31 March annually. This holding is to be maintained (taking into account annual changes in fixed remuneration levels) for as long as they remain employed by QBE. New executives are required to build their shareholding over a three year period after becoming an executive. The necessary minimum shareholding requirement was met by all current executives.

Compliance with the requirement is assessed as at 31 March each year. If an executive does not meet the minimum shareholding as at the annual review date, QBE may impose a restriction on the sale of any further equity grants. Individual executives' requirements are recalculated annually to consider fixed remuneration increases and changes in the share price or exchange rates.

The total shareholding investment of executives is shown in the table on page 97.

Current exposure

Executives have further exposure to QBE's share price through their unvested conditional rights and options. The exercise price of options issued to executives in 2008 and 2009 exceeds the share price at the balance date (details are provided on page 163). The value of conditional rights granted in these years has fallen due to the lower QBE share price, demonstrating the alignment between shareholder returns and at-risk reward.

Trading policy

Trading in QBE ordinary shares is generally only permitted during designated trading windows. A policy exists stating that non-executive directors and executives should notify any intended share transaction to nominated people within the Group.

The policy prohibits the hedging of unvested equity entitlements by executives. The purpose of this prohibition is to ensure that, until awards granted under the QIS and LTI have vested, there is an alignment between the interests of executives and shareholders, with the effect that market share value movements (either positive or negative) will economically impact executive rewards. There is a further restriction on hedging vested equity entitlements if such entitlement counts towards the executive's minimum shareholding requirement.

The policy is enforced by requiring non-executive directors and executives to sign an annual declaration that confirms compliance with the restrictions on hedging. A copy of QBE's trading policy for dealing in securities is available from www.qbe.com/investor information/corporate governance/background documents.

How do we use remuneration consultants?

Remuneration consultants provide guidance on remuneration for executives, facilitate discussion, review industry peer groups for remuneration and at-risk reward benchmarking and provide guidance on current trends in executive remuneration practices.

Any advice provided by remuneration consultants is used as a guide, and is not a substitute for thorough consideration of all the issues by each non-executive director on the Remuneration Committee.

From 1 January to 30 November 2012, the Remuneration Committee retained Guerdon Associates as its independent remuneration adviser.

From 1 December 2012, the Remuneration Committee appointed UK based firm, FIT Remuneration Consultants, to reflect a better alignment with QBE's business operations and overseas-based executives.

The Remuneration Committee is satisfied that the advice provided by Guerdon Associates and FIT Remuneration Consultants during 2012 were provided free from undue influence by QBE executives.

The cost of advice and assistance provided by Guerdon Associates in 2012 was $67,000 (A$64,000).

The cost of advice and assistance provided by FIT Remuneration Consultants in 2012 was $22,000 (£14,000).

Remuneration report CONTINUED

3. Remuneration in detail

Statutory remuneration disclosures

The following table provides details of the remuneration of QBE's executives, as determined by reference to applicable Australian accounting standards for the financial year ended 31 December 2012. Remuneration has been converted to US dollars using the cumulative average rate of exchange for the relevant year.

			SHORT-TERM EMPLOYEE BENEFITS			POST EMPLOYMENT BENEFITS	OTHER LONG-TERM EMPLOYEE BENEFITS	SHARE BASED PAYMENTS [1]			
EXECUTIVES	YEAR	CURRENCY '000	BASE SALARY	OTHER [2]	QIS-CASH [3]	SUPER-ANNUATION	LONG SERVICE LEAVE	CONDITIONAL RIGHTS	OPTIONS	TERMINATION BENEFITS	TOTAL
Group head office											
John Neal	2012	US$	1,623	57	–	–	323	1,054	72	–	3,129
	2011	US$	1,249	154	–	–	317	973	108	–	2,801
Neil Drabsch	2012	US$	1,076	193	–	17	59	1,258	59	–	2,662
	2011	US$	1,038	194	–	37	27	656	89	–	2,041
Jenni Smith	2012	US$	678	14	–	17	44	172	28	–	953
	2011	US$	656	18	–	15	35	223	41	–	988
George Thwaites	2012	US$	671	21	–	17	14	170	25	–	918
	2011	US$	653	27	–	20	18	216	34	–	968
Divisional											
Steven Burns	2012	US$	1,116	391	1,542	–	–	1,145	138	–	4,332
	2011	US$	1,083	380	1,004	–	–	1,588	284	–	4,339
Colin Fagen	2012	US$	898	51	1,048	17	38	92	12	–	2,156
	2011	US$	386	27	–	11	69	48	8	–	549
John Rumpler	2012	US$	1,023	75	–	17	113	428	17	–	1,673
	2011	US$	985	113	878	15	8	285	26	–	2,310
Jose Sojo [4]	2012	US$	479	34	193	–	–	153	11	–	870
	2011	US$	–	–	–	–	–	–	–	–	–
Former KMP executives [5]											
Gary Brader	2012	US$	242	11	242	–	15	33	–	–	543
	2011	US$	687	3	–	15	44	95	4	–	848
Des Fogarty	2012	US$	161	149	–	–	–	50	10	–	370
	2011	US$	506	66	–	103	–	217	45	–	937
Duncan Ramsay	2012	US$	276	50	–	–	14	71	11	–	422
	2011	US$	791	138	–	16	19	276	50	–	1,290
KMP executives who left in 2012											
Michael Goodwin [6]	2012	US$	379	265	–	9	22	191	11	378	1,255
	2011	US$	608	467	–	26	15	409	27	–	1,552
Blair Nicholls [7]	2012	US$	242	6	–	–	14	62	10	2,136	2,470
	2011	US$	692	5	–	16	16	239	55	–	1,023
Frank O'Halloran [8]	2012	US$	1,506	337	1,222	17	187	688	93	7,406	11,456
	2011	US$	2,326	637	–	15	87	1,241	213	–	4,519
Total	2012	US$	10,370	1,654	4,247	111	843	5,567	497	9,920	33,209
	2011	US$	11,660	2,229	1,882	289	655	6,466	984	–	24,165

1 The fair value at grant date of options and conditional rights is calculated using a binomial model. The fair value of each option and conditional right is recognised evenly over the service period ending at vesting date. Details of grants of conditional rights and options are provided in note 31 to the financial statements.

2 "Other" includes provision of motor vehicles, health insurance, spouse travel, staff insurance discount benefits received during the year, life assurance and personal accident insurance and the applicable taxes thereon. It also includes the deemed value of interest free share loans which is also disclosed in note 31(C) to the financial statements. Directors' and officers' liability insurance has not been included in other remuneration since it is not possible to determine an appropriate allocation basis.

3 Includes QIS cash award and other amounts which are the accrued entitlement for the financial year, payable in March 2013.

4 Jose Sojo was appointed as Chief Executive Officer, Latin American Operations on 16 January 2011. His remuneration for 2011 in his previous role is not included in this report.

5 Gary Brader, Des Fogarty and Duncan Ramsay ceased being KMP on 1 May 2012 as a result of the Group Executive restructure. In 2012, remuneration shown is for the period 1 January to 1 May.

6 Michael Goodwin ceased his role with effect from 27 July 2012. His termination benefit is analysed in the table on page 97.

7 Blair Nicholls ceased his role with effect from 1 May 2012. His termination benefit is analysed in the table on page 97.

8 Frank O'Halloran retired from the role of Group Chief Executive Officer on 17 August 2012. His termination benefit is analysed in the table on page 97.

Termination benefits

The following table provides further detail on the termination benefit components that were attributable to executives who ceased employment during the financial year ended 31 December 2012, as determined under applicable Australian accounting standards.

KMP WHO LEFT IN 2012	REDUNDANCY PAYMENT[4] US$000	LONG SERVICE LEAVE ACCRUAL US$000	PAYMENT FOR PAST SERVICE[5] US$000	APPORTIONED FIXED REMUNERATION TO TERMINATION DATE[6] US$000	QIS CASH US$000	QIS-DEA (CASH IN LIEU OF EQUITY) US$000	RETIREMENT ALLOWANCE[7] US$000	INTEREST NOT CHARGED ON RECOURSE & NON-RECOURSE LOAN[8] US$000	ACCELERATED ACCOUNTING CHARGE – CONDITIONAL RIGHTS & OPTIONS[9] US$000	TOTAL[10] US$000
Frank O'Halloran[1]	–	9	–	73	59	1,025	2,423	24	3,793	7,406
Michael Goodwin[2]	–	17	523	730	–	–	–	2	(894)	378
Blair Nicholls[3]	757	21	512	363	–	–	–	–	483	2,136

1 Frank O'Halloran ceased to be KMP on 17 August 2012. He remained an employee until 28 August 2012 in order to formally serve out his six months' notice period.
2 Michael Goodwin ceased to be KMP on 27 July 2012. He remained an employee until 27 January 2013 in order to formally serve out his contractual six months' notice period. Michael Goodwin will become a non-executive director of several Asian boards during 2013 (based on a 12 month contract) and will be paid an annual amount of $120,000.
3 Blair Nicholls ceased to be KMP on 1 May 2012. He remained an employee until 31 October 2012 in accordance with an agreed notice period.
4 Redundancy payment in accordance with QBE's policy – three weeks' pay for each year of service, based on fixed remuneration.
5 Payment for past service approved by the Remuneration Committee.
6 Apportioned fixed remuneration from the date of ceasing to be KMP to the date of termination of employment. Michael Goodwin's fixed remuneration includes contractual expatriate benefits in accordance with his Singapore based terms.
7 Retirement allowance is equal to one year's fixed remuneration and is subject to shareholder approval at the 2013 AGM. This reduced retirement allowance was advised to the ASX on 1 April 2009 and disclosed in subsequent annual reports. (The allowance was previously 150% of Frank O'Halloran's total remuneration cost being his annual base salary plus short-term incentive for the year prior to the date of his retirement. The retirement allowance was first agreed in 1999).
8 Interest not charged on recourse and non-recourse loans is deemed interest calculated from the date of ceasing to be KMP to the date of loan repayment. In the case of Michael Goodwin, his deemed interest was calculated to 31 December 2012 as he had a non-recourse loan balance of A$35,000 still outstanding at that date. The loan has subsequently been repaid.
9 Accounting charge accelerated or reversed due to termination. Under the QIS-DEA rules, upon termination of employment (through redundancy or retirement) prior year grants of conditional rights and options are permitted to be released early (shareholder approval obtained at the AGM of 5 April 2011).
10 Amounts have been converted to US dollars using the average rate of exchange for the 2012 year.

Equity-based remuneration

Executive investment in QBE as at 31 January 2013

The table below shows the investment exposure of QBE's current executives as at 31 January 2013. Amounts in the table include relevant interests but do not include interests attributable to personally related parties.

CURRENT EXECUTIVES	ORDINARY SHARES NUMBER	CONDITIONAL RIGHTS NUMBER	TOTAL POTENTIAL SHARES IN QBE AT 31 JAN 2013 NUMBER	VALUE OF POTENTIAL SHARES IN QBE AT 31 JAN 2013 US$000	COST TO REPAY SHARE LOANS US$000	NET INVESTMENT IN QBE AT 31 JAN 2013 US$000
Group head office						
John Neal	138,258	283,338	421,596	5,240	–	5,240
Neil Drabsch	256,130	108,390	364,520	4,531	(2,008)	2,523
Jenni Smith	51,078	48,514	99,592	1,238	–	1,238
George Thwaites	44,297	48,071	92,368	1,148	(181)	967
Divisional						
Steven Burns	66,892	310,181	377,073	4,687	–	4,687
Colin Fagen	67,662	26,236	93,898	1,167	(418)	749
John Rumpler	78,190	141,711	219,901	2,733	(535)	2,198
Jose Sojo	12,578	49,362	61,940	770	–	770

1 The closing share price at 31 January 2013 was A$11.92 ($12.43 using the 31 January closing rate of exchange).

Remuneration report CONTINUED

3. Remuneration in detail CONTINUED

Conditional rights

(i) Deferred equity awards

Details of conditional rights to ordinary shares in QBE provided as remuneration to executives during 2012 under the terms of the QIS-DEA are set out below. When exercisable, each conditional right is convertible into one ordinary share of the company.

	CONDITIONAL RIGHTS GRANTED IN THE YEAR NUMBER	VALUE OF CONDITIONAL RIGHTS GRANTED IN THE YEAR [1] US$000	CONDITIONAL RIGHTS VESTED AND EXERCISED IN THE YEAR NUMBER	VALUE OF CONDITIONAL RIGHTS AT VESTING DATE US$000
Group head office				
John Neal	–	–	87,976	1,080
Neil Drabsch	–	–	37,321	458
Jenni Smith		–	17,297	212
George Thwaites	–	–	16,242	199
Divisional				
Steven Burns	63,310	772	164,863	2,023
Colin Fagen	–	–	6,226	76
John Rumpler	56,502	689	8,621	106
Jose Sojo	22,710	277	8,785	108
Former KMP executives				
Gary Brader	–	–	3,127	38
Des Fogarty	–	–	20,269	249
Duncan Ramsay	–	–	21,055	258
KMP executives who left in 2012				
Michael Goodwin	–	–	25,257	310
Blair Nicholls	–	–	49,134	646
Frank O'Halloran	–	–	216,899	2,829

1 The value at grant date is calculated in accordance with AASB 2 Share-based Payment.

(ii) Long-term incentive plan

Details of conditional rights to ordinary shares in QBE provided as remuneration to executives during 2012 under the terms of the LTI plan are set out below. LTI conditional rights are subject to future performance hurdles as detailed on page 94 of this report. When exercisable, each conditional right is convertible into one ordinary share of the company.

	CONDITIONAL RIGHTS GRANTED IN THE YEAR NUMBER	VALUE OF CONDITIONAL RIGHTS AT GRANT DATE [1] US$000	CONDITIONAL RIGHTS VESTED AND EXERCISED IN THE YEAR NUMBER	VALUE OF CONDITIONAL RIGHTS AT VESTING DATE US$000
Group head office				
John Neal	50,934	621	–	–
Neil Drabsch	21,753	265	–	–
Jenni Smith	8,213	100	–	–
George Thwaites	8,213	100	–	–
Divisional				
Steven Burns	16,956	207	–	–
Colin Fagen	4,863	59	–	–
John Rumpler	12,069	147	–	–
Former KMP executives				
Gary Brader	8,595	105	–	–
Des Fogarty	5,750	70	–	–
Duncan Ramsay	9,868	120	–	–
KMP executives who left in 2012				
Michael Goodwin	7,841	96	–	–
Blair Nicholls	8,663	106	–	–
Frank O'Halloran	95,501	1,165	–	–

1 The value at grant date is calculated in accordance with AASB 2 Share-based Payment.

1 Highlights & overview
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(iii) Future performance conditional rights

Details of conditional rights to ordinary shares in QBE provided as remuneration to executives during 2012 are set out below. When exercisable, each conditional right is convertible into one ordinary share of the company.

	CONDITIONAL RIGHTS GRANTED IN THE YEAR	VALUE OF CONDITIONAL RIGHTS AT GRANT DATE [1]	CONDITIONAL RIGHTS VESTED AND EXERCISED IN THE YEAR	VALUE OF CONDITIONAL RIGHTS AT VESTING DATE
	NUMBER	US$000	NUMBER	US$000
Group head office				
John Neal	90,000	1,328	–	–

1 The value at grant date is calculated in accordance with AASB 2 Share-based Payment.

On 5 April 2012, John Neal was granted an appointment performance incentive of a total of 90,000 conditional rights to fully paid QBE shares without payment. The conditional rights comprise three tranches of 30,000 each and are subject to future performance hurdles, namely the achievement of the QBE Group ROE target as agreed with the non-executive directors in each of the three years (2012 to 2014). If a performance hurdle is not met, the conditional rights for that year will lapse and no compensation payment will be made in lieu of the conditional rights.

The minimum ROE target was not achieved in 2012. As a result, the first tranche of 30,000 conditional rights lapsed subsequent to 31 December 2012.

Options

Details of options over the ordinary shares in QBE provided as remuneration to executives are set out below. When exercisable, each option is convertible into one ordinary share of the company. Options vested in 2012 were earned under the legacy LTI terms for the 2006 performance year and were granted in March 2007. For Gary Brader, the options vested in 2012 were earned under the legacy DCP terms for the 2008 performance year granted in March 2009.

No options were granted or exercised in the current year.

NAME	OPTIONS VESTED IN THE YEAR	OPTIONS LAPSED IN THE YEAR	VALUE OF OPTIONS AT LAPSE DATE [1]
	NUMBER	NUMBER	US$000
Group head office			
John Neal	32,066	50,559	–
Neil Drabsch	24,776	50,460	–
Jenni Smith	11,009	22,566	–
George Thwaites	8,545	7,485	–
Divisional			
Steven Burns	61,031	210,515	–
Colin Fagen	4,255	7,727	–
John Rumpler	7,475	13,711	–
Jose Sojo	–	–	–
Former KMP executives			
Gary Brader	5,018	4,750	–
Des Fogarty	12,298	25,924	–
Duncan Ramsay	13,807	26,981	–
KMP who left in 2012			
Michael Goodwin	2,968	2,076	–
Blair Nicholls	62,736	41,366	–
Frank O'Halloran	253,186	94,771	–

1 The value of options at lapse date was nil reflecting the fact that the exercise price of the options exceeds the value of the underlying shares at that date.

Remuneration report CONTINUED

3. Remuneration in detail CONTINUED

Employment agreements

The terms and conditions of employment of each executive reflect market conditions at the time of their contract negotiation on appointment and subsequently. The material terms of the employment agreements for the current executives are summarised in the table below.

CONTRACTUAL TERM	EXECUTIVES AFFECTED	CONDITIONS
Duration of contract	All	Permanent full-time contract until notice given by either party
Notice to be provided by executive or QBE	All	Notice periods are 12 months for John Neal and Steven Burns Other executives' notice periods are six months, except for Neil Drabsch whose notice period is four weeks (or five weeks by QBE)
Involuntary termination	All	QBE may pay an executive's fixed remuneration and QIS-cash awards for the current financial year and must pay statutory entitlements such as accrued annual and long service leave (where applicable) together with superannuation benefits. In the event of termination through death, disability, redundancy or retirement and no disciplinary procedure or notice to terminate employment is pending, the executive is entitled to the value of outstanding QIS-cash awards, legacy DCP awards for previous years plus a pro-rata share of the value of QIS for the current financial year. In addition, the Remuneration Committee may exercise its discretion to vest LTI awards that have been granted for previous years
Voluntary termination	All	In the case of voluntary termination, executives forfeit all conditional rights to ordinary shares not yet vested under the LTI and legacy DCP, and all unexercised options under the legacy DCP. QBE may pay an executive's fixed remuneration and QIS-cash awards for the current financial year and must pay statutory entitlements such as accrued annual and long service leave (where applicable) together with superannuation benefits
Payment for past services	John Neal	Three weeks' fixed remuneration for each year of service capped at 12 months' fixed remuneration on termination if not a "bad leaver"
Retirement benefit	All	No specific arrangements in place (excluding superannuation)
Post-employment restraints	John Neal	12 month non-compete agreement
	Neil Drabsch	Two year non-compete agreement post retirement

4. Non-executive directors' remuneration

Remuneration philosophy

Non-executive director remuneration reflects QBE's desire to attract, motivate and retain independent experienced directors and to ensure their active participation in the Group's affairs for the purposes of corporate governance, regulatory compliance and other matters. QBE aims to provide a level of remuneration for non-executive directors comparable with its peers, which include multinational financial institutions. The Board reviews surveys published by independent remuneration consultants and other public information to ensure that fee levels are appropriate. The remuneration arrangements of non-executive directors are distinct and separate from the executives. Non-executive directors do not have formal service agreements.

Non-executive directors' fee pool

The aggregate amount approved by shareholders at the 2007 AGM was A$2.7 million per annum. Approval will be sought at the March 2013 AGM to increase the non-executive director fee pool to A$3.3 million per annum.

Fee framework

Under the current fee framework, non-executive directors receive a base fee in Australian dollars. In addition, a non-executive director (other than the chairman of all committees and all members of the Funding Committee) may receive further fees for chairmanship or membership of a board committee. Non-executive director fees were increased by 3.59% effective 1 January 2012 but will not increase in 2013.

Active committees in 2012 were as follows:

- Audit and Risk Committee
- Investment Committee
- Remuneration Committee

The approved non-executive director fee structure for 2012 and 2011 is shown in the table below:

FEE FRAMEWORK	2012 US$000	2011 US$000
Chairman base fee	**667**	647
Non-executive director base fee	**209**	203
Committee chairman base fee	**50**	49
Committee membership fee	**27**	27

The Funding Committee met in 2012; however, its members received no fees.

Other benefits

Non-executive directors do not receive any performance-based remuneration such as cash incentives or equity awards. Under the company's constitution, non-executive directors are entitled to be reimbursed for all travel and related expenses properly incurred in connection with the business of the company. Non-executive directors based overseas receive an annual cash travel allowance in addition to fees for the extra time involved, (except Irene Lee who was originally based in Australia).

Superannuation

QBE pays superannuation of 9% to Australian-based non-executive directors. Overseas-based non-executive directors receive the cash equivalent amount as additional fees.

Other retirement benefits

Non-executive directors previously received a retirement allowance based on their period of service. The allowance was limited to the aggregate of the director's fees in the last three years of service, subject to a minimum of 10 years' service. Where service was less than 10 years, a pro-rata amount was paid. With effect from 31 December 2003, the Board terminated the retirement allowance to non-executive directors. Accrued retirement benefits at 31 December 2003 are preserved until retirement and are subject to an annual increase equal to the average five year Australian government bond rate. Shareholders approved an increase in non-executive directors' remuneration, and the company's constitution was amended at the 2004 AGM to recognise this change.

The table below sets out the preserved retirement allowances of the relevant non-executive directors for the year ended 31 December 2012.

RETIREMENT ALLOWANCE [1]	2012 US$000	2011 US$000
Len Bleasel AM [2]	**–**	148
Belinda Hutchinson AM	**347**	331
Charles Irby	**136**	130
Irene Lee	**99**	94

1 Retirement allowance has been converted to US dollars using the closing rate of exchange for the relevant year.

2 Len Bleasel retired on 30 September 2012. He received his accrued retirement allowance of $153,000 (A$147,000).

Remuneration report CONTINUED

Remuneration

Details of the nature and amount of each component of the remuneration of our non-executive directors for the year ended 31 December 2012 are set out in the table below:

		SHORT-TERM EMPLOYMENT BENEFITS		POST EMPLOYMENT BENEFITS		
NON-EXECUTIVE DIRECTOR	YEAR	FEES[1] US$000	OTHER[2] US$000	SUPERANNUATION US$000	RETIREMENT BENEFITS US$000	TOTAL[3] US$000
Duncan Boyle	2012	291	1	23	–	315
	2011	287	1	17	–	305
John Graf [4]	2012	123	–	–	–	123
	2011	–	–	–	–	–
John Green	2012	268	–	20	–	288
	2011	264	–	15	–	279
Isabel Hudson	2012	341	–	–	–	341
	2011	324	–	–	–	324
Belinda Hutchinson AM	2012	710	–	17	9	736
	2011	691	–	14	15	720
Charles Irby	2012	335	–	–	4	339
	2011	324	–	–	6	330
Irene Lee	2012	313	–	–	3	316
	2011	287	1	17	4	309
Non-executive director who left in 2012						
Len Bleasel AM [5]	2012	219	–	15	3	237
	2011	287	–	17	6	310
Total	2012	2,600	1	75	19	2,695
	2011	2,464	2	80	31	2,577

1 Charles Irby and Isabel Hudson are UK residents. John Graf is a US resident. They each receive an annual travel allowance of $43,000 (A$41,500) and, in lieu of superannuation in Australia, additional fees of 9%, both of which are included in directors' fees. Irene Lee is a Hong Kong resident and receives additional fees of 9% in lieu of superannuation, which is included in her directors' fees.

2 Staff insurance discount benefits received during the year.

3 Remuneration has been converted to US dollars using the average rate of exchange for the relevant year.

4 John Graf was appointed on 20 August 2012. Remuneration is for the period 20 August to 31 December 2012.

5 Len Bleasel retired on 30 September 2012. Remuneration is for the period 1 January to 30 September 2012 and excludes payment of retirement allowance (see page 101).

5. Glossary and terms

TERM	DEFINITION
Combined operating ratio (COR)	Refer to the glossary of insurance terms.
Deferred Compensation Plan (DCP)	A legacy remuneration arrangement granting equity benefits which ceased from 1 January 2010. Only executives were invited to participate.
Diluted earnings per share	Refer to note 28 to the financial statements.
Fixed remuneration	All guaranteed pay inclusive of base salary, superannuation and other guaranteed benefits.
Key management personnel (KMP)	Accounting standards require disclosure of the remuneration of directors (executive and non-executive) and those persons having authority and responsibility for planning, directing and controlling the activities of the Group, either directly or indirectly. This group is collectively defined as "key management personnel". AASB 124: Related Party Disclosures specifically requires that non-executive directors are included as key management personnel even though they are not part of QBE's "management". The individuals included on page 88 were considered key management personnel for either the full reporting period or part thereof because they are members of the Group Executive, being the management body responsible for the Group's strategy and operation. The term is generally used in the report to refer to executives only, as appropriate.
Long-Term Incentive Plan (LTI)	The at-risk reward structure that grants equity awards subject to a five year vesting period and performance hurdles. Details are provided on page 94 of this report. Participation in the LTI is limited to key management personnel excluding non-executive directors.
QBE Incentive Scheme (QIS)	The at-risk reward structure that comprises cash awards and deferred equity awards effective from 1 January 2010 to 31 December 2012. Details are provided on page 92 of this report. Participation in the QIS is limited to key management personnel excluding non-executive directors.
Return on equity (ROE)	Net profit after tax (NPAT) on a management basis as a percentage of adjusted opening allocated capital. For the determination of Group incentives, the management result is net profit after tax on a seven year spread basis of accounting, which spreads realised and unrealised gains on equities and properties evenly over a seven year period. This is adjusted to add back the non-cash expense of amortisation and impairment of identifiable intangible assets and tax thereon. Opening allocated capital is adjusted for dividend and capital movements in the year.

Legacy equity schemes

DEFERRED COMPENSATION PLAN (DCP)	DESCRIPTION
Until 31 December 2008 and applicable to awards granted in March 2009 and prior	For DCP awards made up to and including March 2009 in relation to financial performance in 2008 and prior years, KMP were provided with the opportunity to acquire equity in the form of conditional rights to fully paid shares without payment and options to subscribe for shares at market value at the grant date. The DCP award amount was restricted to the lesser of 66.67% of the short-term incentive (STI) award for that year or 100% of fixed remuneration or base (cash) salary as at 31 December in the financial year prior to the year in which the STI award was paid. This DCP award amount was used to acquire conditional rights to fully paid shares and options respectively as follows: • conditional rights to shares to the value of 60% of the DCP award, converted to shares after three years; and • options over ordinary shares to the value of 40% of the DCP award, with the resulting number multiplied by three, exercisable after five years (three years if in Group Investment division). Interest free personal recourse loans were available on terms permitted by the Employee Share and Option Plan to persons in the employment of QBE who hold options under the DCP, to fund the exercise of the options. Interest-free personal recourse loans under the DCP will cease by 5 March 2015 after the final vesting of all incentives granted in March 2009.
From 1 January 2009 and applicable to awards granted in March 2010	For DCP awards made in March 2010 in respect of financial performance for 2009, executives received conditional rights to fully paid shares. The maximum DCP award was based on an amount which is the lesser of 80% of the STI award (previously 66.67%) in that year or 100% of fixed remuneration or base (cash) salary as at 31 December in the financial year prior to the year in which the STI award is paid. The maximum DCP award was used as the basis of calculating the number of conditional rights to fully paid shares as follows: • conditional rights to the value of 50% of the DCP award, converted to shares after three years; and • conditional rights to the value of 50% of the DCP award, converted to shares after five years. The vesting of the conditional rights is contingent on there being no material subsequent deterioration of the consolidated entity's ROE during the vesting period.
All awards	Conditional rights and options relating to the achievement of profit targets in the financial year were granted in March of the following year. The share price upon which the allocation of conditional rights was calculated was the volume weighted average sale price of QBE shares over the five trading days on the ASX prior to the grant date. Notional dividends earned are added to the value of the conditional rights granted during the vesting period.

Remuneration report CONTINUED

6. Valuation of conditional rights and options

Conditional rights

Details of conditional rights issued affecting remuneration of key management personnel in the previous, current or future reporting periods are as follows:

GRANT DATE	DATE EXERCISABLE	VALUE PER RIGHT AT GRANT DATE [1]
4 March 2008	3 March 2011	A$24.22
4 April 2008	4 April 2011	A$27.00
1 January 2009	2 January 2012	A$25.37
6 March 2009	5 March 2012	A$17.57
5 March 2010	4 March 2013	A$20.90
5 March 2010	4 March 2015	A$20.90
31 March 2010	30 March 2013	A$20.90
31 March 2010	30 March 2015	A$20.90
1 January 2011	1 January 2014	A$18.44
7 March 2011	6 March 2014	A$17.93
7 March 2011	6 March 2016	A$17.93
5 April 2011	4 April 2014	A$17.93
5 April 2011	4 April 2016	A$17.93
18 October 2011	1 January 2013	A$14.05
1 January 2012	1 January 2015	A$13.11
7 March 2012	6 March 2015	A$11.78
7 March 2012	6 March 2017	A$11.78
5 April 2012	4 April 2015	A$14.25
1 September 2012	1 March 2013	A$13.03
1 September 2012	1 March 2014	A$13.03
1 September 2012	1 March 2015	A$13.03

1 The fair value at grant date of conditional rights is calculated using a binomial model. The fair value of each conditional right is recognised evenly over the service period ending at vesting date. Details of grants of conditional rights are provided in note 31 to the financial statements.

Options

Options affecting remuneration of key management personnel in the previous, current or future reporting periods are as follows:

GRANT DATE	DATE EXERCISABLE	EXPIRY DATE	EXERCISE PRICE	VALUE PER RIGHT AT GRANT DATE [1]
2 March 2006	1 March 2011	2 March 2012	A$20.44	A$4.58
7 April 2006	6 April 2011	7 April 2012	A$20.44	A$5.63
2 March 2007	1 March 2012	2 March 2013	A$32.68	A$6.28
2 March 2007	28 February 2011	31 March 2012	A$20.44	A$12.55
4 April 2007	3 April 2012	4 April 2013	A$32.68	A$6.28
4 March 2008	3 March 2011	3 March 2012	A$24.22	A$3.98
4 March 2008	4 March 2013	4 March 2014	A$24.22	A$4.63
4 March 2008	28 February 2011	31 March 2012	A$20.44	A$3.36
4 April 2008	3 April 2013	4 April 2014	A$27.00	A$5.16
7 March 2009	5 March 2012	6 March 2013	A$17.57	A$2.36
6 March 2009	5 March 2014	6 March 2015	A$17.57	A$2.81
6 March 2009	28 February 2011	31 March 2012	A$20.44	A$2.77
5 March 2010	28 February 2011	31 March 2012	A$20.44	A$1.88
7 March 2011	28 February 2011	31 March 2012	A$20.44	nil

1 The fair value at grant date of options is calculated using a binomial model. The fair value of each option is recognised evenly over the service period ending at vesting date. Details of grants of options are provided in note 31 to the financial statements.

Directors' report CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2012

Auditor

PricewaterhouseCoopers, Chartered Accountants, continue in office in accordance with section 327B of the *Corporations Act 2001*.

Non-audit services

During the year, PricewaterhouseCoopers has performed certain other services in addition to its statutory duties.

The Board of directors has considered the position and, in accordance with the advice received from the Audit Committee, is satisfied that the provision of the non-audit services is compatible with the general standard of independence for auditors imposed by the *Corporations Act 2001*. The directors are satisfied that the provision of non-audit services by the auditor, as provided in note 35 to the financial statements, did not compromise the auditor independence requirements of the *Corporations Act 2001* for the following reasons:

- all non-audit services have been reviewed by the Audit Committee to ensure that they do not impact the impartiality and objectivity of the auditor; and
- none of the services undermine the general principles relating to auditor independence as set out in APES 110: Code of Ethics for Professional Accountants.

A copy of the auditor's independence declaration required under section 307C of the *Corporations Act 2001* is set out on page 106.

Details of amounts paid or payable to PricewaterhouseCoopers for audit and non-audit services are provided in note 35 to the financial statements.

Rounding of amounts

The company is of a kind referred to in the ASIC class order 98/100 dated 10 July 1998 (as amended by class order 04/667 dated 15 July 2004) relating to the "rounding off" of amounts in the directors' report. Amounts have been rounded off in the directors' report to the nearest million dollars or, in certain cases, to the nearest thousand dollars in accordance with that class order.

Signed in SYDNEY this 26th day of February 2013 in accordance with a resolution of the directors.

BJ Hutchinson AM
Director

JD Neal
Director

Directors' report CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2012

Auditor's independence declaration for the year ended 31 December 2012

As lead auditor for the audit of QBE Insurance Group Limited for the year ended 31 December 2012, I declare that, to the best of my knowledge and belief, there have been:

(a) no contraventions of the auditor independence requirements of the *Corporations Act 2001* in relation to the audit; and

(b) no contraventions of any applicable code of professional conduct in relation to the audit.

This declaration is in respect of QBE Insurance Group Limited and the entities it controlled during the period.

K.G. Smith.

KG Smith
Partner, PricewaterhouseCoopers

Sydney
26 February 2013

Financial report contents

Financial statements

Notes to the financial statements

This financial report includes the consolidated financial statements for QBE Insurance Group Limited (the ultimate parent entity or the company) and its controlled entities (QBE or the Group). All amounts in the financial report are presented in US dollars unless otherwise stated.

QBE Insurance Group Limited is a company limited by shares, incorporated and domiciled in Australia. Its registered office is located at:

Level 2, 82 Pitt Street
Sydney NSW 2000
Australia

A description of the nature of the Group's operations and its principal activities is included on pages 9 to 63, none of which is part of this financial report.

The financial report was authorised for issue by the directors on 26 February 2013.

Through the use of the internet, we have ensured that our corporate reporting is timely, complete and available globally at minimum cost to the company. All material press releases, financial reports and other information are available at our QBE investor centre on our website: www.qbe.com.

Consolidated statement of comprehensive income

FOR THE YEAR ENDED 31 DECEMBER 2012

	NOTE	2012 US$M	2011 US$M
Gross written premium		18,434	18,291
Unearned premium movement		(93)	(451)
Gross earned premium revenue	6(A)	18,341	17,840
Outward reinsurance premium		(2,360)	(2,592)
Deferred reinsurance premium movement		(183)	111
Outward reinsurance premium expense	6(B)	(2,543)	(2,481)
Net earned premium (a)		15,798	15,359
Gross claims incurred	6(B), 8	(12,695)	(12,540)
Reinsurance and other recoveries revenue	6(A), 8	2,267	2,074
Net claims incurred (b)	8	(10,428)	(10,466)
Gross commission expense	6(B)	(2,874)	(2,567)
Reinsurance commission revenue	6(A)	314	276
Net commission (c)		(2,560)	(2,291)
Other acquisition costs (d)	6(B)	(800)	(720)
Underwriting and other expenses (e)	6(B)	(1,557)	(1,388)
Underwriting result (a)+(b)+(c)+(d)+(e)		453	494
Investment and other income – policyholders' funds	7	845	612
Investment expenses – policyholders' funds	7	(36)	(21)
Insurance profit		1,262	1,085
Investment and other income – shareholders' funds	7	421	207
Investment expenses – shareholders' funds	7	(14)	(22)
Financing and other costs	6(B)	(324)	(275)
Share of net profits of associates	18	3	6
Amortisation of intangibles and impairment of goodwill/intangibles	6(B)	(407)	(133)
Profit before income tax		941	868
Income tax expense	9	(161)	(149)
Profit after income tax		780	719
Other comprehensive income			
Net movement in foreign currency translation reserve	26(D)	(75)	(195)
Actuarial losses on defined benefit superannuation plans	24(C)	(46)	(17)
Gains on revaluation of owner occupied properties	26(D)	1	5
Associates' share of other comprehensive income	26(D)	4	(2)
Income tax relating to components of other comprehensive income		(1)	(41)
Other comprehensive income (expense) after income tax		(117)	(250)
Total comprehensive income after income tax		663	469
Profit after income tax attributable to:			
Ordinary equity holders of the company		761	704
Non-controlling interests		19	15
		780	719
Total comprehensive income after income tax attributable to:			
Ordinary equity holders of the company		644	454
Non-controlling interests		19	15
		663	469

Earnings per share for profit after income tax attributable to ordinary equity holders of the company	NOTE	2012 US CENTS	2011 US CENTS
Basic earnings per share	28	65.1	64.9
Diluted earnings per share	28	61.6	61.3

The consolidated statement of comprehensive income should be read in conjunction with the accompanying notes.

Consolidated balance sheet

AS AT 31 DECEMBER 2012

	NOTE	2012 US$M	2011 US$M
Assets			
Cash and cash equivalents	10	**2,025**	1,457
Investments	11	**29,471**	26,466
Derivative financial instruments	12	**24**	42
Trade and other receivables	13	**5,232**	5,514
Current tax assets		**3**	347
Reinsurance and other recoveries on outstanding claims	22	**4,377**	3,693
Other assets		**10**	30
Deferred insurance costs	14	**2,606**	2,432
Assets held for sale		**–**	73
Defined benefit plan surpluses	24	**1**	1
Property, plant and equipment	15	**564**	448
Deferred tax assets	16	**290**	86
Investment properties	17	**29**	28
Investment in associates	18	**62**	55
Intangible assets	19	**6,068**	6,065
Total assets		**50,762**	46,737
Liabilities			
Derivative financial instruments	12	**14**	45
Trade and other payables	20	**2,012**	1,817
Current tax liabilities		**451**	162
Unearned premium	21	**8,559**	8,069
Outstanding claims	22	**22,789**	20,677
Provisions	23	**76**	95
Defined benefit plan deficits	24	**139**	102
Deferred tax liabilities	16	**373**	575
Borrowings	25	**4,932**	4,757
Total liabilities		**39,345**	36,299
Net assets		**11,417**	10,438
Equity			
Share capital	26(A)	**10,002**	8,939
Treasury shares held in trust	26(B)	**(1)**	(2)
Equity component of hybrid securities	26(C)	**134**	132
Reserves	26(D)	**(1,859)**	(1,776)
Retained profits		**3,082**	3,093
Shareholders' funds		**11,358**	10,386
Non-controlling interests		**59**	52
Total equity		**11,417**	10,438

The consolidated balance sheet should be read in conjunction with the accompanying notes.

Consolidated statement of changes in equity

FOR THE YEAR ENDED 31 DECEMBER 2012

2012	SHARE CAPITAL US$M	TREASURY SHARES HELD IN TRUST US$M	EQUITY COMPONENT OF HYBRID SECURITIES US$M	RESERVES US$M	RETAINED PROFITS US$M	SHARE-HOLDERS' FUNDS US$M	NON-CONTROLLING INTERESTS US$M	TOTAL EQUITY US$M
As at 1 January	8,939	(2)	132	(1,776)	3,093	10,386	52	10,438
Profit after income tax	–	–	–	–	761	761	19	780
Other comprehensive income	–	–	–	(86)	(31)	(117)	–	(117)
Total comprehensive income	–	–	–	(86)	730	644	19	663
Transactions with owners in their capacity as owners								
Shares acquired and held in trust	–	(27)	–	–	–	(27)	–	(27)
Share based payment expense	–	–	–	36	–	36	–	36
Shares vested and/or released to participants	–	28	–	(28)	–	–	–	–
Contributions of equity, net of transaction costs and tax	920	–	–	–	–	920	–	920
Purchase of non-controlling interests	–	–	–	(8)	–	(8)	(3)	(11)
Dividends paid on ordinary shares	–	–	–	–	(781)	(781)	(7)	(788)
Dividend reinvestment under Bonus Share Plan	–	–	–	–	40	40	–	40
Foreign exchange	143	–	2	3	–	148	(2)	146
As at 31 December	10,002	(1)	134	(1,859)	3,082	11,358	59	11,417

2011	SHARE CAPITAL US$M	TREASURY SHARES HELD IN TRUST US$M	EQUITY COMPONENT OF HYBRID SECURITIES US$M	RESERVES US$M	RETAINED PROFITS US$M	SHARE-HOLDERS' FUNDS US$M	NON-CONTROLLING INTERESTS US$M	TOTAL EQUITY US$M
As at 1 January	7,972	(1)	132	(1,527)	3,735	10,311	82	10,393
Profit after income tax	–	–	–	–	704	704	15	719
Other comprehensive income	–	–	–	(244)	(6)	(250)	–	(250)
Total comprehensive income	–	–	–	(244)	698	454	15	469
Transactions with owners in their capacity as owners								
Shares acquired and held in trust	–	(29)	–	–	–	(29)	–	(29)
Share based payment expense	–	–	–	40	–	40	–	40
Shares vested and/or released to participants	–	28	–	(28)	–	–	–	–
Taxation on options	–	–	–	(1)	–	(1)	–	(1)
Contributions of equity, net of transaction costs and tax	982	–	–	–	–	982	–	982
Purchase of non-controlling interests	–	–	–	(16)	–	(16)	(29)	(45)
Dividends paid on ordinary shares	–	–	–	–	(1,391)	(1,391)	(14)	(1,405)
Dividend reinvestment under Bonus Share Plan	–	–	–	–	51	51	–	51
Foreign exchange	(15)	–	–	–	–	(15)	(2)	(17)
As at 31 December	8,939	(2)	132	(1,776)	3,093	10,386	52	10,438

Consolidated statement of cash flows

FOR THE YEAR ENDED 31 DECEMBER 2012

	NOTE	2012 US$M	2011 US$M
Operating activities			
Premium received		**18,886**	16,994
Reinsurance and other recoveries received		**2,159**	1,582
Outward reinsurance paid		**(2,527)**	(2,580)
Claims paid		**(11,151)**	(9,967)
Acquisition and other underwriting costs paid		**(4,861)**	(4,051)
Interest received		**834**	846
Dividends received		**24**	17
Other operating income		**58**	58
Other operating payments		**(352)**	(360)
Interest paid		**(316)**	(297)
Income taxes paid		**(1)**	(103)
Net cash flows from operating activities [1]	10	**2,753**	2,139
Investing activities			
Proceeds on sale of equity investments		**1,070**	1,179
Purchase of equity investments		**(801)**	(1,173)
Proceeds from (payments for) forward foreign exchange contracts		**36**	(54)
Purchase of other investments		**(1,773)**	(2,884)
Proceeds on disposal of controlled entities		**–**	41
Payments for controlled entities and businesses acquired [2]		**(520)**	(498)
Proceeds on sale of investment property		**76**	1
Purchase of investment property		**–**	(5)
Proceeds on sale of property, plant and equipment		**4**	2
Purchase of property, plant and equipment		**(289)**	(140)
Net cash flows from investing activities		**(2,197)**	(3,531)
Financing activities			
Proceeds from issue of shares		**635**	396
Share issue expenses		**(9)**	–
Proceeds from settlement of staff share loans		**14**	11
Purchase of treasury shares		**(30)**	(29)
Proceeds from borrowings		**986**	1,767
Repayment of borrowings		**(1,066)**	(219)
Dividends paid		**(466)**	(776)
Net cash flows from financing activities		**64**	1,150
Net movement in cash and cash equivalents		**620**	(242)
Cash and cash equivalents at the beginning of the financial year		**1,457**	1,686
Effect of exchange rate changes		**(52)**	13
Cash and cash equivalents at the end of the financial year	10	**2,025**	1,457

1 Included within net cash flows from operating activities are premiums received of $1,796 million (2011 $811 million), reinsurance recoveries received of $404 million (2011 $52 million), outward reinsurance paid of $507 million (2011 $234 million) and claims paid of $1,395 million (2011 $374 million) that are paid in to/out of a specified account as required by government authorities.

2 Net of cash acquired.

The consolidated statement of cash flows should be read in conjunction with the accompanying notes.

Notes to the financial statements

FOR THE YEAR ENDED 31 DECEMBER 2012

1. Summary of significant accounting policies

The principal accounting policies adopted in the preparation of the financial report are set out below. These policies have been consistently applied to all the years presented unless otherwise stated. The financial report includes the consolidated financial statements for QBE Insurance Group Limited (the company), its controlled entities (QBE or the Group) and its associates.

(A) Basis of preparation

This general purpose financial report has been prepared in accordance with Australian accounting standards, other authoritative pronouncements of the Australian Accounting Standards Board (AASB), Urgent Issues Group Interpretations and the requirements of the *Corporations Act 2001*. The Group has applied all new accounting standards and amendments that are mandatory for the first time in the current financial year. The adoption of these standards did not have any impact on the current period or any prior period and is not likely to affect future periods.

(i) Compliance with IFRS

The financial report complies with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board.

(ii) Historical cost convention

These financial statements have been prepared under the historical cost convention, as modified by certain exceptions noted in the financial report, with the principal exceptions being the measurement of financial assets at fair value and the measurement of the outstanding claims liability and related reinsurance and other recoveries at present value. Refer to note 4.

The preparation of the financial statements requires the use of certain critical accounting estimates. It also requires management to exercise judgment in the process of applying the Group's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions or estimates are significant, are disclosed in note 4.

(iii) Presentation currency

The presentation currency used in the preparation of the financial report is US dollars. The Group has selected a US dollar presentation currency because a significant proportion of its underwriting activity is denominated in US dollars. The US dollar is also the currency which is widely understood by the global insurance industry, international investors and analysts.

(B) Principles of consolidation

(i) Controlled entities

The consolidated financial statements incorporate the assets and liabilities of all entities controlled by the company as at 31 December 2012 and the results of all controlled entities for the financial year then ended. Control is defined as the power to govern the financial and operating policies, generally accompanying a shareholding of more than one-half of the voting rights. The effects of all transactions between controlled entities are eliminated in full. Non-controlling interests in the results and equity of controlled entities are shown separately in the consolidated statement of comprehensive income and balance sheet.

Where control of an entity commences during a financial year, its results are included in the consolidated statement of comprehensive income from the date on which control commences. Where control of an entity ceases during a financial year, its results are included for that part of the year during which the control existed.

(ii) Business combinations

Business combinations are accounted for using the acquisition method when control of an entity or business is obtained. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any non-controlling interest. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the controlled entity acquired, the difference is recognised directly in profit or loss. Costs of acquisition are expensed as incurred.

Where a cash settlement on acquisition is deferred, the future payable is discounted to present value. Where a cash settlement on acquisition is contingent on the outcome of uncertain future events, the fair value of the obligation is classified as a liability and is subsequently remeasured through profit or loss.

Non-controlling interests in an acquiree are recognised either at fair value or at the non-controlling interest's proportionate share of the acquiree's net identifiable assets. This decision is made on an acquisition-by-acquisition basis.

(iii) Associates

Entities over which significant influence is exercised are accounted for using equity accounting principles. Significant influence is presumed to exist where between 20% and 50% of the voting rights of an entity are held, but can also arise where less than 20% is held through active involvement and influencing policy decisions affecting the entity. The investment is initially recognised at cost (fair value of consideration provided plus directly attributable costs) and is subsequently adjusted for the post-acquisition change in the associate's net assets. The Group's share of the profit or loss of the associate is included in the profit or loss of the Group and disclosed as a separate line in the statement of comprehensive income.

Distributions received reduce the carrying amount of the investment. Movements in the total equity of the associate, being those movements that are not recognised in the profit or loss or other comprehensive income, are recognised directly in equity of the Group and disclosed in the statement of changes in equity. The investments are reviewed annually for impairment.

When the Group's share of losses exceeds its interest in the associate, the carrying amount of the investment is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred obligations or made payments on behalf of the associate.

(C) Premium revenue

Premium comprises amounts charged to policyholders, excluding taxes collected on behalf of third parties. The earned portion of premium received and receivable, including unclosed business, is recognised as revenue. Premium on unclosed business is brought to account based upon the pattern of booking of renewals and new business.

(D) Unearned premium

Unearned premium is calculated based on the term of the risk and in accordance with the expected pattern of the incidence of risk underwritten, using either the daily pro-rata method or the 24ths method, adjusted where appropriate for seasonality.

At each balance sheet date, the adequacy of the unearned premium liability is assessed on a net of reinsurance basis against the present value of the expected future cash flows relating to potential future claims in respect of the relevant insurance contracts, plus an additional risk margin to reflect the inherent uncertainty of the central estimate. The assessment is carried out at the operating segment level, being a portfolio of contracts subject to broadly similar risks and which are managed together as a single portfolio. If the present value of expected future cash flows relating to future claims plus the additional risk margin exceeds the unearned premium liability less related intangible assets and related deferred acquisition costs, then the unearned premium liability is deemed to be deficient. The resulting deficiency is recognised immediately through profit or loss.

(E) Outward reinsurance

Premium ceded to reinsurers is recognised as an expense from the attachment date over the period of indemnity of the reinsurance contract in accordance with the expected pattern of the incidence of risk. Accordingly, a portion of outward reinsurance premium is treated as a prepayment at the balance sheet date.

(F) Claims

The provision for outstanding claims is measured as the central estimate of the present value of expected future claims payments plus a risk margin. The expected future payments include those in relation to claims reported but not yet paid; claims incurred but not reported (IBNR); claims incurred but not enough reported (IBNER); and estimated claims handling costs. Claims expense represents claims payments adjusted for the movement in the outstanding claims liability.

The expected future payments are discounted to present value using a risk-free rate.

A risk margin is applied to the central estimate, net of reinsurance and other recoveries, to reflect the inherent uncertainty in the central estimate.

(G) Reinsurance and other recoveries

Reinsurance and other recoveries on paid claims, reported claims not yet paid, IBNR and IBNER are recognised as revenue.

Amounts recoverable are assessed in a manner similar to the assessment of outstanding claims. Recoveries are measured as the present value of the expected future receipts, calculated on the same basis as the provision for outstanding claims.

(H) Acquisition costs

Acquisition costs (which include commission costs) are the costs associated with obtaining and recording insurance contracts. Acquisition costs are capitalised when they relate to the acquisition of new business or the renewal of existing business and are referred to as deferred acquisition costs. These costs are amortised on the same basis as the earning pattern of the premium, over the period of the insurance contract to which they relate. At the reporting date, deferred acquisition costs represent the capitalised costs that relate to the unearned premium. Acquisition costs are deferred in recognition of their future benefit and are measured at the lower of cost and recoverable amount.

(I) Investment income

Interest income is recognised on an accruals basis. Dividends are recognised when the right to receive payment is established. Investment income includes realised and unrealised gains or losses on financial assets which are reported on a combined basis as fair value gains or losses on financial assets.

(J) Taxation

The income tax expense or revenue for the period is the tax payable on the current period's taxable income based on the applicable income tax rate for each jurisdiction, adjusted for changes in deferred tax assets and liabilities attributable to temporary differences and to unused tax losses.

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the end of the reporting period in the countries where the company's subsidiaries and associates operate and generate taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation and establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred tax liabilities are not recognised if they arise from the initial recognition of goodwill. Deferred income tax is also not accounted for if it arises from initial recognition of an asset or liability, in a transaction other than a business combination, that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the end of the reporting period and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred tax assets are recognised for deductible temporary differences and unused tax losses only if it is probable that future taxable amounts will be available to utilise those temporary differences and losses.

Deferred tax assets and liabilities are not recognised for temporary differences between the carrying amount and tax bases of investments in foreign operations where the company is able to control the timing of the reversal of the temporary differences and it is probable that the differences will not reverse in the foreseeable future.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets and liabilities and when the deferred tax balances relate to the same taxation authority. Current tax assets and tax liabilities are offset where the entity has a legally enforceable right to offset and intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

The company and its wholly-owned Australian controlled entities have implemented the tax consolidation legislation. As a consequence, these entities are taxed as a single entity and the deferred tax assets and liabilities of these entities are offset in the consolidated financial statements.

Current and deferred tax is recognised in profit or loss, except to the extent that it relates to items recognised in other comprehensive income or directly in equity. In this case, the tax is also recognised in other comprehensive income or directly in equity, as appropriate.

(K) Insurance profit

Insurance profit is derived by adding investment income on assets backing policyholders' funds to the underwriting result.

(L) Cash and cash equivalents

Cash and cash equivalents includes cash at bank and on hand and deposits at call which are readily convertible to cash on hand and which are used for operational cash requirements.

(M) Investments

Investments comprise interest-bearing assets, equities and equity derivative financial instruments. Investments are designated as fair value through profit or loss on initial recognition. They are initially recorded at fair value, being the cost of acquisition excluding transaction costs, and are subsequently remeasured to fair value at each reporting date. The policy of management is to designate a group of financial assets or financial liabilities at fair value through profit or loss when that group is both managed and its performance evaluated on a fair value basis for both internal and external reporting in accordance with the Group's documented investment strategy.

For securities traded in an active market, the fair value is determined by reference to published closing bid price quotations. For securities that are not traded and securities that are traded in a market that is not active, fair value is determined using valuation techniques generally by reference to the fair value of recent arm's length transactions involving the same or similar instruments. Fixed and floating rate securities are valued using independently sourced valuations. Discounted cash flow analysis or option pricing models may be used for a small number of investments.

All purchases and sales of investments that require delivery of the asset within the time frame established by regulation or market convention ("regular way" transactions) are recognised

Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2012

1. Summary of significant accounting policies CONTINUED

at trade date, being the date on which the Group commits to buy or sell the asset. Investments are derecognised when the right to receive future cash flows from the asset has expired or has been transferred and the Group has transferred substantially all the risks and rewards of ownership.

(N) Derivative financial instruments

The Group is subject to currency, interest rate, price, credit and liquidity risks. Derivative financial instruments (derivatives) may be used to manage these risks.

Derivatives are initially recognised at fair value, being generally the transaction price on the date a derivative contract is entered into, and are subsequently remeasured to their fair value. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument and the nature of the item being hedged. Derivatives which are not part of a hedging relationship are valued at fair value through profit or loss. Derivatives which are part of a hedging relationship are accounted for as set out in note 1(O).

For derivatives traded in an active market, the fair value of derivatives presented as assets is determined by reference to published closing bid price quotations and the fair value of derivatives presented as liabilities is determined by reference to published closing ask price quotations. For derivatives that are not traded or which are traded in a market that is not sufficiently active, fair value is determined using generally accepted valuation techniques.

(O) Hedging transactions

Borrowings and derivatives held for risk management purposes which meet the criteria specified in AASB 139: Financial Instruments: Recognition and Measurement are accounted for using fair value hedge accounting, cash flow hedge accounting, or hedging of a net investment in a foreign operation accounting, as appropriate to the risks being hedged.

In accordance with the criteria for hedge accounting, when a financial instrument is designated as a hedge, the relevant entity formally documents the relationship between the hedging instrument and hedged item as well as its risk management objectives and its strategy for undertaking the various hedging transactions. The relevant entity also documents its assessment, both at hedge inception and on an ongoing basis, of whether the hedging instruments are highly effective in offsetting changes in fair values or cash flows of hedged items.

Hedge accounting is discontinued when:

- the hedge no longer meets the criteria for hedge accounting;
- the hedging instrument expires or is sold, terminated or exercised;
- the hedged item matures, is sold or repaid; or
- the entity revokes the designation.

(i) Fair value hedge accounting

Changes in the fair value of derivatives that qualify and are designated as fair value hedges are recognised through profit or loss, together with changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. If the hedge no longer meets the criteria for hedge accounting, the fair value hedging adjustment cumulatively made to the carrying value of the hedged item is, for items carried at amortised cost, amortised over the period to maturity of the previously designated hedge relationship using the effective interest method. If the hedged item is sold or repaid, the unamortised fair value adjustment is recognised immediately through profit or loss.

(ii) Cash flow hedge accounting

For qualifying cash flow hedges, the fair value gain or loss associated with the effective portion of the cash flow hedge is initially recognised directly in shareholders' equity and transferred to profit or loss in the period when the hedged item will affect profit or loss. The gain or loss on any ineffective portion of the hedging instrument is recognised through profit or loss immediately. When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the hedged item affects profit or loss. When a transaction is no longer expected to occur, the cumulative gain or loss that was recognised in equity is immediately recognised through profit or loss.

(iii) Hedges of net investments in foreign operations

Hedges of net investments in foreign operations are accounted for in a manner similar to cash flow hedges. The gain or loss on the effective portion of the hedging instrument is recognised directly in equity and the gain or loss on the ineffective portion is recognised immediately through profit or loss. The cumulative gain or loss previously recognised in equity is recognised through profit or loss on the disposal or partial disposal of the foreign operation.

(P) Receivables

Receivables are recognised at amounts receivable less a provision for impairment. A provision for impairment is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original term of the receivable. Any increase or decrease in the provision for impairment is recognised in profit or loss within underwriting expenses. When a receivable is uncollectable, it is written off against the provision for impairment account. Subsequent recoveries of amounts previously written off are credited against underwriting expenses in profit or loss.

(Q) Borrowings

Borrowings are initially measured at fair value net of transaction costs directly attributable to the transaction and are subsequently measured at amortised cost. Any difference between the proceeds and the redemption amount is recognised through profit or loss over the period of the financial liability using the effective interest method.

Hybrid securities are those which have both liability and equity components. On issue of hybrid securities, the fair value of the liability component, being the obligation to make future payments of principal and interest to investors, is calculated using a market interest rate for an equivalent non-convertible note. The residual amount, representing the fair value of the conversion option, is included in equity with no recognition of any change in the value of the option in subsequent periods. The liability is included in borrowings and carried on an amortised cost basis with interest on the securities recognised as financing costs using the effective interest method until the liability is extinguished on conversion or maturity of the securities.

(R) Investment properties

Investment properties, being those properties held for rental income and capital appreciation, are valued by reference to external market valuations at fair value through profit or loss.

(S) Property, plant and equipment

Owner occupied properties are measured at fair value by reference to external market valuations. When a revaluation increases the carrying value of a property, the increase is credited to the revaluation reserve in equity and recognised in other comprehensive income. To the extent that the increase reverses a decrease previously recognised in profit or loss, the increase is first recognised through profit or loss.

When an asset's carrying amount is decreased as a result of a revaluation, the decrease is recognised through profit or loss. To the extent that the decrease reverses an increase previously recognised in other comprehensive income, the decrease is first recognised in other comprehensive income.

All other plant and equipment is stated at historical cost less accumulated depreciation and impairment.

Leasehold improvements, office equipment (including IT hardware and software), fixtures and fittings and motor vehicles are depreciated using the straight line method over the Group's estimated useful life of each class of asset. Estimated useful lives are between three and 10 years for all classes. An asset's carrying amount is written down to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. Refer note 1(U).

(T) Intangible assets

(i) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets acquired. For the purpose of impairment testing, goodwill is allocated to cash generating units, or groups of cash generating units, that are expected to benefit from the synergies of the business combination. For this purpose, the cash generating unit, or group of units, is determined principally by reference to how goodwill is monitored by management. The recoverability of goodwill is tested annually for impairment or more frequently when changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised as the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and its value in use.

(ii) Intangible assets

Intangible assets are measured at cost. Those with a finite useful life are amortised over their estimated useful life in accordance with the pattern of expected benefit. Estimated useful lives are between three and 21 years. Intangible assets with an indefinite useful life are not subject to amortisation but are tested for impairment annually or more often if there is an indication of impairment. Intangible assets with a finite useful life are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

(U) Impairment of assets

Assets that have an indefinite useful life are tested annually for impairment or more frequently when changes in circumstances indicate that the carrying amount may not be recoverable. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised as the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and its value in use. For the purposes of assessing impairment, assets are grouped in cash generating units which are the lowest levels for which there are separately identifiable cash flows.

Impairment testing of goodwill is explained in note 1(T)(i).

(V) Provisions

Provisions for liabilities are made when the Group has a legal or constructive obligation to transfer economic benefits that are of uncertain timing or amount. Provisions are determined based on management's best estimate of the expenditure required to settle the obligation. Expected future payments are discounted to present value. The provision for long service leave is explained in note 1(AA)(v). The provision for contingent consideration in relation to business combinations is explained in note 1(B)(ii).

(W) Foreign currency

(i) Presentation currency

The Group's financial statements are presented in US dollars because a significant proportion of its underwriting activity is denominated in US dollars and because the US dollar is widely accepted and understood by the global insurance industry, international investors and analysts. See note 1(A)(iii).

(ii) Translation of foreign currency transactions and balances

Items included in the financial statements of controlled entities are measured using the currency of the primary economic environment in which the entity operates (the functional currency). Foreign currency transactions are translated into functional currencies at the spot rates of exchange applicable at the dates of the transactions. At the balance sheet date, monetary assets and liabilities denominated in foreign currencies are retranslated at the rates of exchange prevailing at that date. Resulting exchange gains and losses are included in profit or loss.

(iii) Translation of foreign operations

The results and balance sheets of all foreign operations that have a functional currency different from the Group's presentation currency are translated into the presentation currency as follows:

- assets and liabilities are translated at the closing balance sheet date rates of exchange; and
- income and expenses are translated at cumulative average rates of exchange.

On consolidation, exchange differences arising from the translation of the net investment in foreign operations, and of financial liabilities and other instruments designated as hedges of foreign operations, are taken to shareholders' equity and recognised in other comprehensive income. When a foreign operation is sold in whole or part, these exchange differences are reversed out of other comprehensive income and recognised in profit or loss as part of the gain or loss on sale.

(iv) Hedging transactions

Derivatives and borrowings may be used to hedge the foreign exchange risk relating to certain transactions. Refer to note 1(O).

(v) Exchange rates

The principal exchange rates affecting the Group were:

	2012		2011	
	PROFIT OR LOSS	BALANCE SHEET	PROFIT OR LOSS	BALANCE SHEET
A$/US$	**1.036**	**1.040**	1.041	1.022
£/US$	**1.589**	**1.623**	1.605	1.554
€/US$	**1.291**	**1.319**	1.392	1.294

(X) Equity

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction from the proceeds, net of tax.

The equity component of hybrid securities is calculated and disclosed as set out in note 1(Q).

(Y) Earnings per share

(i) Basic earnings per share

Basic earnings per share is determined by dividing net profit after income tax attributable to members of the company, adjusted for the cost of servicing equity other than ordinary shares, by the weighted average number of ordinary shares outstanding during the financial year, adjusted for bonus elements in ordinary shares issued during the year, and excluding treasury shares (see note AB).

(ii) Diluted earnings per share

Diluted earnings per share adjusts the earnings figure used in the determination of basic earnings per share to exclude the after income tax effect of interest and other financing costs associated with dilutive potential ordinary shares, and adjusts the weighted average number of shares assumed to have been issued for no consideration. It also adjusts the weighted average number of shares to include dilutive potential ordinary shares and instruments with a mandatory conversion feature.

Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2012

1. Summary of significant accounting policies CONTINUED

(Z) Dividends

Provision is made for dividends which are declared, being appropriately authorised and no longer at the discretion of the entity, on or before the end of the financial year but not distributed at the balance sheet date.

(AA) Employee benefits

(i) Superannuation

The Group participates in a number of superannuation plans and contributes to these plans in accordance with plan rules and actuarial recommendations, which are designed to ensure that each plan's funding provides sufficient assets to meet its liabilities.

Defined contribution plans

Defined contribution plans are post-employment benefit plans under which an entity pays a fixed contribution into a fund during the course of employment and has no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods. Contributions to defined contribution plans are expensed as incurred.

Defined benefit plans

Defined benefit plans are post-employment benefit plans other than defined contribution plans. The liability recognised in the balance sheet in respect of defined benefit superannuation plans is the present value of the defined benefit obligation at the balance sheet date less the fair value of plan assets, adjusted for any unrecognised past service costs. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high quality corporate or government bonds that are denominated in the currency in which the benefits will be paid, and that have a term to maturity approximating the term of the related superannuation liability. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are recognised directly in equity and shown in other comprehensive income. Past service costs are recognised immediately in profit or loss, unless the changes to the superannuation plan are conditional on the employees remaining in service for a specified period of time (the vesting period), in which case the past service costs are amortised on a straight line basis over the vesting period.

(ii) Share based payments

Share based remuneration is provided in various forms to eligible employees and executives. All of the arrangements are equity settled, share based payments. The fair value of the employee services received in exchange for the grant of those instruments is recognised as an expense. The total amount to be expensed over the vesting period is determined by reference to the fair value of the instruments granted, excluding the impact of any non-market vesting conditions. The fair value at grant date of the options and conditional rights is calculated using a binomial model. The fair value of each instrument is recognised evenly over the service period ending at the vesting date. Non-market vesting conditions are included in assumptions about the number of instruments that are expected to become exercisable.

At each balance sheet date, the Group revises its estimates of the number of options that are expected to become exercisable due to the achievement of vesting conditions. The Group recognises the impact of the revision of original estimates, if any, in profit or loss with a corresponding adjustment to equity.

(iii) Profit sharing and bonus plans

The Group recognises a liability and an expense for bonuses and profit sharing based on a formula that takes into consideration the profit attributable to the company's shareholders.

(iv) Termination benefits

Termination benefits are payable when employment is terminated before the normal retirement date or when an employee accepts voluntary redundancy in exchange for these benefits. The Group recognises termination benefits when it has demonstrably committed to either:

- terminating the employment of current employees according to a detailed formal plan without possibility of withdrawal; or
- providing termination benefits as a result of an offer made to encourage voluntary redundancy.

(v) Long service leave

The provision for long service leave is measured as the present value of expected future payments to be made in respect of services provided by employees up to the reporting date using the projected unit credit method. Benefits due more than 12 months after the balance sheet date are discounted to present value.

(AB) Treasury shares held in trust

Treasury shares are shares in the Group that are held by trusts for the purpose of satisfying the company's obligations under the Employee Share and Option Plan (the Plan). The assets, liabilities and results of share based remuneration trusts are included in the balance sheet and results of the Group. Any shares in the company held by a trust are measured at cost (including any attributable acquisition costs). No gain or loss is recognised in profit or loss on the sale, cancellation or reissue of these shares. On consolidation, these shares are presented on the balance sheet as treasury shares held in trust and represent a reduction in equity.

(AC) Leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to profit or loss on a straight line basis over the period of the lease.

(AD) Rounding of amounts

The company is of a kind referred to in the ASIC class order 98/100 dated 10 July 1998 (as amended by class order 04/667 dated 15 July 2004) relating to the "rounding off" of amounts in the financial statements. Amounts have been rounded off in the financial statements to the nearest million dollars or, in certain cases, to the nearest thousand dollars in accordance with that class order.

(AE) Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the Group Executive, being the management body responsible for the Group's strategy and operations, and the Group Board of directors.

(AF) Ultimate parent entity financial information

Shares in controlled entities are recorded at cost less a provision for impairment in the ultimate parent entity balance sheet.

2. New accounting standards and amendments

TITLE		OPERATIVE DATE
AASB 9	Financial Instruments	1 January 2015
AASB 9 (revised)	Financial Instruments	1 January 2015
AASB 10	Consolidated Financial Statements	1 January 2013
AASB 11	Joint Arrangements	1 January 2013
AASB 12	Disclosure of Interests in Other Entities	1 January 2013
AASB 13	Fair Value Measurement	1 January 2013
AASB 119 (revised)	Employee Benefits	1 January 2013
AASB 127 (revised)	Separate Financial Statements	1 January 2013
AASB 128	Investments in Associates and Joint Ventures	1 January 2013
2011-4	Amendments to Australian Accounting Standards to Remove Individual Key Management Personnel Disclosure Requirements	1 January 2014
2011-9	Amendments to Australian Accounting Standards – Presentation of Items of Other Comprehensive Income	1 January 2013
2012-2	Amendments to Australian Accounting Standards – Disclosures – Offsetting Financial Assets and Financial Liabilities	1 January 2013
2012-3	Amendments to Australian Accounting Standards – Offsetting Financial Assets and Financial Liabilities	1 January 2014
2012-5	Amendments to Australian Accounting Standards arising from the Annual Improvements 2009-2011 cycle	1 January 2013
2012-10	Amendments to Australian Accounting Standards – Transition Guidance and Other Amendments	1 January 2013

The Australian accounting standards and amendments detailed in the table above are not mandatory for the Group until the operative dates stated; however, early adoption is permitted except for AASB 2011-4, where early adoption is not permitted.

The Group will apply the standards and amendments detailed above for the reporting periods beginning on the operative dates set out above. An initial assessment of the financial impact of the standards and amendments has been undertaken and they are not expected to have a material impact on the Group's financial statements or accounting policies.

3. Segment information

(A) Operating segments

Australian Accounting Standard 8: Operating Segments (AASB 8) requires an entity to disclose information to enable users of its financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates. In accordance with AASB 8, the Group has identified its operating segments based on the reports that are used by the Group Executive (being the chief operating decision maker) and the Group Board of directors for measuring performance and determining the allocation of capital. The operating segments have been identified by management based on the way that the Group's underwriting products and services are managed within the various markets in which we operate.

The Group is an international general insurance and reinsurance group underwriting most major commercial and personal lines classes of business through operations in 48 countries. The business is managed as follows:

- North American Operations writes general insurance and reinsurance business in the US and Bermuda.
- Latin American Operations writes general insurance business in North, Central and South America.
- European Operations writes general insurance business principally in the UK and throughout mainland Europe, both general insurance and reinsurance business through Lloyd's of London, and reinsurance business in Ireland and mainland Europe.
- Australian & New Zealand Operations primarily underwrites general insurance risks throughout Australia and New Zealand, providing all major lines of insurance for personal and commercial risks.
- Asia Pacific Operations provides personal, commercial and specialist general insurance covers throughout the Asia Pacific region.
- Equator Re is based in Bermuda and provides reinsurance protection to related entities. All inward premium received by Equator Re is derived from within the Group and is eliminated on consolidation.

As a result of management changes during the year, New Zealand Operations (previously reported as part of Asia Pacific Operations) is now reported together with Australian Operations as Australian & New Zealand Operations. Asia Pacific Operations now excludes New Zealand Operations from its management reporting. We have restated comparatives accordingly.

Intersegment transactions are priced on an arm's length basis and are eliminated on consolidation. Gross earned premium has been analysed by class of business in note 5(B)(i).

In determining the allocation of liabilities, and therefore net assets, by operating segment we are required to make assumptions over the allocation of the Group's risk margin. The determination of the appropriate risk margin is necessarily undertaken at the consolidated entity level in order to recognise the benefits of product and geographic diversification. This determination is made on a consolidated basis in accordance with the requirements of AASB 1023 and as explained in note 4(A)(iii). The allocation of the Group risk margin to operating segment is performed at a Group level. Reporting by operating segment is performed on a basis consistent with the way in which the business is managed. For Australian & New Zealand Operations, Asia Pacific Operations and Equator Re, this management basis fully reflects AASB 1023 requirements. Additional risk margins have been added to North American Operations and Equator Re in the current year.

Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2012

3. Segment information CONTINUED

2012	NORTH AMERICAN OPERATIONS US$M	LATIN AMERICAN OPERATIONS US$M	EUROPEAN OPERATIONS US$M	AUSTRALIAN AND NEW ZEALAND OPERATIONS US$M	ASIA PACIFIC OPERATIONS US$M	EQUATOR RE US$M	EQUATOR RE ELIMINATION US$M	TOTAL US$M
Total assets	14,781	1,967	18,134	14,300	1,549	7,411	(7,380)	50,762
Total liabilities	11,676	1,555	15,383	11,209	1,072	5,830	(7,380)	(39,345)
Net assets	3,105	412	2,751	3,091	477	1,581	–	11,417
Property, plant and equipment	217	55	124	154	14	–	–	564
Investment properties	3	3	19	–	4	–	–	29
Intangible assets	3,250	241	723	1,792	62	–	–	6,068
Gross written premium	6,569	1,223	5,077	4,987	578	3,710	(3,710)	18,434
Gross earned premium revenue – external	6,978	1,170	4,854	4,794	545	–	–	18,341
Gross earned premium revenue – internal	–	–	–	–	–	3,712	(3,712)	–
Outward reinsurance premium expense	(3,477)	(152)	(1,523)	(671)	(130)	(302)	3,712	(2,543)
Net earned premium	3,501	1,018	3,331	4,123	415	3,410	–	15,798
Net claims incurred	(2,717)	(567)	(2,078)	(2,487)	(176)	(2,403)	–	(10,428)
Net commission	(221)	(226)	(567)	(557)	(94)	(895)	–	(2,560)
Underwriting and other expenses	(800)	(171)	(507)	(691)	(86)	(102)	–	(2,357)
Underwriting result	(237)	54	179	388	59	10	–	453
Net investment income on policyholders' funds	67	67	148	391	7	129	–	809
Insurance profit	(170)	121	327	779	66	139	–	1,262
Net investment income on shareholders' funds	126	12	99	102	14	54	–	407
Financing and other costs	(150)	(12)	(55)	(93)	(3)	(11)	–	(324)
Share of net profits of associates	–	–	–	3	–	–	–	3
Amortisation of intangibles and impairment of goodwill/intangibles	(301)	(36)	(20)	(11)	(39)	–	–	(407)
Profit (loss) before income tax	(495)	85	351	780	38	182	–	941
Income tax expense	189	(40)	(42)	(225)	(22)	(21)	–	(161)
Profit (loss) after income tax	(306)	45	309	555	16	161	–	780
Profit after income tax attributable to non-controlling interests	–	(1)	(1)	(7)	(10)	–	–	(19)
Net profit (loss) after income tax	(306)	44	308	548	6	161	–	761

2011	NORTH AMERICAN OPERATIONS US$M	LATIN AMERICAN OPERATIONS US$M	EUROPEAN OPERATIONS US$M	AUSTRALIAN AND NEW ZEALAND OPERATIONS US$M	ASIA PACIFIC OPERATIONS US$M	EQUATOR RE US$M	EQUATOR RE ELIMINATION US$M	TOTAL US$M
Total assets	14,813	1,039	17,294	12,794	1,175	6,795	(7,173)	46,737
Total liabilities	11,233	770	14,729	10,380	860	5,500	(7,173)	36,299
Net assets	3,580	269	2,565	2,414	315	1,295	–	10,438
Property, plant and equipment	134	49	133	121	11	–	–	448
Investment properties	4	1	19	–	4	–	–	28
Intangible assets	3,534	97	650	1,765	19	–	–	6,065
Gross written premium	7,529	768	4,828	4,699	467	3,807	(3,807)	18,291
Gross earned premium revenue – external	7,431	752	4,635	4,551	457	14	–	17,840
Gross earned premium revenue – internal	–	–	–	–	–	3,683	(3,683)	–
Outward reinsurance premium expense	(3,413)	(132)	(1,485)	(683)	(116)	(335)	3,683	(2,481)
Net earned premium	4,018	620	3,150	3,868	341	3,362	–	15,359
Net claims incurred	(2,622)	(351)	(2,054)	(2,674)	(149)	(2,616)	–	(10,466)
Net commission	(264)	(118)	(536)	(516)	(73)	(784)	–	(2,291)
Underwriting and other expenses	(754)	(87)	(417)	(661)	(76)	(113)	–	(2,108)
Underwriting result	378	64	143	17	43	(151)	–	494
Net investment income on policyholders' funds	62	37	155	225	17	95	–	591
Insurance profit (loss)	440	101	298	242	60	(56)	–	1,085
Net investment income on shareholders' funds	60	5	45	45	4	26	–	185
Financing and other costs	(143)	(2)	(45)	(73)	(1)	(11)	–	(275)
Share of net profits of associates	–	–	–	6	–	–	–	6
Amortisation of intangibles and impairment of goodwill/intangibles	(113)	(7)	(2)	(11)	–	–	–	(133)
Profit before income tax	244	97	296	209	63	(41)	–	868
Income tax expense	(20)	(32)	(22)	(41)	(20)	(14)	–	(149)
Profit after income tax	224	65	274	168	43	(55)	–	719
Profit after income tax attributable to non-controlling interests	–	(1)	–	(8)	(6)	–	–	(15)
Net profit after income tax	224	64	274	160	37	(55)	–	704

(B) Geographical analysis

The operating segments reported to management in the table above are defined by reference to the geographical locations of each operating segment and, as such, satisfy the requirements of a geographical analysis as well as an operating segment analysis.

4. Critical accounting estimates and judgments

The Group is an international general insurance and reinsurance group underwriting most major commercial and personal lines classes of business through operations in 48 countries. The class of business mix is shown on page 124 and an analysis of the Group's gross written and net earned premium from insurance and reinsurance business is shown on page 18. The head office function is located in Australia and exists to support the activities of divisional operations, which are described in note 2.

In view of the geographic and product diversity, the Group has developed a strong, centralised risk management and policy framework, designed to ensure consistency of approach across a number of operational activities, subject to the specific requirements of local markets, legislation and regulation. Such operational activities include underwriting, claims management, actuarial assessment of the claims provision and investment management. In addition, assessment of the net outstanding claims provision set at a divisional level is subject to detailed head office review. The probability of adequacy derived from the Group's insurance liabilities is measured by the Group Chief Actuary.

Given the centralised approach to many of its activities and the product and geographic diversification, sensitivity analyses in respect of critical accounting estimates and judgments are presented at the consolidated Group level in order to provide information and analysis which is meaningful, relevant, reliable and comparable year on year. Sensitivity disclosure at business segment or product level would not provide a meaningful overview given the complex interrelationships between the variables underpinning the Group's operations.

The Group makes estimates and judgments in respect of the reported amounts of certain assets and liabilities. These estimates and judgments are determined by qualified and experienced employees with reference to historical data and reasoned expectations of future events, and are continually updated. The key areas in which critical estimates and judgments are applied are described on the following pages.

Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2012

4. Critical accounting estimates and judgments CONTINUED

(A) Outstanding claims provision

The Group's net outstanding claims provision comprises:

- the gross central estimate of expected future claims payments;
- amounts recoverable from reinsurers based on the gross central estimate;
- a reduction to reflect the discount to present value using risk-free rates of return to reflect the time value of money; and
- a risk margin that reflects the inherent uncertainty in the net discounted central estimate.

A net discounted central estimate is intended to represent the mean of the distribution of the expected future cash flows. As the Group requires a higher probability that estimates will be adequate over time, a risk margin is added to the net discounted central estimate to determine the outstanding claims provision.

(i) Central estimate

The provision for expected future payments includes those in relation to claims reported but not yet paid; claims incurred but not reported (IBNR); claims incurred but not enough reported (IBNER); and estimated claims handling costs, being the direct and indirect expenses incurred in the settlement of claims.

The estimation of IBNR is generally subject to a greater degree of uncertainty than the estimation of the cost of settling claims already notified to the Group, where more information about the claims is generally available. Liability and other long tail classes of business, where claims settlement may not happen for many years after the event giving rise to the claim, typically display greater variability between initial estimates and final settlement due to delays in reporting claims, uncertainty in respect of court awards and future claims inflation. Claims in respect of property and other short tail classes are typically reported and settled sooner after the claim event, giving rise to more certainty. The estimation techniques and assumptions used in determining the central estimate are described below.

The Group's process for establishing the central estimate involves extensive consultation with internal and external actuaries, claims managers, underwriters and other senior management. This process includes quarterly in-house claims review meetings attended by senior divisional and Group management and detailed review by external actuaries at least annually. The risk management procedures related to the actuarial function are explained further in note 5.

The determination of the amounts that the Group will ultimately pay for claims arising under insurance and reinsurance contracts involves a number of critical assumptions. Some of the uncertainties impacting these assumptions are as follows:

- changes in patterns of claims incidence, reporting and payment;
- volatility in the estimation of future costs for long tail insurance classes due to the longer period of time that elapses before a definitive determination of the ultimate claims cost can be made;
- incidence of catastrophic events close to the balance sheet date;
- changes in the legal environment, including the interpretation of liability laws and the quantum of damages; and
- social and economic trends, for example price and wage inflation and interest rates.

The potential impact of changes in key assumptions used in the determination of the central estimate and the probability of adequacy of the central estimate on the Group's profit or loss are summarised in note 4(A)(v).

Central estimates for each class of business are determined by reference to a variety of estimation techniques, generally based on a statistical analysis of historical experience which assumes an underlying pattern of claims development and payment. The final selected central estimates are based on a judgmental consideration of the results of each method and qualitative information, for example, the class of business, the maturity of the portfolio and the expected term to settlement of the class. Projections are based on both historical experience and external benchmarks where relevant.

Central estimates are calculated gross of any reinsurance recoveries. A separate estimate is made of the amounts recoverable from reinsurers based on the gross central estimate.

The net central estimate is discounted at risk-free rates of return to reflect the time value of money. Details of the key assumptions applied in the discounting process are summarised in note 4(A)(iv).

(ii) Assets arising from contracts with reinsurers

Assets arising from reinsurance recoveries under contracts with the Group's reinsurers are determined using the same methods described above. In addition, the recoverability of these assets is assessed at each balance sheet date to ensure that the balances properly reflect the amounts that will ultimately be received, taking into account counterparty credit risk and the contractual terms of the reinsurance contract. Counterparty credit risk in relation to reinsurance assets is considered in note 5.

(iii) Risk margin

Risk margins are determined by management and are held to mitigate the potential for uncertainty in the central estimate. The determination of the appropriate level of risk margin takes into account similar factors to those used to determine the central estimate, such as:

- change in the mix of business, in particular the mix of short tail and long tail business and the overall weighted average term to settlement;
- prior accident year claims development; and
- the level of uncertainty in the net discounted central estimate due to actuarial estimation, data quality issues, variability of key discount and inflation assumptions and economic and legislative uncertainty.

The variability by class of business is measured using techniques similar to those used in determining the central estimate. These techniques determine a range of possible outcomes of ultimate payments and assign a likelihood to outcomes at different levels. These techniques use standard statistical distributions, and the measure of variability is referred to as the coefficient of variation. The potential impact of changes in the coefficient of variation assumptions on the Group's profit or loss is summarised in note 4(A)(v).

The appropriate risk margin for two or more classes of business or for two or more geographic locations combined is likely to be less than the sum of the risk margins for the individual classes. This reflects the benefit of diversification in general insurance. The statistical measure used to determine diversification is called the correlation. The higher the correlation between two classes of business, the more likely it is that a negative outcome in one class will correspond to a negative outcome in the other class. For example, high correlation exists between classes of business affected by court cases involving bodily injury claims such as motor third party liability (CTP), workers' compensation and public liability.

The risk margin for the Group is determined by analysing the variability of each class of business and the correlation between classes of business and divisions. Correlations are determined for aggregations of classes of business, where appropriate, at the divisional level. Whilst there are estimation techniques for determining correlations, they are difficult to apply. The correlations adopted by the Group are generally derived from industry analysis, the Group's historical experience and the judgment of experienced and qualified actuaries.

The probability of adequacy is a statistical measure of the relative adequacy of the outstanding claims provision and is derived from a comparison of the risk margin with the net discounted central estimate. Using a range of outcomes, it allows a determination of the probability of adequacy represented by a risk margin. For example, a 90% probability of adequacy indicates that the outstanding claims provision is expected to be adequate nine times in 10. The probability of adequacy is not of itself an accounting policy or estimate as defined by AASB 108: Accounting Policies, Changes in Accounting Estimates and Errors. The appropriate level of risk margin is not determined by reference to a fixed probability of adequacy.

(iv) Financial assumptions used to determine the outstanding claims provision

Discount rates

AASB 1023: General Insurance Contracts (AASB 1023) requires that the outstanding claims provision shall be discounted for the time value of money using risk-free rates that are based on current observable, objective rates that relate to the nature, structure and terms of the future obligations. The standard also states that government bond rates may be an appropriate starting point in determining a risk-free rate. The Group generally uses currency specific risk-free rates to discount the outstanding claims provision.

The weighted average risk-free rate for each operating segment and a weighted average discount rate for the consolidated Group are summarised below.

	2012 %	2011 %
North American Operations	**0.99**	1.06
Latin American Operations	**16.64**	12.51
European Operations	**1.28**	1.62
Australian & New Zealand Operations	**3.05**	3.60
Asia Pacific Operations	**0.99**	1.82
Equator Re	**1.27**	1.42
Group	**2.16**	2.10

Weighted average term to settlement

The relevant discount rate is applied to the anticipated cash flow profile of the central estimate, including related reinsurance recoveries, determined by reference to a combination of historical analysis and current expectations of when claims and recoveries will be settled. Details of the weighted average term to settlement of the Group's outstanding claims provision, analysed by operating segment and currency, is summarised below.

	2012 YEARS						2011 YEARS					
	US$	£	A$	€	OTHER	TOTAL	US$	£	A$	€	OTHER	TOTAL
North American Operations	**2.6**	**–**	**–**	**–**	**–**	**2.6**	2.7	–	–	–	–	2.7
Latin American Operations	**0.8**	**–**	**–**	**–**	**2.5**	**2.4**	1.3	–	–	–	3.0	2.9
European Operations	**2.6**	**3.4**	**3.2**	**4.7**	**3.1**	**3.7**	2.6	3.4	3.4	4.8	3.2	3.7
Australian & New Zealand Operations	**–**	**–**	**2.5**	**–**	**2.2**	**2.5**	–	–	2.6	–	2.2	2.6
Asia Pacific Operations	**1.7**	**–**	**1.3**	**3.1**	**1.6**	**1.6**	3.1	–	2.5	2.9	1.6	1.7
Equator Re	**2.2**	**3.8**	**2.8**	**3.1**	**2.3**	**2.6**	2.1	3.5	2.5	2.9	2.0	2.5
Group	**2.5**	**3.6**	**2.6**	**4.6**	**2.4**	**2.9**	2.5	3.4	2.6	4.6	2.4	2.9

(v) Impact of changes in key variables on the outstanding claims provision

The impact of changes in key variables used in the calculation of the outstanding claims provision is summarised in the table on page 122. Each change has been calculated in isolation from the other changes and each change shows the after tax impact on profit assuming that there is no change to any of the other variables. In practice, this is considered unlikely to occur as, for example, an increase in interest rates is normally associated with an increase in the rate of inflation. As can be seen from the table, the impact of a change in discount rates is largely offset by the impact of a change in the rate of inflation.

The sensitivities below assume that all changes directly impact profit after tax. In practice, however, it is likely that if the central estimate was to increase by 5%, at least part of the increase would result in a decrease in the probability of adequacy. Likewise, if the coefficient of variation were to increase by 1%, it is likely that the probability of adequacy would reduce from its current level and that the change would therefore impact the amount of risk margins held rather than net profit after income tax or equity.

The impact of a change in interest rates on profit after tax due to market value movements on fixed interest securities is shown in note 5(D)(ii).

Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2012

4. Critical accounting estimates and judgments CONTINUED

	SENSITIVITY %	PROFIT (LOSS)[1] 2012 US$M	2011 US$M
Central estimate	+5	**(598)**	(552)
	–5	**598**	552
Inflation rate	+0.5	**(171)**	(160)
	–0.5	**167**	156
Discount rate	0.5	**167**	155
	–0.5	**(171)**	(158)
Coefficient of variation	+1	**(139)**	(123)
	–1	**139**	119
Probability of adequacy	+1	**(43)**	(39)
	–1	**41**	36
Weighted average term to settlement	+10	**81**	69
	–10	**(81)**	(69)

1 Net of tax at the Group's prima facie rate of 30%

(B) Liability adequacy test

At each balance date, the adequacy of the unearned premium liability is assessed on a net of reinsurance basis against the present value of the expected future cash flows relating to potential future claims, plus a risk margin to reflect the inherent uncertainty of the central estimate (refer note 21(D)). Future claims are those claims expected to arise from claims events occurring after the balance date. The assessment is carried out using the same methods described in note 4(A).

AASB 1023 requires that this test be carried out at the level of a "portfolio of contracts that are subject to broadly similar risks and are managed together in a single portfolio". As AASB 1023 does not explicitly define "broadly similar risks" or "managed together as a single portfolio", the Group has interpreted these terms in a way that reflects our day to day approach to managing the various risks to which the Group is exposed i.e. at the operating segment level. The Group's operating segments or divisions are structured in a way that facilitates the efficient and effective management of our insurance businesses, and recognises that these businesses are subject to broadly similar risks such as the interest and inflation rate environment; pricing risk; credit risk; social and political risks such as unemployment and social unrest; and common insurance risks such as exposure to weather-related or natural catastrophe risks.

(C) Retirement benefit obligations

The present value of the obligations arising from the Group's defined benefit superannuation plans is determined by external actuaries based on discount rate, inflation rate, mortality rate, salary growth and investment return assumptions.

The discount rate applied to the various plans is the interest rate on high quality corporate bonds where there is a sufficiently deep market or the appropriate government bond rate in the absence of such markets.

Mortality assumptions are affected by experience which indicates increasing longevity, particularly for certain age groups of the population. The Group has considered the consensus of professional opinions from a number of external actuaries in respect of the appropriateness of the mortality tables selected for use in the valuation of the superannuation obligations for each of the Group's plans.

The potential impact of a 1% increase or decrease in the discount rate and inflation assumptions is summarised below. Movements in the assumptions are reflected directly in equity in accordance with the accounting policy set out in note 1(AA)(i) and do not impact net profit after tax.

	SENSITIVITY %	EQUITY INCREASE (DECREASE) 2012 US$M	2011 US$M
Discount rate	+1	**29**	24
	–1	**(69)**	(54)
Inflation rate	+1	**(18)**	(10)
	–1	**6**	3

(D) Intangible assets

Goodwill and intangible assets with an indefinite useful life are tested annually for impairment or more frequently when changes in circumstances indicate that the carrying amount may not be recoverable. Intangible assets subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. The impairment review is based on the net present value of estimated future cash flows of the relevant asset, the relevant cash generating unit or relevant group of cash generating units. For details of key assumptions and estimates used, refer to note 19.

The discount rates used to value cash generating units at 31 December 2012 as part of the impairment testing of goodwill are included in note 19(B)(i). If the discount rates applied in these calculations were increased by 1% over the rates applied at 31 December 2012, the Group would be required to reflect an impairment charge to assets of nil (2011 nil).

(E) Business combinations

The Group makes estimates and judgments in determining the fair value of assets and liabilities acquired in a business combination. Refer to note 29 for further details.

5. Risk Management

An overview of the Group's risk management framework is provided in the risk management statement on pages 66 to 69 and in the risk management section of the corporate governance statement on pages 78 and 79.

The Group's risk management policy, strategy and framework are embedded in the head office function and in each of the divisional operations, ensuring a consistent approach to managing risk across the organisation. The Board annually approves a comprehensive risk management strategy (RMS) and a reinsurance management strategy (REMS), both of which are lodged with the Australian Prudential Regulation Authority (APRA).

The Group's risk management policy objectives are to:

- achieve competitive advantage through better understanding the risk environment in which QBE operates;
- optimise risk and more effectively allocate capital and resources by assessing the balance of risk and reward; and
- avoid unwelcome surprises by reducing uncertainty and volatility.

It is QBE's policy to adopt a rigorous approach to managing risk throughout the Group. Risk management is a continuous process and an integral part of quality business management. QBE's approach is to integrate risk management into the broader management processes of the organisation. It is QBE's philosophy to ensure that risk management remains embedded in the business and that the risk makers or risk takers are themselves the risk managers. Specifically, the management of risk must occur at each point in the business management cycle.

Risk management is a key part of our governance structure and our strategic and business planning. It underpins the setting of limits and authorities and it is embedded in the monitoring and evaluation of performance. This holistic approach to risk management allows all of the Group's risks to be managed in an integrated manner.

QBE's global risk management framework defines the risks that QBE is exposed to and sets out the framework to manage those risks and meet strategic objectives whilst taking into account the creation of value for our shareholders. The framework is made up of complementary elements that are embedded throughout the business management cycle and culture. Key aspects include: governance, risk appetite and tolerance, delegated authorities, risk policies, measurement and modelling, risk and control self assessment, risk treatment, optimisation and ongoing improvement through management action plans and risk and performance monitoring.

A fundamental part of the Group's overall risk management strategy is the effective governance and management of the risks that impact the amount, timing and uncertainty of cash flows from insurance contracts. The operating activities of the Group expose it to risks such as market risk, credit risk and liquidity risk. The Group's risk management framework recognises the unpredictability of financial markets and seeks to minimise potential adverse effects on its financial performance. The Group has established internal controls to manage risk in the key areas of exposure relevant to its business.

QBE's risk profile is described under the following broad risk categories:

- Strategic and business risk
- Insurance risk
- Credit risk
- Market risk
- Liquidity risk
- Operational risk

Each of these is described more fully in sections (A) to (F) below.

(A) Strategic and business risk

Strategic risk refers to the current and prospective impact on earnings and/or capital arising from strategic business decisions, implementation of decisions and responsiveness to external change. This includes risks associated with business strategy and change, investment strategy and corporate governance. Of particular relevance are acquisition and capital management risk.

(i) Acquisition risk

The Group's strategy of growth by acquisition exposes it to additional risks. Acquisition risks are principally managed by the Group's controls over the selection of potential acquisitions, due diligence, negotiation of warranties and indemnities and subsequent integration processes. QBE has experienced due diligence teams in each operating division and has documented minimum requirements for carrying out due diligence.

(ii) Capital management risk

Australian and overseas controlled entities are subject to extensive prudential and other forms of regulation in the jurisdictions in which they conduct business. Prudential regulation is generally designed to protect policyholders. Regulation covers a number of areas including solvency, change in control and capital movement limitations. The regulatory environment in Australia and overseas continues to evolve in response to economic, political and industry developments. QBE works closely with regulators and monitors regulatory developments across its global operations to assess their potential impact on its ability to meet solvency and other requirements. Refer to note 26(E).

(B) Insurance risk

Insurance risk is the risk of fluctuations in the timing, frequency and severity of insured events and claims settlements, relative to the expectations at the time of underwriting. This includes underwriting, catastrophe claims concentration and claims estimation risks. The risks inherent in any single insurance contract are the possibility of the insured event occurring and the uncertainty of the amount of the resulting claim. By the very nature of an insurance contract, these risks are random and unpredictable. In relation to the pricing of individual insurance contracts and the determination of the level of the outstanding claims provision in relation to a portfolio of insurance contracts, the principal risk is that the ultimate claims payments will exceed the carrying amount of the provision established.

Experience shows that the larger the portfolio of similar insurance contracts, the smaller the relative variability around the expected outcome will be. In addition, a more diversified insurance and reinsurance group is less likely to be affected by a change in any one specific portfolio. The Group has developed its underwriting strategy to diversify the type of insurance risks accepted and, within each of these categories, to achieve a sufficiently large population of risks to reduce the variability of the expected outcome.

QBE has established the following protocols to manage its insurance risk across the underwriting, claims and actuarial disciplines.

(i) Underwriting risks

Selection and pricing of risks

Underwriting authority is delegated to experienced underwriters for the forthcoming year following a detailed retrospective and prospective analysis of each class of business as part of the Group's annual business planning process. Delegated authorities reflect the level of risk which QBE is prepared to take.

Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2012

5. Risk management CONTINUED

The authorities include reference to some combination of:

- return on risk adjusted equity;
- gross written premium;
- premium per contract;
- sum insured per contract;
- aggregate exposures per zone;
- probable maximum loss and realistic disaster scenarios (RDSs);
- levels and quality of reinsurance protection;
- geographic exposures; and/or
- classes of business and types of product that may be written.

Limits in respect of each of the above are set at a portfolio, divisional and Group-wide level and are included within business plans for individual classes of business. They are adjusted at a local level to reflect a risk factor in respect of each controlled entity depending on previous underwriting results, the economic environment and other potential drivers of volatility.

Insurance and reinsurance policies are written in accordance with local management practices and regulations within each jurisdiction taking into account the Group's risk appetite and tolerance and underwriting standards. Non-standard and long-term policies may only be written if expressly included in the delegated authorities. No individual long-term or non-standard policy is material to the Group.

Pricing of risks is controlled by the use of in-house pricing models relevant to specific portfolios and the markets in which QBE operates. Experienced underwriters and actuaries maintain historical pricing and claims analysis for each portfolio and this is combined with a detailed knowledge of current developments in the respective markets and classes of business.

Concentration risk

The Group's exposure to concentrations of insurance risk is mitigated by a portfolio diversified across many countries and through hundreds of classes of business. Product diversification is achieved through a strategy of developing strong underwriting skills in a wide variety of classes of business. A combination of core and speciality products under the control of employees skilled in underwriting such products allows QBE to lead underwrite in many of the markets in which it operates.

The table below demonstrates the diversity of QBE's operations.

GROSS EARNED PREMIUM	2012 US$M	2011 US$M
Property	**6,125**	5,849
Motor and motor casualty	**2,838**	2,525
Liability	**2,022**	2,091
Agriculture & bloodstock	**1,856**	2,266
Workers' compensation	**1,443**	1,266
Marine, energy & aviation	**1,307**	1,276
Financial and credit	**1,065**	907
Accident & health	**780**	650
Professional indemnity	**725**	752
Other	**180**	258
	18,341	17,840

The Group has potential exposure to catastrophe losses that may impact more than one operating division. Each year, the Group sets its tolerance to concentration risk. RDSs, using industry standard and QBE determined probable maximum losses and various catastrophe models, are calculated for each portfolio as part of the business planning process. These RDSs are aggregated across all portfolios and divisions to determine the Group's maximum event retention (MER) which is the estimated maximum net claim from a one in 250 year natural catastrophe event. The MER must be less than the Group's concentration risk tolerance, otherwise steps such as the purchase of additional reinsurance are taken to limit the exposure.

(ii) Claims management and claims estimation risks

The Group's approach to determining the outstanding claims provision and the related sensitivities are set out in note 4. QBE seeks to ensure the adequacy of its outstanding claims provision by reference to the following controls:

- experienced claims managers work with underwriters on coverage issues and operate within the levels of authority delegated to them in respect of the settlement of claims;
- processes exist to ensure that all claims advices are captured and updated on a timely basis and with a realistic assessment of the ultimate claims cost;
- initial IBNR estimates are set by experienced internal actuaries in conjunction with the local product managers and underwriters for each class of business in each business unit. The valuation of the central estimate is primarily performed by actuaries who are not involved in the pricing function and who therefore provide an independent assessment;
- the determination of the risk margin is performed by senior management and the Board with input from the Group Chief Actuary;
- the aggregate outstanding claims provision for each controlled entity is assessed in a series of quarterly internal claims review meetings which are attended by senior divisional management and the Group Chief Actuary in order to ensure consistency of provisioning practices across all divisions; and
- around 96% of the Group's central estimate is reviewed by external actuaries.

Despite the rigour involved in the establishment and review of the outstanding claims provision, the provision is subject to significant uncertainty for the reasons set out in note 4.

(iii) Outwards reinsurance

The Group limits its exposure to an individual catastrophe or an accumulation of claims by reinsuring a portion of risks underwritten. In this way, the Group can control exposure to insurance losses, reduce volatility of reported results and protect capital.

Effective governance and management of reinsurance protection is a fundamental part of the Group's risk management practices. QBE has in place systems, internal controls and processes to ensure that its reinsurance arrangements are appropriate to enable the Group to meet its obligations to policyholders, whilst protecting the wealth of its shareholders. This framework is outlined in the Group's REMS which states that the Group's maximum risk tolerance for an individual natural catastrophe at a 1 in 250 year probability is 4.5% of budgeted net earned premium.

The senior authority for purchasing reinsurance is the Group Chief Executive Officer and/or the Group Chief Reinsurance Officer, who generally act after consultation with and based on recommendations from the Group Reinsurance Forum (GRF).

The GRF determines the Group's exposure to and appetite for catastrophes and individual risks net of reinsurance as part of the business planning process. The resulting strategy is recommended to the Group Chief Executive Officer, who provides the final approval on the reinsurance purchasing strategy. The GRF monitors and reports on placement of reinsurance and oversees the relevant committees that monitor reinsurance credit risk and commutation risks, as well as the processes for evaluating the effectiveness of reinsurances purchased. Credit risk is considered in note 5(C)(ii).

The Group purchases significant levels of external reinsurance protection to ensure that the Group's net retention is aligned with its risk tolerance. In addition, the Group retains a portion of its reinsurance placements through its captive, Equator Re. These retained covers represent risk that the Group is able to retain but which the individual licensed subsidiaries do not wish to retain due to their lower capital base. Reinsurance cover provided by Equator Re gives reinsurance protection to individual licensed subsidiaries enabling QBE to more effectively manage capital.

(C) Credit risk

Credit risk is the risk of default by borrowers and transactional counterparties as well as the loss of value of assets due to deterioration in credit quality. Exposure to credit risk results from financial transactions with securities issuers, debtors, brokers, policyholders, reinsurers and guarantors.

The Group's credit risk arises mainly from investment and reinsurance protection activities. The following policies and procedures are in place to mitigate the Group's exposure to credit risk:

- A Group-wide investment credit risk policy is in place which defines what constitutes credit risk for QBE and establishes tolerance levels. Compliance with the policy is monitored and exposures and breaches are reported to the Group Investment Committee.
- Net exposure limits are set for each counterparty or group of counterparties in relation to investments, cash deposits and forward foreign exchange exposures. The policy also sets out minimum credit ratings for investments.
- QBE has strict guidelines covering the limits and terms of net open derivative positions and the counterparties with which we may transact. The Group does not expect any investment counterparties to fail to meet their obligations given their strong credit ratings and therefore does not require collateral or other security to support derivatives. The Group only uses derivatives in highly liquid markets.
- Credit risk in respect of premium debtors and reinsurance receivables is actively monitored. Strict controls are maintained over counterparty exposures. Business is transacted with counterparties that have a strong credit rating and concentration of risk is managed by adherence to counterparty limits. The provision for impairment is formally assessed by management at least four times a year.

(i) Investment counterparty credit risk

The following table provides information regarding the Group's aggregate credit risk exposure at the balance sheet date in respect of the major classes of financial assets. Trade and other receivables are excluded from this analysis on the basis that they comprise smaller credit risk items which generally cannot be rated and are not individually material. The analysis classifies the assets according to Moody's counterparty credit ratings. Aaa is the highest possible rating. Rated assets falling outside the range of Aaa to Baa are classified as speculative grade.

	CREDIT RATING						
	Aaa US$M	Aa US$M	A US$M	Baa US$M	SPECULATIVE GRADE US$M	NOT RATED US$M	TOTAL US$M
As at 31 December 2012							
Cash and cash equivalents	**135**	**820**	**829**	**115**	**42**	**84**	**2,025**
Interest-bearing investments	**11,958**	**12,295**	**4,031**	**291**	**622**	**151**	**29,348**
Derivative financial instruments	**–**	**11**	**11**	**2**	**–**	**–**	**24**
As at 31 December 2011							
Cash and cash equivalents	66	492	783	12	81	23	1,457
Interest-bearing investments	6,181	14,976	3,919	578	386	100	26,140
Derivative financial instruments	–	21	21	–	–	–	42

The carrying amount of the relevant asset classes in the balance sheet represents the maximum amount of credit exposure. The fair value of derivatives shown on the balance sheet represents the current risk exposure but not the maximum risk exposure that could arise in the future as a result of changing values. Further details are provided in note 12.

The following table provides information regarding the ageing of the Group's financial assets that are past due but not impaired and largely unrated at the balance sheet date.

	NEITHER PAST DUE NOR IMPAIRED US$M	PAST DUE BUT NOT IMPAIRED				
		0 TO 3 MONTHS US$M	3 TO 6 MONTHS US$M	6 MONTHS TO 1 YEAR US$M	GREATER THAN 1 YEAR US$M	TOTAL US$M
As at 31 December 2012						
Premium receivable	**1,996**	**646**	**82**	**45**	**21**	**2,790**
Other trade debtors	**152**	**8**	**2**	**24**	**12**	**198**
Other debtors	**206**	**4**	**5**	**7**	**3**	**225**
Treasury receivables	**6**	**–**	**–**	**–**	**–**	**6**
Investment receivables	**134**	**–**	**–**	**–**	**–**	**134**
As at 31 December 2011						
Premium receivable	1,904	432	91	49	21	2,497
Other trade debtors	285	33	5	3	6	332
Other debtors	210	4	2	3	6	225
Treasury receivables	8	1	–	–	–	9
Investment receivables	170	–	–	–	–	170

Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2012

5. Risk management CONTINUED

(ii) Reinsurance counterparty credit risk

The Group's objective is to maximise placement of reinsurance with highly rated counterparties. Concentration of risk with reinsurance counterparties is monitored strictly and regularly by the Group's Security Committee and is controlled by reference to the following protocols:

- Treaty or facultative reinsurance is placed in accordance with the requirements of the Group's REMS and Group Security Committee guidelines.
- Reinsurance arrangements are regularly reassessed to determine their effectiveness based on current exposures, historical losses and potential future losses based on RDSs and the Group's MER.
- Exposure to reinsurance counterparties and the credit quality of those counterparties is actively monitored.

Credit risk exposures are calculated regularly and compared with authorised credit limits. In certain cases, the Group requires letters of credit or other collateral arrangements to be provided to guarantee the recoverability of the amount involved. The credit rating analysis below includes the impact of such security arrangements. In some cases, further security has been obtained in the form of trust arrangements, reinsurer default protection and other potential offsets. This additional security has not been included in the credit rating analysis set out below.

The following table provides information about the quality of the Group's credit risk exposure in respect of reinsurance and other recoveries on outstanding claims at the balance sheet date. The analysis classifies the assets according to Standard & Poor's counterparty credit ratings. AAA is the highest possible rating. Rated assets falling outside the range of AAA to BBB are classified as speculative grade.

		CREDIT RATING						
		AAA US\$M	AA US\$M	A US\$M	BBB US\$M	SPECULATIVE GRADE US\$M	NOT RATED US\$M	TOTAL US\$M
Reinsurance recoveries on outstanding claims [1,2]	2012	**110**	**2,383**	**1,392**	**27**	**57**	**138**	**4,107**
	2011	43	2,129	1,283	32	54	152	3,693
Reinsurance recoveries on paid claims [1]	2012	**2**	**692**	**114**	**6**	**5**	**14**	**833**
	2011	1	921	148	2	5	20	1,097

1 Net of a provision for impairment.
2 Excludes other recoveries.

The following table provides further information regarding the ageing of reinsurance recoveries on paid claims at the balance sheet date.

			PAST DUE BUT NOT IMPAIRED				
		NEITHER PAST DUE NOR IMPAIRED US\$M	0 TO 3 MONTHS US\$M	3 TO 6 MONTHS US\$M	6 MONTHS TO 1 YEAR US\$M	GREATER THAN 1 YEAR US\$M	TOTAL US\$M
Reinsurance recoveries on paid claims [1]	2012	**629**	**88**	**26**	**59**	**31**	**833**
	2011	911	70	27	28	61	1,097

1 Net of a provision for impairment.

(D) Market risk

Market risk is the risk of variability in the value of, and returns on, investments and the risk associated with variability of interest rates, credit spreads, foreign exchange rates and economy-wide inflation on both assets and liabilities, excluding insurance liabilities.

Market risk comprises three types of risk: currency risk (due to fluctuations in foreign exchange rates); interest rate risk (due to fluctuations in market interest rates); and price risk (due to fluctuations in market prices). Within each of these categories, risks are evaluated before considering the effect of mitigating controls. The existence and effectiveness of such mitigating controls are then measured to ensure that residual risks are maintained within the Group's risk appetite and tolerance.

(i) Currency risk

The Group's exposure to currency risk generally arises as a result of either the translation of foreign currency amounts back to the functional currency of a controlled entity (operational currency risk) or due to the translation of the Group's net investment in foreign operations back to the functional currency of the ultimate parent entity of Australian dollars and to QBE's presentation currency of US dollars.

Operational currency risk

The Group is exposed to currency risk in respect of its operational net foreign currency exposures within each of its controlled entities. This risk is managed as follows:

- Each controlled entity manages the volatility arising from changes in foreign exchange rates by matching liabilities with assets of the same currency, as far as is practicable, thus ensuring that any exposures to foreign currencies are minimised.
- Forward foreign exchange contracts are used where possible to protect residual currency positions. These forward foreign exchange contracts are accounted for in accordance with the derivatives accounting policy set out in note 1(N).

Foreign exchange gains or losses arising from operational foreign currency exposures are reported in profit or loss consistent with the gains or losses from related forward foreign exchange contracts. The risk management process covering the use of forward foreign exchange contracts involves close senior management scrutiny, including regular board and other management reporting. All forward foreign exchange contracts are subject to delegated authority levels provided to management and the levels of exposure are reviewed on an ongoing basis.

The Group's aim is to mitigate, where possible, its operational foreign currency exposures at a controlled entity level. From time to time, the company or controlled entities may maintain an operational foreign currency exposure to offset currency volatility arising from translation of foreign currency forecast profits, subject to senior management approval and adherence to board approved limits.

The analysis below demonstrates the impact on profit after income tax of a 10% strengthening or weakening of the major currencies to which QBE is exposed. The sensitivity is measured with reference to the Group's residual (or unmatched) operational foreign currency exposures at the balance sheet date. Operational foreign exchange gains or losses are recognised in profit or loss in accordance with the policy set out in note 1(W)(ii). The sensitivities provided demonstrate the impact of a change in one key variable in isolation whilst other assumptions remain unchanged. This analysis does not take into account that the matching of currency assets and liabilities is actively managed and therefore assumes no response by management to movements in a variable.

		RESIDUAL EXPOSURE		PROFIT (LOSS)[1]	
EXPOSURE CURRENCY	SENSITIVITY %	2012 US$M	2011 US$M	2012 US$M	2011 US$M
Australian dollar	+10	**47**	8	**3**	1
	-10			**(3)**	(1)
Sterling	+10	**11**	45	**1**	3
	-10			**(1)**	(3)
Euro	+10	**22**	(6)	**2**	–
	-10			**(2)**	–
Hong Kong dollar	+10	**8**	4	**1**	–
	-10			**(1)**	–
Canadian dollar	+10	**23**	49	**2**	3
	-10			**(2)**	(3)
Thai baht	+10	**8**	(124)	**1**	(9)
	-10			**(1)**	9

1 Net of tax at the Group's prima facie rate of 30%.

Currency risk in relation to net investment in foreign operations

QBE is exposed to currency risk in relation to:

- the translation of the ultimate parent entity's net investment in foreign operations to its functional currency of Australian dollars; and
- the translation of all foreign operations to the presentation currency of US dollars.

The ultimate parent entity's currency risk in relation to its net investment in foreign operations may be hedged using foreign currency borrowings and forward foreign exchange contracts within authorities set out by the Board. Hedging relationships which meet the hedging criteria set out in AASB 139 are accounted for in accordance with the accounting policy set out in note 1(O). The extent of hedging this exposure is carefully managed to ensure an appropriate balance between currency risk and associated risks such as liquidity risk and stability of capital adequacy levels.

Currency management processes are actively monitored by the Group Chief Financial Officer and involve close senior management scrutiny, including regular board and other management reporting. All hedge transactions are subject to delegated authority levels provided to management, and the levels of exposure are reviewed on an ongoing basis. All instruments that are designated as hedges in accordance with AASB 139 are tested for effectiveness on both a prospective and a retrospective basis. These tests are performed at least quarterly.

Foreign exchange gains or losses arising on translation of the Group's foreign operations to the Group's US dollar presentation currency are recognised directly in equity in accordance with the policy set out in note 1(W)(iii). The Group does not hedge this exposure. The analysis below demonstrates the impact on equity of a 10% strengthening or weakening against the US dollar of the major currencies to which QBE is exposed through its net investment in foreign operations. The basis for the sensitivity calculation is the Group's actual residual exposure at the balance sheet date.

		RESIDUAL EXPOSURE		EQUITY INCREASE (DECREASE)	
	SENSITIVITY %	2012 US$M	2011 US$M	2012 US$M	2011 US$M
Australian dollar	+10	**7,630**	5,383	**763**	538
	-10			**(763)**	(538)
Sterling	+10	**(831)**	680	**(83)**	68
	-10			**83**	(68)
Euro	+10	**731**	511	**70**	51
	-10			**(70)**	(51)
Hong Kong dollar	+10	**130**	(39)	**13**	(4)
	-10			**(13)**	4
Argentinian peso	+10	**372**	83	**37**	8
	-10			**(37)**	(8)
New Zealand dollar	+10	**128**	105	**13**	10
	-10			**(13)**	(10)
Singapore dollar	+10	**96**	78	**10**	8
	-10			**(10)**	(8)
Colombian peso	+10	**94**	80	**9**	8
	-10			**(9)**	(8)

Further information on hedging arrangements is provided in note 12.

Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2012

5. Risk management CONTINUED

(ii) Interest rate risk

Financial instruments with a floating interest rate expose the Group to cash flow interest rate risk, whereas fixed interest rate instruments expose the Group to fair value interest rate risk.

QBE's risk management approach is to minimise interest rate risk by actively managing investment portfolios to achieve a balance between cash flow interest rate risk and fair value interest rate risk. The Group invests in high quality, liquid interest-bearing securities and cash and actively manages the duration of the fixed interest portfolio.

Interest-bearing borrowings issued by the Group are valued at amortised cost and therefore do not expose the Group result to fair value interest rate risk. In addition, the majority of these interest-bearing borrowings are at fixed interest rates and so do not expose the entity to cash flow interest rate risk.

The claims provision is discounted to present value by reference to risk-free interest rates. The Group is therefore exposed to potential underwriting result volatility as a result of interest rate movements. In practice, however, an increase or decrease in interest rates is normally offset by a corresponding increase or decrease in inflation. Details are provided in note 4(A)(v). QBE has a policy of maintaining a relatively short duration for assets backing policyholders' funds in order to minimise any further potential volatility affecting insurance profit.

The contractual maturity profile of QBE's interest-bearing financial assets, and hence its exposure to interest rate risk, and the effective weighted average interest rate for interest-bearing financial assets is analysed in the table below. The table includes investments at the maturity date of the security; however, many of the longer dated securities have call dates of relatively short duration. At 31 December 2012, the average modified duration of cash and fixed interest securities was 0.52 years (2011 0.4 years).

		INTEREST-BEARING FINANCIAL ASSETS MATURING IN						
		1 YEAR OR LESS	1 TO 2 YEARS	2 TO 3 YEARS	3 TO 4 YEARS	4 TO 5 YEARS	OVER 5 YEARS	TOTAL
At 31 December 2012								
Fixed rate	US$M	**13,158**	**2,536**	**927**	**440**	**1,001**	**60**	**18,122**
Weighted average interest rate	%	**1.1**	**1.5**	**1.5**	**2.1**	**3.2**	**9.3**	**1.3**
Floating rate	US$M	**4,329**	**3,025**	**3,026**	**1,553**	**1,020**	**298**	**13,251**
Weighted average interest rate	%	**1.2**	**2.3**	**2.9**	**3.9**	**3.7**	**1.9**	**2.4**
At 31 December 2011								
Fixed rate	US$M	9,119	1,832	338	175	191	634	12,289
Weighted average interest rate	%	1.4	2.1	3.2	3.7	2.1	7.0	1.9
Floating rate	US$M	3,401	3,108	3,423	2,894	1,951	531	15,308
Weighted average interest rate	%	1.6	3.2	4.2	5.1	5.1	4.6	3.7

All financial assets are measured at fair value through profit or loss. Movements in interest rates impact the value of interest-bearing financial assets and therefore impact reported profit after tax. The impact of a 0.5% increase or decrease in interest rates on interest-bearing financial assets owned by the Group at the balance sheet date is shown in the table below.

		PROFIT (LOSS)[1]	
	SENSITIVITY %	2012 US$M	2011 US$M
Interest rate movement – interest-bearing financial assets	+0.5	**(57)**	(37)
	-0.5	**47**	32

1 Net of tax at the Group's prima facie rate of 30%

(iii) Price risk

Price risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from interest rate or currency risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded on the market.

QBE is exposed to price risk on its investment in equities and uses derivative financial instruments to manage this exposure. The risk management processes over these derivative financial instruments are the same as those explained in note 5(D)(i) in respect of forward foreign exchange contracts. Exposure is also managed by diversification across worldwide markets and currencies.

At 31 December 2012, 0.3% (2011 1.1%) of the Group's investments and cash was held in listed equities, of which the majority was publicly traded in the major financial markets.

All equities are measured at fair value through profit or loss. The impact of a 20% increase or decrease in the value of equity investments owned by the Group at the balance sheet date on consolidated profit after tax is shown in the table below. The calculation assumes that exposures are unhedged although in practice QBE may purchase derivatives to manage this exposure. The price risk in relation to unlisted securities is immaterial in terms of the possible impact on profit or loss and has not been included in the sensitivity analysis.

	SENSITIVITY %	PROFIT (LOSS)[1] 2012 US$M	2011 US$M
ASX 200	+20	11	17
	-20	(11)	(17)
EURO STOXX	+20	3	5
	-20	(3)	(5)
S&P 500	+20	–	11
	-20	–	(11)

1 Net of tax at the Group's prima facie rate of 30%

QBE is also exposed to price risk on its investment in corporate fixed interest and floating rate securities. All corporate securities are measured at fair value through profit or loss. Movements in credit spreads impact the value of corporate fixed interest and floating rate securities and therefore impact reported profit after tax.

This risk is managed by investing in high quality, liquid interest-bearing corporate securities and by managing the credit spread duration of the corporate securities portfolio.

The impact of a 0.5% increase or decrease in credit spreads on corporate fixed interest and floating rate securities owned by the Group at the balance date is shown in the table below.

	SENSITIVITY %	PROFIT (LOSS)[1] 2012 US$M	2011 US$M
Credit spread movement – corporate interest-bearing financial assets	+0.5	(98)	(123)
	-0.5	83	116

1 Net of tax at the Group's prima facie rate of 30%

(E) Liquidity risk

Liquidity risk is the risk of insufficient liquid assets to meet liabilities as they fall due to policyholders and creditors. This includes the risk associated with asset liability management. The key objective of the Group's asset and liability management strategy is to ensure that sufficient liquidity is maintained at all times to meet QBE's obligations including its settlement of insurance liabilities and, within these parameters, to optimise investment returns for policyholders and shareholders.

Liquidity must be sufficient to meet both planned and unplanned cash requirements. The Group is exposed to liquidity risk mainly through its obligations to make payments in relation to its insurance activities.

In addition to treasury cash held for working capital requirements, and in accordance with the Group's liquidity policy, a minimum percentage of consolidated investments and cash is held in liquid, short-term money market securities to ensure that there are sufficient liquid funds available to meet insurance and investment obligations. QBE has a strong liquidity position. The maturity of the Group's interest-bearing financial assets is included in the table on page 128.

The Group limits the risk of liquidity shortfalls resulting from mismatches in the timing of claims payments and receipts of claims recoveries by negotiating cash call clauses in reinsurance contracts and seeking accelerated settlements for large reinsurance recoveries.

The following table summarises the maturity profile of certain of the Group's financial liabilities based on the remaining contractual obligations. Borrowings and contractual undiscounted interest payments are disclosed by reference to the first call date of the borrowings. Details are included in note 25.

	1 YEAR OR LESS US$M	1 TO 3 YEARS US$M	3 TO 5 YEARS US$M	OVER 5 YEARS US$M	NO FIXED TERM US$M	TOTAL US$M
As at 31 December 2012						
Trade payables	1,070	36	9	7	10	1,132
Treasury payables	44	–	–	–	–	44
Investment payables	9	–	–	–	–	9
Borrowings	1,161	1,414	1,843	500	–	4,918
Contractual undiscounted interest payments	330	410	112	37	–	889
As at 31 December 2011						
Trade payables	905	111	8	3	5	1,032
Treasury payables	41	–	–	–	–	41
Investment payables	14	–	–	–	–	14
Borrowings	672	1,577	2,373	152	–	4,774
Contractual undiscounted interest payments	248	480	215	4	–	947

The Group has no significant concentration of liquidity risk.

Notes to the financial statements CONTINUED

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5. Risk management CONTINUED

The maturity profile of the Group's net outstanding claims provision is analysed in note 22. For the maturity profile of derivative financial instruments refer to note 12.

(F) Operational risk

Operational risk is the risk of financial loss resulting from inadequate or failed internal processes, people and systems or from external events (including legal risk). The Group manages operational risk within the same robust risk management framework as its other risks. The risk assessment and monitoring framework involves on-going:

- identification and review of the key risks to the Group;
- definition of the acceptable level of risk appetite and tolerance;
- assessment of those risks throughout the Group in terms of the acceptable level of risk (risk tolerance) and the residual risk remaining after having considered risk treatment;
- assessment of whether each risk is within the acceptable level of risk, or requires appropriate action be taken to mitigate any excess risk;
- transparent monitoring and reporting of risk management related matters on a timely basis; and
- alignment of internal audit programs with risks.

One of the cornerstones of the Group's risk management framework is the recruitment and retention of high quality people who are entrusted with appropriate levels of autonomy within the parameters of disciplined risk management practices.

QBE operates a system of delegated authorities based on expertise and proven performance, and compliance is closely monitored. Other controls include effective segregation of duties, access controls and authorisation and reconciliation procedures.

6. Income and expenses

(A) Income summary

	2012 US$M	2011 US$M
Gross earned premium revenue		
Direct and facultative	**16,902**	16,294
Inward reinsurance	**1,439**	1,546
	18,341	17,840
Other revenue		
Reinsurance and other recoveries revenue	**2,267**	2,074
Reinsurance commission revenue	**314**	276
	20,922	20,190
Other income		
Interest, dividend and other income	**797**	799
Net fair value gains on financial assets	**504**	–
Net fair value gains on investment properties	**–**	4
Net fair value gains on owner occupied properties	**–**	6
Net fair value gains on assets held for sale	**3**	–
Realised gains on sale of controlled entities	**–**	9
Gain on purchase of controlled entity	**–**	2
Gain on repurchase of debt securities	**–**	2
Foreign exchange gains	**–**	188
Share of net profits of associates	**3**	6
	1,307	1,016
Income	**22,229**	21,206

(B) Expenses summary

	2012 US$M	2011 US$M
Outward reinsurance premium expense	**2,543**	2,481
Gross claims incurred	**12,695**	12,540
Gross commission expense	**2,874**	2,567
Other acquisition costs	**800**	720
Underwriting and other expenses [1]	**1,557**	1,388
Net fair value losses on financial assets	**–**	191
Net fair value losses on owner occupied properties	**3**	–
Net fair value losses on sale of controlled entities	**11**	–
Loss on sale of repurchased debt securities	**12**	–
Investment expenses	**50**	43
Financing and other costs	**324**	275
Amortisation of intangibles and impairment of goodwill/intangibles [2]	**407**	133
Foreign exchange losses	**12**	–
Expenses	**21,288**	20,338

1 Includes $219 million (2011 $137 million) of agency income earned by the Group's agency operations which is treated as a recovery of the Group's underwriting expenses.
2 Includes an impairment charge of $150 million (2011 $3 million). Details are provided in note 19.

(C) Specific items

	2012 US$M	2011 US$M
Defined contribution superannuation plan expense	**104**	93
Payments on operating leases	**60**	85
Depreciation of property, plant and equipment	**92**	87

7. Investment income

	2012 US$M	2011 US$M
Interest, dividend and other income		
Dividends received or receivable	**24**	17
Interest received or receivable	**769**	786
Other investment income	**4**	(4)
	797	799
Net fair value gains (losses) on financial assets		
Equities	**59**	(19)
Fixed interest and other	**445**	(172)
	504	(191)
Net fair value gains on investment properties	**–**	4
Net fair value (losses) gains on owner occupied properties	**(3)**	6
Net fair value gains on assets held for sale	**3**	–
Realised (losses) gains on sale of controlled entities	**(11)**	9
Gain on purchase of controlled equity	**–**	2
(Losses on sale) gain on repurchase of debt securities	**(12)**	2
Foreign exchange (losses) gains	**(12)**	188
Investment and other income	**1,266**	819
Investment expenses	**(50)**	(43)
Net investment and other income	**1,216**	776

	POLICYHOLDERS' FUNDS		SHAREHOLDERS' FUNDS		INVESTMENT INCOME	
	2012 US$M	2011 US$M	2012 US$M	2011 US$M	2012 US$M	2011 US$M
Investment and other income	**845**	612	**421**	207	**1,266**	819
Investment expenses	**(36)**	(21)	**(14)**	(22)	**(50)**	(43)
Net investment and other income	**809**	591	**407**	185	**1,216**	776

Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2012

8. Claims incurred

(A) Claims analysis

	2012 US$M	2011 US$M
Gross claims incurred and related expenses		
Direct and facultative	11,755	10,824
Inward reinsurance	940	1,716
	12,695	12,540
Reinsurance and other recoveries		
Direct and facultative	2,066	1,639
Inward reinsurance	201	435
	2,267	2,074
Net claims incurred	10,428	10,466

(B) Claims development

Current year claims relate to risks borne in the current reporting year. Prior year claims relate to a reassessment of the risks borne in all previous reporting years and include releases of risk margins as claims are paid. Refer note 8(C) below.

	2012			2011		
	CURRENT YEAR US$M	PRIOR YEARS US$M	TOTAL US$M	CURRENT YEAR US$M	PRIOR YEARS US$M	TOTAL US$M
Gross claims incurred and related expenses						
Undiscounted	14,114	(1,319)	12,795	13,679	(1,597)	12,082
Discount	(381)	281	(100)	(298)	756	458
	13,733	(1,038)	12,695	13,381	(841)	12,540
Reinsurance and other recoveries						
Undiscounted	3,649	(1,383)	2,266	2,981	(983)	1,998
Discount	(35)	36	1	(34)	110	76
	3,614	(1,347)	2,267	2,947	(873)	2,074
Net claims incurred						
Undiscounted	10,465	64	10,529	10,698	(614)	10,084
Discount	(346)	245	(101)	(264)	646	382
	10,119	309	10,428	10,434	32	10,466

(C) Reconciliation of net claims incurred to claims development table

The development of the net undiscounted central estimate of outstanding claims for the 10 most recent accident years is shown in note 22(E). This note is a reconciliation of the amounts included in the table in note 8(B) and the current financial year movements in the claims development table.

	2012			2011		
	CURRENT YEAR US$M	PRIOR YEARS US$M	TOTAL US$M	CURRENT YEAR US$M	PRIOR YEARS US$M	TOTAL US$M
Net undiscounted claims development – central estimate (note 22)	9,647	464	10,111	10,360	(64)	10,296
Acquisitions – central estimate	(201)	–	(201)	(448)	–	(448)
	9,446	464	9,910	9,912	(64)	9,848
Movement in claims settlement costs			336			380
Movement in discount			53			382
Inflation adjustment [1]			50			–
Movement in risk margin			88			(124)
Other movements (including foreign exchange)			(9)			(20)
Net claims incurred – discounted			10,428			10,466

1 Adjustment to workers' compensation business in Argentina to reflect inflation impact of $204 million less related discount of $154 million.

Net incurred claims includes prior year net undiscounted central estimate development of $464 million. This arises primarily in our North American Operation due to an upgrade of claims provisions on underperforming and run-off portfolios and in Equator Re due to increased claims estimates for 2011 catastrophes and development on non-US casualty business. This adverse development was partly mitigated by positive prior accident year development in our Australian & New Zealand Operations, primarily in relation to dust disease claims.

9. Income tax

(A) Reconciliation of prima facie tax to income tax expense

	2012 US$M	2011 US$M
Profit before income tax	941	868
Prima facie tax payable at 30%	282	260
Tax effect of non-temporary differences:		
Untaxed dividends	(4)	(3)
Differences in tax rates	(90)	7
Other, including non-allowable expenses and non-taxable income	(34)	(70)
Prima facie tax adjusted for non-temporary differences	154	194
Deferred tax assets no longer recognised	(2)	(24)
Overprovision in prior years	9	(21)
Income tax expense	161	149
Analysed as follows:		
Current tax	575	(72)
Deferred tax	(423)	242
Overprovision in prior years	9	(21)
	161	149
Deferred tax (credit) expense comprises:[1]		
Deferred tax assets recognised in profit or loss	(167)	(190)
Deferred tax liabilities recognised in profit or loss	(256)	432
	(423)	242

1 Consolidated deferred tax expense includes $30 million (2011 $28 million) credited to profit as a result of changes in income tax rates.

(B) Tax consolidation legislation

The accounting policy in relation to this legislation is set out in note 1(J).

On adoption of the tax consolidation legislation, the directors of the company and its Australian entities entered into a tax sharing and tax funding agreement that requires the Australian entities to fully compensate the company for current tax liabilities and to be fully compensated by the company for any current tax or deferred tax assets in respect of tax losses arising from external transactions occurring after the date of implementation of the tax consolidation legislation. The contributions are allocated by reference to the notional taxable income of each Australian entity.

Details of franking credits available to shareholders are shown in note 27(D).

10. Cash and cash equivalents

	2012 US$M	2011 US$M
Cash at bank and on hand	1,230	835
Overnight money	49	107
Cash management trusts	495	286
Term deposits	251	229
	2,025	1,457
Analysed as follows:		
Fixed interest rate	229	372
Floating interest rate	1,796	1,085
	2,025	1,457

Amounts in cash and cash equivalents are the same as those included in the cash flow statement.

(A) Restrictions on use

Cash and cash equivalents includes balances readily convertible to cash. All balances are held to service operational cash requirements. Included in cash and cash equivalents are amounts totalling $104 million (2011 $74 million) which are held in Lloyd's syndicate trust funds. In order to conduct underwriting business within some territories, Lloyd's syndicates are required to lodge assets in locally regulated trust funds. Under Lloyd's bye-laws, these amounts can only be used to pay claims and allowable expenses of the syndicates and cannot be withdrawn from the trust funds until allowed to be distributed as profit once annual solvency requirements are met.

QBE has operations in many countries which have foreign exchange controls and regulations. The nature of the controls and regulations is highly dependant on the relevant country's banking practices, and these practices can vary from simple reporting requirements to outright prohibition of movement of funds without explicit prior central bank approval. The impact of these controls and regulations may be the restriction of the Group's capacity to repatriate capital and/or profits. QBE's operations in these countries are generally small; however, in Argentina our exposure is more significant and hence the foreign exchange controls and regulations may have a significant impact on our ability to repatriate funds.

Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2012

10. Cash and cash equivalents CONTINUED

(B) Reconciliation of cash flows from operating activities to profit after income tax

	2012 US$M	2011 US$M
Cash flows from operating activities	2,753	2,139
Depreciation of property, plant and equipment	(92)	(87)
Amortisation and impairment of goodwill/intangibles	(407)	(133)
Realised (losses) gains on sale of controlled entities	(11)	9
(Loss) gain on repurchase of debt securities	(12)	2
Loss on sale of plant and equipment	(90)	(30)
Net foreign exchange (losses) gains	(12)	188
Other gains (losses) on financial assets	472	(196)
Increase in net outstanding claims	(1,110)	(1,562)
Increase in unearned premium	(93)	(451)
(Decrease) increase in deferred insurance costs	(133)	248
(Decrease) increase in trade debtors	(683)	145
Increase in net operating assets	195	226
Share of net profit of associates	3	6
Decrease in trade payables	191	298
Increase in tax liabilities	(160)	(47)
Increase in share based payments	(40)	(44)
Decrease in defined benefit plan surplus/deficit	9	8
Profit after income tax	780	719

11. Investments

	2012 US$M	2011 US$M
Fixed interest rate		
Short-term money	7,598	6,431
Government bonds	7,013	3,565
Corporate bonds	3,282	1,921
	17,893	11,917
Floating interest rate		
Short-term money	568	219
Government bonds	972	458
Corporate bonds	9,839	13,428
Unit trusts	76	118
	11,455	14,223
Equities		
Listed	96	300
Unlisted	27	24
Exchange traded equity options	–	2
	123	326
Total investments	29,471	26,466
Amounts maturing within 12 months	15,462	11,063
Amounts maturing in greater than 12 months	14,009	15,403
Total investments	29,471	26,466

(A) Exchange traded equity derivatives

Contractual amounts for forward contracts at the balance sheet date were nil (2011 nil). The credit risk arising from equity derivatives is nil (2011 $2 million).

(B) Charges over investments and other assets

A controlled entity has given fixed and floating charges over certain of its investments and other assets in order to secure the obligations of the Group's corporate members at Lloyd's of London as described in note 32.

(C) Valuation of investments

All investments are initially recorded at fair value and are subsequently remeasured to fair value at each reporting date. Investments traded in an active market are valued with reference to the closing bid price. The significant majority of other investments, being fixed and floating rate securities, are valued using independently sourced valuations that do not involve the exercise of judgment by management. Less than 1% of investments are valued using common valuation practices such as discounted cash flow analysis and option pricing tools. Any reasonable changes in the inputs used to value these investments would not have a significant impact on the balance sheet.

The investments of the Group are disclosed in the table below using a fair value hierarchy which reflects the significance of inputs into the determination of fair value as follows:

Fair value hierarchy

Level 1: Valuation is based on quoted prices in active markets for the same instruments.

Level 2: Valuation is based on quoted prices in active markets for similar assets or liabilities or other valuation techniques for which all significant inputs are based on observable market data, for example, consensus pricing using broker quotes and valuation models with observable input.

Level 3: Valuation techniques are applied in which any one or more significant input is not based on observable market data.

	2012				2011			
	LEVEL 1 US$M	LEVEL 2 US$M	LEVEL 3 US$M	TOTAL US$M	LEVEL 1 US$M	LEVEL 2 US$M	LEVEL 3 US$M	TOTAL US$M
Short-term money	1,721	6,445	–	8,166	474	6,175	1	6,650
Government bonds	4,977	2,995	13	7,985	1,726	2,296	1	4,023
Corporate bonds	–	12,990	131	13,121	–	15,349	–	15,349
Fixed interest trusts	–	76	–	76	–	118	–	118
Equities – listed	95	–	1	96	299	–	1	300
Equities – unlisted	–	–	27	27	–	–	24	24
Exchange traded equity options	–	–	–	–	2	–	–	2
Total investments	6,793	22,506	172	29,471	2,501	23,938	27	26,466

(D) Movements in level 3 investments

The following table provides an analysis of investments valued with reference to level 3 inputs.

LEVEL 3	2012 US$M	2011 US$M
At 1 January	27	29
Purchases	143	1
Disposals	(2)	(2)
Unrealised gains (losses)	3	(1)
Foreign exchange	1	–
At 31 December	172	27

(E) Restrictions on use

Included in investments are amounts totalling $3,623 million (2011 $3,491 million) which are held in Lloyd's syndicate trust funds. In order to conduct underwriting business within some territories, Lloyd's syndicates are required to lodge assets in locally regulated trust funds. Under Lloyd's bye-laws, these amounts can only be used to pay claims and allowable expenses of the syndicate and cannot be withdrawn from the trust funds until allowed to be distributed as profit once annual solvency requirements are met. Included in this amount is $1,095 million (2011 $1,048 million) of short-term money.

12. Derivative financial instruments

	ASSETS		LIABILITIES	
	2012 US$M	2011 US$M	2012 US$M	2011 US$M
Maturing within 12 months				
Forward foreign exchange contracts	24	42	14	45

Equity derivatives are included in note 11(A).

All derivative positions entered into by the Group are for economic hedging purposes but do not, in all cases, meet the criteria for hedge accounting.

(A) Credit risk

Credit risk arises from the potential failure of counterparties to meet their obligations under the respective contracts at maturity. This arises on derivative financial instruments with unrealised gains. $24 million (2011 $42 million) is receivable from forward foreign exchange contracts at the balance sheet date.

(B) Forward foreign exchange contracts

Forward foreign exchange contracts are entered into by the Group for the purpose of managing residual foreign currency exposures. The Group's policy for managing such exposures is explained in note 5(D). Undiscounted contractual amounts to purchase $2,478 million (2011 $3,033 million) were outstanding at the balance sheet date. All contracts mature within 12 months of the balance date.

Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2012

12. Derivative financial instruments CONTINUED

(C) Determination of fair value and fair value hierarchy

The Group's accounting policy in relation to the valuation of derivatives is set out in note 1(N). Derivatives are analysed in the table below using a fair value hierarchy which reflects the significance of inputs into the determination of fair value. The hierarchy is explained in more detail in note 11(C).

	2012				2011			
	LEVEL 1 US$M	LEVEL 2 US$M	LEVEL 3 US$M	TOTAL US$M	LEVEL 1 US$M	LEVEL 2 US$M	LEVEL 3 US$M	TOTAL US$M
Forward foreign exchange contracts	**10**	**–**	**–**	**10**	(3)	–	–	(3)

(D) Hedging arrangements

At the balance date, no derivatives were designated as hedges.

At the balance sheet date, $3,825 million (2011 $3,750 million) of borrowings and $39 million (2011 nil) of other liabilities were designated as hedges of net investments in foreign operations.

13. Trade and other receivables

	2012 US$M	2011 US$M
Trade debtors		
Premium receivable [1]	**2,790**	2,497
Reinsurance and other recoveries [1]	**833**	1,097
Unclosed premium	**1,046**	1,184
Other trade debtors	**198**	332
	4,867	5,110
Other debtors	**225**	225
Treasury receivables	**6**	9
Investment receivables	**134**	170
Trade and other receivables	**5,232**	5,514
Receivable within 12 months	**4,965**	5,248
Receivable in greater than 12 months	**267**	266
Trade and other receivables	**5,232**	5,514

1 Net of a provision for impairment.

(A) Provision for impairment

	PREMIUM RECEIVABLE		REINSURANCE AND OTHER RECOVERIES	
	2012 US$M	2011 US$M	2012 US$M	2011 US$M
At 1 January	**78**	81	**45**	30
Amounts recognised in profit or loss	**20**	7	**(7)**	3
Other movements	**(8)**	(9)	**5**	12
Foreign exchange	**–**	(1)	**1**	–
At 31 December	**90**	78	**44**	45

(B) Fair value

Due to the short-term nature of these receivables, their carrying value is assumed to approximate their fair value.

(C) Risk

The maximum exposure to credit risk at the reporting date is the fair value of each class of receivables. No receivables are pledged by the Group as collateral for liabilities or contingent liabilities. Information on the ageing and credit rating of balances in the table above, where relevant, is included in note 5. Note 5 also provides more information on the risk management policies of the Group.

14. Deferred insurance costs

	2012 US$M	2011 US$M
Deferred reinsurance premium	**663**	771
Deferred net commission	**1,399**	1,225
Deferred acquisition costs	**544**	436
Deferred insurance costs	**2,606**	2,432
To be expensed within 12 months	**2,435**	2,250
To be expensed in greater than 12 months	**171**	182
Deferred insurance costs	**2,606**	2,432

	DEFERRED REINSURANCE PREMIUM		DEFERRED NET COMMISSION		DEFERRED ACQUISITION COSTS	
	2012 US$M	2011 US$M	2012 US$M	2011 US$M	2012 US$M	2011 US$M
At 1 January	**771**	651	**1,225**	1,032	**436**	320
Acquisitions	**64**	19	**112**	61	**–**	4
Costs deferred in financial year	**500**	778	**1,104**	1,164	**467**	387
Amortisation of costs deferred in previous financial years	**(683)**	(667)	**(1,054)**	(1,027)	**(367)**	(273)
Foreign exchange	**11**	(10)	**12**	(5)	**8**	(2)
At 31 December	**663**	771	**1,399**	1,225	**544**	436

15. Property, plant and equipment

2012	OWNER OCCUPIED PROPERTIES US$M	LEASEHOLD IMPROVEMENTS US$M	OFFICE EQUIPMENT/ FIXTURES & FITTINGS US$M	MOTOR VEHICLES US$M	TOTAL US$M
Cost or valuation	**198**	**122**	**453**	**10**	**783**
At 1 January					
Acquisitions	**4**	**1**	**2**	**–**	**7**
Additions	**4**	**69**	**214**	**2**	**289**
Revaluations	**(3)**	**–**	**–**	**–**	**(3)**
Disposals	**(1)**	**(5)**	**(104)**	**(2)**	**(112)**
Foreign exchange	**3**	**3**	**13**	**–**	**19**
At 31 December	**205**	**190**	**578**	**10**	**983**
Accumulated depreciation and impairment losses					
At 1 January	**–**	**57**	**273**	**5**	**335**
Disposals	**–**	**(2)**	**(14)**	**(2)**	**(18)**
Depreciation charge for the year	**–**	**20**	**70**	**2**	**92**
Foreign exchange	**–**	**1**	**9**	**–**	**10**
At 31 December	**–**	**76**	**338**	**5**	**419**
Carrying amount					
At 31 December	**205**	**114**	**240**	**5**	**564**

2011	OWNER OCCUPIED PROPERTIES US$M	LEASEHOLD IMPROVEMENTS US$M	OFFICE EQUIPMENT/ FIXTURES & FITTINGS US$M	MOTOR VEHICLES US$M	TOTAL US$M
Cost or valuation					
At 1 January	207	116	357	10	690
Acquisitions	–	–	11	–	11
Additions	5	9	124	2	140
Revaluations	14	–	–	–	14
Reclassified from investment property	6	–	–	–	6
Reclassified to assets held for sale	(32)	–	–	–	(32)
Disposals	–	(2)	(36)	(2)	(40)
Foreign exchange	(2)	(1)	(3)	–	(6)
At 31 December	198	122	453	10	783
Accumulated depreciation and impairment losses					
At 1 January	–	44	209	5	258
Disposals	–	(1)	(5)	(2)	(8)
Depreciation charge for the year	–	14	71	2	87
Foreign exchange	–	–	(2)	–	(2)
At 31 December	–	57	273	5	335
Carrying amount					
At 31 December	198	65	180	5	448

Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2012

(A) Owner occupied properties

Principal owner occupied properties are valued annually by the directors effective 31 December based on independent valuations.

All owner occupied properties were valued on the basis of capitalisation of net market rentals allowing for costs of reletting, having regard to comparable on-market sales and discounted future cash flows.

In accordance with the Group's accounting policy, owner occupied properties are measured at fair value. The cost of owner occupied properties at 31 December 2012 was $199 million (2011 $192 million).

16. Deferred income tax

	2012 US$M	2011 US$M
Deferred tax assets	290	86
Deferred tax liabilities	(373)	(575)

(A) Deferred tax assets

(i) The balance comprises temporary differences attributable to:

	2012 US$M	2011 US$M
Amounts recognised in profit or loss		
Financial assets – fair value movements	82	41
Provision for impairment	21	16
Employee benefits	69	60
Defined benefit plans	–	1
Insurance provisions	567	471
Deferred tax losses recognised	366	325
Other	130	123
	1,235	1,037
Amounts recognised in other comprehensive income		
Capitalised expenses	2	3
Defined benefit plans	55	40
	57	43
Deferred tax assets before set-off	1,292	1,080
Set-off of deferred tax liabilities	(1,002)	(994)
	290	86
Deferred tax assets before set-off analysed as follows:		
Recoverable within 12 months	283	301
Recoverable in greater than 12 months	1,009	779
	1,292	1,080

(ii) Movements:

	2012 US$M	2011 US$M
At 1 January	1,080	742
Amounts recognised in profit or loss	167	190
Amounts recognised in other comprehensive income	14	(8)
Acquisitions	31	162
Foreign exchange	–	(6)
At 31 December	1,292	1,080

(B) Tax losses

The Group has not brought to account $99 million (2011 $90 million) of tax losses, which includes the benefit arising from tax losses in overseas countries. This benefit will only be brought to account when the directors believe it is probable that it will be realised. This benefit of tax losses will only be obtained if:

- the Group derives future assessable income of a nature and an amount sufficient to enable the benefit from the deductions for the losses to be realised;
- the Group continues to comply with the conditions for deductibility imposed by tax legislation; and
- no changes in tax legislation adversely affect the Group in realising the benefit from the deductions for the losses.

(C) Deferred tax liabilities

(i) The balance comprises temporary differences attributable to:

	2012 US$M	2011 US$M
Amounts recognised in profit or loss		
Intangibles	(243)	(323)
Insurance provisions	(763)	(887)
Taxation of Financial Arrangements transitional adjustment	(70)	(101)
Financial assets – fair value movements	(97)	(26)
Other provisions	(36)	(109)
Other items	(154)	(99)
	(1,363)	(1,545)
Amounts recognised in other comprehensive income		
Owner occupied property	(12)	(20)
Other	–	(4)
	(12)	(24)
Deferred tax liabilities before set-off	(1,375)	(1,569)
Set-off of deferred tax assets	1,002	994
	(373)	(575)
Deferred tax liabilities before set-off analysed as follows:		
Recoverable within 12 months	(195)	(247)
Recoverable in greater than 12 months	(1,180)	(1,322)
	(1,375)	(1,569)

(ii) Movements:

	2012 US$M	2011 US$M
At 1 January	(1,569)	(1,051)
Amounts recognised in profit or loss	256	(432)
Amounts recognised in other comprehensive income	12	(4)
Acquisitions	(67)	(94)
Foreign exchange	(7)	12
At 31 December	(1,375)	(1,569)

17. Investment properties

	2012 US$M	2011 US$M
At 1 January	28	66
Additions	1	5
Disposals	(1)	–
Fair value gains	–	4
Reclassified to assets held for sale	–	(41)
Reclassification from (to) owner occupied property	–	(6)
Foreign exchange	1	–
At 31 December	29	28

Investment properties are valued annually by the directors based on independent valuations.

All investment properties were valued on the basis of capitalisation of net market rentals allowing for costs of reletting, having regard to comparable on-market sales and discounted future cash flows. Investment properties are not expected to be realised within 12 months.

Rental income from investment properties was $4 million (2011 $6 million).

Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2012

18. Investment in associates

(A) Movements in carrying amounts

	2012 US$M	2011 US$M
At 1 January	55	53
Share of profit	3	6
Other comprehensive income	4	(2)
Foreign exchange	–	(2)
At 31 December	62	55

(B) Extracts from entity financial statements

2012	GROUP SHARE OF: ASSETS US$M	LIABILITIES US$M	GROSS WRITTEN PREMIUM US$M	NET PROFIT AFTER TAX US$M
QBE del Istmo Reinsurance Company Inc	144	(90)	66	5
Pacific Re Limited	6	(2)	2	–
Raheja QBE General Insurance Limited	11	(2)	1	–
	161	(94)	69	5

2011	GROUP SHARE OF: ASSETS US$M	LIABILITIES US$M	GROSS WRITTEN PREMIUM US$M	NET PROFIT AFTER TAX US$M
QBE del Istmo Reinsurance Company Inc	137	(88)	60	5
Pacific Re Limited	6	(2)	2	–
Raheja QBE General Insurance Limited	10	(1)	1	–
	153	(91)	63	5

19. Intangible assets

	IDENTIFIABLE INTANGIBLES						GOODWILL	TOTAL
2012	LLOYD'S SYNDICATE CAPACITY US$M	CUSTOMER RELATION-SHIPS US$M	BRAND NAMES US$M	INSURANCE LICENCES US$M	SOFTWARE US$M	OTHER US$M	US$M	US$M
Cost								
At 1 January	82	1,333	78	75	88	44	4,666	6,366
Acquisitions	–	190	12	–	1	1	156	360
Disposals	–	–	–	(6)	–	–	–	(6)
Additions/reclassifications	–	11	10	(13)	–	(8)	25	25
Impairment	–	(43)	(46)	(7)	–	(1)	(53)	(150)
Foreign exchange	4	(7)	(1)	–	–	1	34	31
At 31 December	86	1,484	53	49	89	37	4,828	6,626
Amortisation								
At 1 January	–	(231)	(9)	–	(39)	(22)	–	(301)
Amortisation for the year	–	(226)	(10)	–	(14)	(7)	–	(257)
Foreign exchange	–	(2)	–	–	–	2	–	–
At 31 December	–	(459)	(19)	–	(53)	(27)	–	(558)
Carrying amount								
At 31 December	86	1,025	34	49	36	10	4,828	6,068

2011	LLOYD'S SYNDICATE CAPACITY US$M	CUSTOMER RELATION-SHIPS US$M	BRAND NAMES US$M	INSURANCE LICENCES US$M	SOFTWARE US$M	OTHER US$M	GOODWILL US$M	TOTAL US$M
	IDENTIFIABLE INTANGIBLES							
Cost								
At 1 January	81	715	58	57	49	28	4,573	5,561
Acquisitions	–	615	18	9	35	16	128	821
Additions/reclassifications	–	8	7	10	4	–	(24)	5
Impairment	–	–	(4)	–	–	–	–	(4)
Foreign exchange	1	(5)	(1)	(1)	–	–	(11)	(17)
At 31 December	82	1,333	78	75	88	44	4,666	6,366
Amortisation								
At 1 January	–	(133)	(4)	–	(24)	(13)	–	(174)
Amortisation for the year	–	(100)	(6)	–	(15)	(9)	–	(130)
Impairment	–	–	1	–	–	–	–	1
Foreign exchange	–	2	–	–	–	–	–	2
At 31 December	–	(231)	(9)	–	(39)	(22)	–	(301)
Carrying amount								
At 31 December	82	1,102	69	75	49	22	4,666	6,065

(A) Identifiable intangibles

Lloyd's syndicate capacity, insurance licences and some brand names are considered to have an indefinite useful life and no amortisation is charged. All remaining intangible assets are amortised over their finite useful lives and the amortisation charge is included in amortisation and impairment of goodwill/intangibles in the income statement. The most significant classes of intangible assets are detailed below.

(i) Lloyd's syndicate capacity

Syndicate allocated capacity is the aggregate of the premium limits of each member of that syndicate at a point in time. An existing capital provider has the first right to participate on the next year of account, giving the indefinite right to participate on all future years of account. The Lloyd's syndicate capacity intangible asset relates to the syndicate capacity acquired as part of the acquisition of QBE Underwriting Limited (formerly trading as Limit) in 2000 and costs incurred as a result of increasing capacity since that date. The Group has demonstrated a long-term commitment to developing its operations at Lloyd's. Since acquiring QBE Underwriting Limited, the Group has increased its share of ownership of all syndicates from 55% in 2000 to 91% for the 2012 underwriting year. The value of this asset is in the access it gives to future underwriting profits at Lloyd's. For these reasons, Lloyd's syndicate capacity is deemed to have an indefinite useful life.

(ii) Customer relationships

Customer relationships comprise the capitalisation of future profits relating to insurance contracts acquired and the expected renewal of those contracts. It also includes the value of the distribution networks and agency relationships. Customer relationships will be amortised over remaining lives of between three and 25 years depending on the classes of business to which the assets relate.

(iii) Brand names

This asset reflects the revenue generating ability of acquired brands. In some circumstances, brand names are considered to have an indefinite useful life due to the long-term nature of this asset. When there is a contractual limit on the use of the brand name, the asset will be amortised over the remaining period, being in the range of two to 20 years.

(iv) Insurance licences

This asset gives the Group the right to operate in certain geographic locations and to write certain classes of business with a potential to generate additional revenue. It is considered to have an indefinite useful life due to its long-term nature.

(v) Software

This is the fair value of key operating systems acquired in business combinations which will benefit the future operations of the acquired entity. Capitalised software will be amortised over periods ranging from three to 13 years, reflecting the period during which the Group is expected to benefit from the use of the software.

(vi) Impairment testing of identifiable intangible assets

The Group's accounting policy in respect of impairment testing of identifiable intangible assets is set out in note 1(T). The recoverable amount of each intangible asset with an indefinite useful life has been determined by reference to a value in use calculation based on the following key assumptions and estimates:

- cash flow forecasts relevant to the initial valuation of the identifiable intangible asset are reviewed, and updated if appropriate, by management. Cash flow forecasts are based on a combination of actual performance to date combined with management's expectations of future performance based on prevailing and anticipated market factors; and
- discount rates reflect a beta and a market risk premium sourced from observable market information and a specific risk premium appropriate to reflect the nature of the risk associated with the intangible asset or the cash generating unit to which the asset is allocated.

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FOR THE YEAR ENDED 31 DECEMBER 2012

19. Intangible assets CONTINUED

(B) Goodwill

Goodwill is allocated to cash generating units, or groups of units, expected to benefit from synergies arising from the acquisition giving rise to the goodwill. Cash generating units reflect the level at which goodwill is monitored by management. As the Group continues to acquire operations and reorganise the way that operations are managed, reporting structures may change giving rise to a reassessment of cash generating units and/or the allocation of goodwill to those cash generating units.

The goodwill relating to certain acquisitions is denominated in currencies other than the US dollar and so is subject to foreign exchange movements.

Goodwill is analysed by groups of cash generating units as follows:

	2012 US$M	2011 US$M
North American Operations	**2,354**	2,332
Australian Operations [1]	**1,729**	910
QBE LMI	**–**	787
QBE Insurance Europe	**264**	233
Lloyd's division	**236**	240
Other	**245**	164
	4,828	4,666

1 During 2012, a change in management and reporting structures resulted in QBE LMI being fully integrated into Australian Operations.
2 None of the cash generating units included in "Other" is individually significant to the total goodwill.

(i) Impairment testing of goodwill

The Group's accounting policy in respect of impairment testing of goodwill is set out in note 1(T). The recoverable amount of each cash generating unit has been determined by reference to a value in use calculation based on the following key assumptions and estimates:

- cash flow projections based on the latest three year business plan which has been approved by the Board. Cash flow forecasts are based on a combination of historical performance combined with management's expectations of future performance based on prevailing and anticipated market factors;
- terminal value is calculated using a perpetuity growth formula based on the cash flow forecast for year three. Growth rates reflect the long-term average of the countries relevant to the cash generating unit and are sourced from observable market information. The terminal growth rates used in management's impairment testing are: North American Operations 2.3%, Australian Operations 3%, QBE Insurance Europe 1.5% and Lloyd's division 2.5%; and
- discount rates reflect a beta and a market risk premium sourced from observable market information and a specific risk premium appropriate to reflect the nature of the business of each cash generating unit.

The pre-tax discount rates used to value significant cash generating units at 31 December 2012 and 31 December 2011 were as follows:

	2012 %	2011 %
North American Operations	**15.1**	11.1
Australian Operations [1]	**10.4**	10.7
QBE LMI	**–**	10.8
QBE Insurance Europe	**11.1**	10.2
Lloyd's division	**8.4**	10.3

1 During 2012, a change in management and reporting structures resulted in QBE LMI being fully integrated into Australian Operations.

(C) Impairment losses and changes in amortisation method

(i) Impairment losses – identifiable intangibles

During the year, an impairment loss of $91 million was charged to the income statement as a result of strategic initiatives undertaken in our North American Operations, particularly initiatives to promote the QBE brand name and streamline distribution channels. The recoverable amount of the intangible assets were based on value in use calculations using discount rates of 8.0% to 11.5%.

During the year, an impairment loss of $5 million was charged to the income statement for our Puerto Rican operation, Optima, due to uncertainty over cash flows relating to reinsurance synergies. The impairment loss resulted in identifiable intangibles being written down to nil value. The recoverable amount was based on a value in use calculation using a discount rate of 15.8%.

(ii) Impairment losses – goodwill

During the year, an impairment loss of $37 million was charged to the income statement as a result of uncertainty over future cash flows arising from the acquisition of the insurance subsidiary of Hang Seng Bank. The recoverable amount was based on a value in use calculation using a discount rate of 9.5%.

During the year, an impairment loss of $16 million was charged to the income statement for our Puerto Rican operation, Optima, due to uncertainty over cash flows relating to reinsurance synergies. The recoverable amount was based on a value in use calculation using a discount rate of 15.8%.

(iii) Changes to amortisation method

The amortisation profile applied to distribution rights acquired as part of the Balboa acquisition in 2011 has been revised to better reflect the pattern of benefits expected. The impact of this change in accounting estimate is an increase in the amortisation charge for the year ended 31 December 2012 of $80 million, with a corresponding reduction in future amortisation charge.

20. Trade and other payables

	2012 US$M	2011 US$M
Trade payables	**1,132**	1,032
Other payables and accrued expenses	**827**	730
Treasury payables	**44**	41
Investment payables	**9**	14
Trade and other payables	**2,012**	1,817
Payable within 12 months	**1,938**	1,584
Payable in greater than 12 months	**74**	233
Trade and other payables	**2,012**	1,817

21. Unearned premium

(A) Unearned premium

	2012 US$M	2011 US$M
At 1 January	**8,069**	6,788
Acquisitions	**258**	837
Deferral of premium on contracts written in the period	**6,994**	6,645
Earning of premium written in previous periods	**(6,901)**	(6,194)
Disposals	**(5)**	–
Foreign exchange	**144**	(7)
At 31 December	**8,559**	8,069
To be earned within 12 months	**7,683**	7,352
To be earned in greater than 12 months	**876**	717
Unearned premium	**8,559**	8,069

(B) Net premium liabilities

	NOTE	2012 US$M	2011 US$M
Unearned premium		**8,559**	8,069
Deferred insurance costs	14	**(2,606)**	(2,432)
Net premium liabilities		**5,953**	5,637

(C) Expected present value of future cash flows for future claims including risk margin

	2012 US$M	2011 US$M
Undiscounted central estimate	**5,367**	5,436
Risk margin	**215**	220
	5,582	5,656
Discount to present value	**(343)**	(374)
Expected present value of future cash flows for future claims including risk margin	**5,239**	5,282

(D) Liability adequacy test

The probability of adequacy applied in the liability adequacy test differs from the probability of adequacy adopted in determining the outstanding claims provision. The reason for the difference is that the former is a benchmark used only to test the sufficiency of net premium liabilities whereas the latter is a measure of the adequacy of the outstanding claims provision actually carried by the Group.

AASB 1023 requires the inclusion of a risk margin in insurance liabilities, but does not prescribe a minimum level of margin. Whilst there is established practice in the calculation of the probability of adequacy of the outstanding claims provision, no such guidance exists in respect of the level of risk margin to be used in determining the adequacy of net premium liabilities. The Group has adopted a risk margin of 4.3% for premium liabilities, for the purpose of the liability adequacy test to produce a 75% probability of adequacy in respect of total insurance liabilities. The 75% basis is a recognised industry benchmark in Australia, being the minimum probability of adequacy required for Australian licensed insurers by APRA. Without allowing for diversification benefits, the application of the 4.3% risk margin to the premium liabilities is estimated to achieve a probability of adequacy of 70% on premium liabilities on a standalone basis.

The application of the liability adequacy test in respect of the net premium liabilities identified a surplus at 31 December 2012 and 2011.

(E) Risk margin

The process used to determine the risk margin is explained in note 4(A)(iii).

The risk margin in expected future cash flows for future claims as a percentage of the discounted central estimate is 4.3% (2011 4.3%).

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FOR THE YEAR ENDED 31 DECEMBER 2012

22. Outstanding claims

(A) Net outstanding claims

	2012 US$M	2011 US$M
Gross outstanding claims	23,642	21,374
Claims settlement costs	448	453
	24,090	21,827
Discount to present value	(1,301)	(1,150)
Gross outstanding claims provision	22,789	20,677
Less than 12 months	8,960	7,869
Greater than 12 months	13,829	12,808
Gross outstanding claims provision	22,789	20,677
Reinsurance and other recoveries on outstanding claims[1]	4,514	3,808
Discount to present value	(137)	(115)
Reinsurance and other recoveries on outstanding claims	4,377	3,693
Less than 12 months	2,358	1,874
Greater than 12 months	2,019	1,819
Reinsurance and other recoveries on outstanding claims	4,377	3,693
Net outstanding claims provision	18,412	16,984
Central estimate	17,079	15,783
Risk margin	1,333	1,201
Net outstanding claims provision	18,412	16,984

1 Reinsurance and other recoveries on outstanding claims is shown net of a provision for impairment of $29 million (2011 $35 million).

(B) Maturity profile of net outstanding claims

The expected maturity of the Group's discounted net outstanding claims provision is analysed below.

2012	1 YEAR OR LESS US$M	1 TO 2 YEARS US$M	2 TO 3 YEARS US$M	3 TO 4 YEARS US$M	4 TO 5 YEARS US$M	OVER 5 YEARS US$M	TOTAL US$M
North American Operations	1,285	574	379	225	124	409	2,996
Latin American Operations	282	95	57	36	28	90	588
European Operations	1,691	1,073	756	593	422	1,371	5,906
Australian & New Zealand Operations	1,731	953	608	392	242	523	4,449
Asia Pacific Operations	188	86	49	25	16	18	382
Equator Re	1,425	833	560	400	267	606	4,091
Group	6,602	3,614	2,409	1,671	1,099	3,017	18,412

2011	1 YEAR OR LESS US$M	1 TO 2 YEARS US$M	2 TO 3 YEARS US$M	3 TO 4 YEARS US$M	4 TO 5 YEARS US$M	OVER 5 YEARS US$M	TOTAL US$M
North American Operations	1,079	574	353	219	134	402	2,761
Latin American Operations	122	112	28	16	7	70	355
European Operations	1,577	1,043	737	542	400	1,299	5,598
Australian & New Zealand Operations	1,697	881	557	360	220	485	4,200
Asia Pacific Operations	148	61	34	19	10	20	292
Equator Re	1,372	779	489	378	254	506	3,778
Group	5,995	3,450	2,198	1,534	1,025	2,782	16,984

An analysis of the weighted average term to settlement of the claims provision is included in note 4(A)(iv).

(C) Risk margin

The process used to determine the risk margin is explained in note 4(A)(iii) and details of the risk-free discount rates adopted are set out in note 4(A)(iv).

The risk margin included in net outstanding claims is 7.8% (2011 7.6%) of the central estimate. The increase in the risk margin reflects increased uncertainty in the net discounted central estimate at 31 December 2012. As a consequence, the probability of adequacy at 31 December 2012 is 87.5% (2011 86.3%) which is well above APRA's 75% benchmark. Net profit after tax would have increased by $50 million if the probability of adequacy was maintained at 86.3%.

(D) Reconciliation of movement in discounted outstanding claims provision

	2012			2011		
	GROSS US$M	REINSURANCE US$M	NET US$M	GROSS US$M	REINSURANCE US$M	NET US$M
At 1 January	**20,677**	**(3,693)**	**16,984**	18,236	(3,219)	15,017
Increase in net claims incurred in current accident year	**13,733**	**(3,614)**	**10,119**	13,381	(2,947)	10,434
Movement in prior year claims provision	**(1,038)**	**1,347**	**309**	(841)	873	32
Incurred claims recognised in the income statement	**12,695**	**(2,267)**	**10,428**	12,540	(2,074)	10,466
Acquisitions/disposals	**298**	**(64)**	**234**	607	(66)	541
Claims payments	**(11,276)**	**1,833**	**(9,443)**	(10,368)	1,683	(8,685)
Foreign exchange	**395**	**(186)**	**209**	(338)	(17)	(355)
At 31 December	**22,789**	**(4,377)**	**18,412**	20,677	(3,693)	16,984

(E) Claims development – undiscounted net central estimate

	2002 & PRIOR US$M	2003 US$M	2004 US$M	2005 US$M	2006 US$M	2007 US$M	2008 US$M	2009 US$M	2010 US$M	2011 US$M	2012[1] US$M	TOTAL US$M
Net claims cost – central estimate:												
At end of accident year		2,485	3,471	3,809	3,463	6,398	6,060	6,148	8,035	10,247	9,647	
One year later		2,300	3,211	3,809	3,358	6,281	6,208	6,185	8,124	10,510	–	
Two years later		2,159	3,043	3,544	3,276	6,403	6,191	6,110	8,237	–	–	
Three years later		2,113	3,004	3,552	3,218	6,399	6,312	6,208	–	–	–	
Four years later		2,058	2,879	3,559	3,156	6,366	6,359	–	–	–	–	
Five years later		2,045	2,879	3,523	3,133	6,363	–	–	–	–	–	
Six years later		2,061	2,889	3,532	3,148	–	–	–	–	–	–	
Seven years later		2,086	2,849	3,521	–	–	–	–	–	–	–	
Eight years later		2,035	2,843	–	–	–	–	–	–	–	–	
Nine years later		2,052	–	–	–	–	–	–	–	–	–	
Current central estimate cost for the 10 most recent accident years		2,052	2,843	3,521	3,148	6,363	6,359	6,208	8,237	10,510	9,647	
Cumulative net claims payments to date		(1,979)	(2,626)	(3,313)	(2,906)	(5,569)	(5,529)	(4,712)	(5,346)	(6,920)	(3,443)	
Net undiscounted central estimate	804	73	217	208	242	794	830	1,496	2,891	3,590	6,204	17,349
Foreign exchange												207
Net undiscounted central estimate at 31 December 2012												17,556
Discount to present value												(1,010)
Inflation adjustment[2]												50
Risk margin												1,333
Claims settlement costs												448
Other												35
Net outstanding claims at 31 December 2012												18,412
Net central estimate development												
Increase (decrease) in the year – current year minus prior year	(69)	17	(6)	(11)	15	(3)	47	98	113	263	9,647	10,111

1 Includes US$201 million of net central estimate relating to 2012 acquisitions which is not included in net incurred claims.
2 Adjustment to workers' compensation business in Argentina to reflect inflation impact of $204 million less related discount of $154 million.

A reconciliation of the net central estimate development to the net incurred claims in the income statement is included in note 8(C).

The Group writes business in currencies other than the US dollar. The translation of outstanding claims denominated in foreign currencies gives rise to foreign exchange movements which have no direct bearing on the development of the underlying claims. To eliminate this distortion, claims liabilities have been translated to the functional currencies of our controlled entities at constant rates of exchange. All estimates of net central estimate claims cost and cumulative claims payments for the 10 most recent accident years reported in functional currencies other than US dollars have been translated to US dollars using the 2012 cumulative average rate of exchange.

The central estimate claims development table is presented net of reinsurance. With operations in 48 countries, hundreds of products, various reinsurance arrangements and with the Group's risk tolerance managed on a consolidated net basis, it is not considered meaningful or practicable to provide this information other than on a consolidated net accident year basis.

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Outstanding claims in respect of acquisitions are included in the net central estimate claims cost in the accident year in which the acquisition was made. The exception is increased participation in Lloyd's syndicates where the increased share of the central estimate of the outstanding claims provision is allocated to the original accident year.

23. Provisions

2012	PROVISION FOR LONG SERVICE LEAVE US$M	AMOUNTS PAYABLE UNDER ACQUISITION AGREEMENTS US$M	OTHER PROVISIONS US$M	TOTAL PROVISIONS US$M
At 1 January	44	23	28	95
Cash payments	(6)	(16)	–	(22)
Amounts charged to the income statement	12	–	–	12
Acquisitions	–	–	3	3
Other movement	–	(1)	(12)	(13)
Foreign exchange	1	–	–	1
At 31 December	51	6	19	76
Payable within 12 months	36	1	15	52
Payable in greater than 12 months	15	5	4	24
At 31 December	51	6	19	76

2011	PROVISION FOR LONG SERVICE LEAVE US$M	AMOUNTS PAYABLE UNDER ACQUISITION AGREEMENTS US$M	OTHER PROVISIONS US$M	TOTAL PROVISIONS US$M
At 1 January	36	450	39	525
Cash payments	–	(439)	–	(439)
Amounts charged (credited) to the income statement	8	–	(1)	7
Other movement	–	(4)	(10)	(14)
Foreign exchange	–	16	–	16
At 31 December	44	23	28	95
Payable within 12 months	37	16	22	75
Payable in greater than 12 months	7	7	6	20
At 31 December	44	23	28	95

24. Defined benefit plans

	2012 US$M	2011 US$M
Defined benefit plan surpluses	1	1
Retirement benefit deficits	(125)	(90)
Post-employment healthcare benefit deficit	(10)	(10)
	(135)	(100)
Committed future contributions	(4)	(2)
Defined benefit plan deficits	(139)	(102)

Entities in the Group participate in a number of superannuation plans which have been established and are sponsored by those entities. A number of these plans provide defined benefits to employees on retirement, disability or death. The benefits are based on years of service and an average salary calculation.

Contributions are made to the plans by both employees and controlled entities, typically as a percentage of salary and within the rules of the plans, and are based on funding schedules prepared by independent actuaries. The contribution rate in respect of defined benefit plans is agreed between the relevant controlled entity and the plans' trustees and actuaries. The Group has no immediate legal obligation to settle the liability.

The Group also sponsors defined benefit healthcare plans that provide post-employment medical benefits and life assurance to eligible retired employees. Contributions are made to cover the current cash outflows from the plans and a liability is recorded to recognise the estimated accrued but not yet funded obligations.

Independent actuarial assessments of all significant plans are completed at least once every three years. The main plans were assessed by various qualified employees of Russell Employee Benefits, AON Hewitt and Towers Watson. All valuations have been updated for information available at 31 December 2012.

(A) Defined benefit surpluses (deficits)

The amounts recognised in the balance sheet for defined benefit plans are as follows:

	DATE OF LAST ACTUARIAL ASSESSMENT	FAIR VALUE OF PLAN ASSETS 2012 US$M	FAIR VALUE OF PLAN ASSETS 2011 US$M	PRESENT VALUE OF PLAN OBLIGATIONS 2012 US$M	PRESENT VALUE OF PLAN OBLIGATIONS 2011 US$M	SURPLUSES NOT RECOGNISED 2012 US$M	SURPLUSES NOT RECOGNISED 2011 US$M	NET RECOGNISED SURPLUSES (DEFICITS) 2012 US$M	NET RECOGNISED SURPLUSES (DEFICITS) 2011 US$M
Defined benefit retirement plans [1]									
Iron Trades insurance staff trust	31 Dec 12	288	275	(247)	(226)	(41)	(49)	–	–
European staff retirement benefit plan	31 Dec 12	12	9	(16)	(13)	–	–	(4)	(4)
Janson Green final salary superannuation scheme	31 Dec 12	199	180	(199)	(178)	–	(2)	–	–
Secura defined benefit plan	31 Dec 12	9	9	(18)	(15)	–	–	(9)	(6)
QBE Australia defined benefit plan	31 Dec 12	27	31	(36)	(43)	–	–	(9)	(12)
QBE the Americas plan	31 Dec 12	230	222	(327)	(286)	–	–	(97)	(64)
Other plans		2	2	(7)	(5)	–	–	(5)	(3)
		767	728	(850)	(766)	(41)	(51)	(124)	(89)
Defined benefit post-employment healthcare plan [2]									
QBE Regional pension restoration plan	31 Dec 12	–	–	(10)	(10)	–	–	(10)	(10)
		767	728	(860)	(776)	(41)	(51)	(134)	(99)

1 Defined benefit retirement plan obligations are funded.
2 Defined benefit post-employment healthcare plan obligations are not funded.

(B) Reconciliation

	2012 US$M	2011 US$M
Fair value of plan assets at 1 January	728	678
Expected return on plan assets	33	35
Actuarial gains on plan assets	15	42
Employer contributions	14	13
Benefits and expenses paid	(45)	(37)
Foreign exchange	22	(3)
Fair value of plan assets at 31 December	767	728
Defined benefit obligations at 1 January	(776)	(762)
Current service cost	(1)	(1)
Interest cost	(35)	(40)
Actuarial losses	(72)	(13)
Benefits and expenses paid	45	37
Foreign exchange	(21)	3
Defined benefit obligations at 31 December	(860)	(776)
Net deficits at 31 December	(93)	(48)
Surpluses not recognised	(41)	(51)
Committed future contributions	(4)	(2)
Net deficits recognised in the balance sheet at 31 December	(138)	(101)

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24. Defined benefit plans CONTINUED

	2012 US$M	2011 US$M
Net deficits at 1 January	**(48)**	(84)
Amounts recognised in profit or loss		
Current service cost	**(1)**	(1)
Interest cost	**(35)**	(40)
Expected return on plan assets	**33**	35
	(3)	(6)
Actuarial (losses) gains included in retained earnings	**(57)**	29
Employer contributions	**14**	13
Foreign exchange	**1**	–
Net deficits at 31 December	**(93)**	(48)

The charge recognised in profit or loss in the year of $3 million (2011 $6 million) has been included in underwriting expenses. The actual return on plan assets was a gain of $48 million (2011 $77 million).

(C) Amounts included in retained earnings

Cumulative actuarial gains and losses included in retained earnings are as follows:

	2012 US$M	2011 US$M
Actuarial losses at 1 January	**162**	145
Movement in the year	**46**	17
Actuarial losses at 31 December	**208**	162
Deferred taxation on actuarial losses at 1 January	**(54)**	(43)
Movement in the year	**(15)**	(11)
Deferred taxation on actuarial losses at 31 December	**(69)**	(54)
Net actuarial losses at 31 December	**139**	108

(D) Principal actuarial assumptions

	2012 %	2011 %
Discount rate	**2.5 – 6.6**	3.7 – 8.2
Expected return on plan assets	**3.0 – 7.0**	4.2 – 7.0
Future salary increases	**2.8 – 8.0**	2.8 – 8.0
Future pension increases	**2.0 – 5.0**	1.8 – 5.0

The expected return on plan assets is based on historical and future expectations of returns for each of the major asset classes as well as the expected and actual allocation of plan assets to these major classes.

(E) Analysis of plan assets

	2012 US$M	2011 US$M
Equities	**173**	155
Bonds	**568**	547
Property	**1**	6
Other	**25**	20
	767	728

(F) Historical summary

	2012 US$M	2011 US$M	2010 US$M	2009 US$M	2008 US$M
Experience (losses) gains arising on plan liabilities	**(1)**	5	1	(7)	27
Experience gains (losses) arising on plan assets	**15**	42	27	23	(109)

	2012 US$M	2011 US$M	2010 US$M	2009 US$M	2008 US$M
Present value of plan obligations	**(860)**	(776)	(762)	(740)	(648)
Fair value of plan assets	**767**	728	678	646	582
Net deficits	**(93)**	(48)	(84)	(94)	(66)

(G) Funding

Employer contributions to the defined benefit retirement plans are based on recommendations by the plans' actuaries. The objective of the Group's funding schedules is to ensure that benefit entitlements are fully funded at the time they become payable. Total employer contributions expected to be paid to the various plans in 2013 amount to $10 million.

25. Borrowings

	2012 US$M	2011 US$M
Payable within 12 months	**1,195**	662
Payable in greater than 12 months	**3,737**	4,095
Total borrowings	**4,932**	4,757

(A) Contractual maturity profile of borrowings

FINAL MATURITY DATE:		2012 US$M	2011 US$M
Bank loans	**Principal amount**		
23 February 2012	A$40 million	**–**	41
15 August 2013	$4 million	**4**	–
		4	41
Senior debt			
14 March 2014	$211 million	**210**	209
14 March 2014	£191 million	**309**	295
28 September 2015	£550 million	**889**	850
		1,408	1,354
Hybrid securities [1, 2]			
12 May 2030	$1,353 million (2011 $1,398 million)	**864**	865
		864	865
Subordinated debt			
15 March 2012	Nil (2011 $20 million)	**–**	20
1 June 2012	Nil (2011 $500 million)	**–**	492
1 July 2023	$220 million	**217**	217
15 June 2035	$16 million	**16**	16
15 March 2036	$80 million	**79**	78
14 December 2036	$15 million	**15**	15
11 December 2039	$500 million	**494**	–
24 May 2041	$1,000 million	**995**	994
24 May 2041	£325 million	**525**	502
		2,341	2,334
Capital securities [3]			
No fixed date	$301 million (2011 $151 million)	**301**	150
No fixed date	£9 million	**14**	13
		315	163
Total borrowings		**4,932**	4,757

1 Hybrid securities are shown net of the equity conversion option. The US dollar principal amount shown is the outstanding amount payable at the end of the 20 year term including accrued interest.
2 Both investors and QBE have the option, in certain circumstances, to request repurchase or redemption of the securities before the final repayment date. Details are provided in note 25(E).
3 QBE has the option to redeem these securities. Details are provided in note 25(G).

(B) Finance costs

Finance costs of $6 million (2011 $13 million) have been capitalised in the year.

(C) Bank loans

In the normal course of business, bank loans are made to controlled entities and may be secured by guarantees or letters of comfort given by the company.

(D) Senior debt

(i) Senior notes due 2014

In 2008, the company issued $211 million and £191 million of senior notes maturing on 14 March 2014. The notes are unsecured and unsubordinated obligations of the Group and will rank equally amongst themselves and, subject to certain exceptions in relation to ranking, with all other unsecured existing and future senior indebtedness of the Group. Interest of 9.75% per annum is payable half yearly on the US dollar notes and interest of 10% per annum is payable half yearly on the sterling notes.

(ii) Senior notes due 2015

In 2009, the company issued £550 million of senior notes maturing on 28 September 2015. The notes are unsecured and unsubordinated obligations of the Group and will rank equally among themselves and, subject to certain exceptions in relation to ranking, with all other unsecured existing and future senior indebtedness of the Group. Interest of 6.125% is payable half yearly in arrears.

Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2012

25. Borrowings CONTINUED

(E) Hybrid securities

(i) Hybrid securities due 2030

In 2010, the Group raised $850 million through the issue of 20 year hybrid securities. Interest accumulates at 2.5% per annum (compounding semi-annually). In the event of conversion, the company will issue a fixed number of shares to the security holders. The conversion rate may be adjusted in certain circumstances to take into account dividends paid on the company's ordinary shares. In the event of redemption, repurchase or maturity, the Group can elect to repay the principal and accreted interest in either cash or the equivalent value in shares of the company, or a combination of both. Investors can request repurchase at the end of three, five, seven, 10 or 15 years from the date of issue. The Group can redeem the securities at any time on or after three years from the date of issue. Investors have the option to convert the security if:

- the market value of the security is less than the US dollar equivalent of the market value of the underlying shares in the company for five consecutive trading days;
- the securities are called for redemption; or
- on certain corporate transactions occurring (e.g. change in control).

The liability component of the securities, being the obligation to make future payments of principal and interest to investors, is included in borrowings and the equity conversion option is included in equity.

In the event of conversion of all the securities, approximately 33.4 million shares will be issued. In the event of redemption, repurchase or maturity, approximately 80 million shares would be issued based on the accreted value and the share price at 31 December 2012.

The hybrid securities are guaranteed by the company and a controlled entity. The claims of investors under these guarantees in general will rank equally with all existing and future unsecured and unsubordinated indebtedness of the company and the controlled entity.

In 2012, $45 million of the hybrid securities were repurchased by the consolidated entity, at no gain or loss. These securities and the corresponding liability are eliminated in the Group's balance sheet.

(F) Subordinated debt

(i) Subordinated debt due 2020

On 1 June 2012, the consolidated entity redeemed the subordinated debt securities for cash.

(ii) Subordinated debt due 2023

In 2003, the Group raised $250 million through the issue of subordinated debt securities with a 20 year maturity, redeemable at the option of the company after 10 years. The securities entitle holders to receive a fixed interest rate of 5.647% per annum for the first 10 years, payable semi-annually on 1 January and 1 July.

During 2009, $30 million of subordinated debt securities due 2023 were repurchased by the Group, for cash, at a discount. These securities continue to be held by the Group. The asset and the corresponding liability are eliminated in the Group's balance sheet.

(iii) Subordinated debt due 2039

On 11 December 2012, the Group raised $500 million through the issue of subordinated debt securities with a 27 year maturity. The securities entitle holders to receive interest at a floating rate of 3.25% over the six month US dollar LIBOR, payable semi-annually in arrears.

The securities are redeemable prior to the ultimate maturity date at the option of QBE on and from 11 December 2019 or earlier for a regulatory event or tax event, provided the securities will be replaced with equal or better capital, APRA is satisfied that QBE will be well above its minimum capital requirements and QBE has received APRA's prior approval.

Investors may exchange the securities into a variable number of QBE ordinary shares from 11 June 2014 to 11 December 2017 and at any time prior to 11 December 2017 upon an acquisition event occurring or if there is an event of default, QBE delists or the volume weighted average price of QBE's ordinary shares is less than or equal to 60% of the issue date volume weighted average price.

(iv) Subordinated debt due 2041

On 24 May 2011, the Group raised $1 billion and £325 million ($526 million) through the issue of subordinated debt securities with a 30 year maturity. The securities entitle holders to receive interest at a fixed rate of 7.25% and 7.5% per annum respectively until 24 May 2021, at which point the rate will reset to a 10 year mid market swap rate plus a spread of 4.05% and 4.0% respectively. The rate will reset again, on the same basis, on 24 May 2031.

The securities are redeemable prior to the ultimate maturity date at the option of QBE with the written approval of APRA, on 24 May 2021, 24 May 2031, 24 May 2041 or in the event of:

- certain tax and US investment company registration events, which allow a redemption at any time; or
- certain regulatory and rating agency equity credit events which allow redemption at any time after 24 May 2016.

(v) Security arrangements

The claims of bondholders pursuant to the subordinated debt will be subordinated in right of payment to the claims of all senior creditors, including policyholders, of the relevant controlled entity.

(G) Capital securities

In 2006, a controlled entity issued £300 million of capital securities. The securities have no fixed redemption date and may not be called for redemption or conversion by the investors. The issuer may redeem the securities on 18 July 2016 and certain specified dates thereafter. On 18 July 2016, the coupon on the securities will change from a fixed to a floating rate.

In 2007, a controlled entity issued $550 million of capital securities. The securities have no fixed redemption date and may not be called for redemption or conversion by the investors. The issuer may redeem the securities on 1 June 2017 and certain specified dates thereafter. On 1 June 2017, the coupon on the securities will change from a fixed to a floating rate.

Both issues of capital securities are subordinated. Distributions are deferrable and not cumulative. If a distribution or principal amount is not paid by the controlled entity, and the company does not pay the amount under the guarantee, then the capital securities are to be redeemed for QBE preference shares. For so long as the distributions or principal amounts are outstanding, no payments (including distributions or principal amounts) are to be made on the company's shares or other instruments ranking junior to the securities. Payment of distributions or principal amounts on equal ranking securities may be paid proportionally.

Between 2008 and 2011, $399 million and £291 million of capital securities were repurchased by the Group for cash, at a discount. During 2012, $150 million were sold back into the market, giving rise to a loss of $12 million. The remaining securities continue to be held by the Group. The assets and the corresponding liabilities are eliminated in the Group's balance sheet.

The performance of the obligations of the controlled entity under the capital securities is guaranteed by the company to the extent that the controlled entity has funds. The guarantee is an unsecured and subordinated obligation of the company. The guarantee ranks senior to the claims of the holders of ordinary shares of the company, equally with equally ranked securities and instruments of the company and junior to the claims of other creditors of the company.

(H) Fair value of borrowings

	2012 US$M	2011 US$M
Bank loans	**4**	41
Senior notes	**1,499**	1,465
Hybrid securities	**883**	851
Subordinated debt	**2,411**	2,155
Capital securities	**308**	140
	5,105	4,652

The fair value of all securities has been estimated using valuation techniques for which all significant inputs are based on observable market data.

26. Equity

(A) Share capital

2012	NUMBER OF SHARES MILLIONS	US$M
Issued ordinary shares, fully paid at 1 January	**1,112**	**8,939**
Shares issued under the Employee Share and Option Plan	**1**	**8**
Shares issued under Dividend Reinvestment Plan	**22**	**283**
Shares issued under Bonus Share Plan	**3**	**–**
Shares issued pursuant to the share placement	**56**	**635**
Share issue expenses (net of taxation)	**–**	**(6)**
Foreign exchange	**–**	**143**
Issued ordinary shares, fully paid at 31 December	**1,194**	**10,002**
Shares notified to the Australian Securities Exchange	**1,197**	**10,023**
Less: Plan shares subject to non-recourse loans, derecognised under Australian GAAP	**(3)**	**(21)**
Issued ordinary shares, fully paid at 31 December	**1,194**	**10,002**

2011	NUMBER OF SHARES MILLIONS	US$M
Issued ordinary shares, fully paid at 1 January	1,048	7,972
Shares issued under the Employee Share and Option Plan	–	5
Employee options exercised	–	3
Shares issued under Dividend Reinvestment Plan	38	578
Shares issued under Bonus Share Plan	4	–
Shares issued pursuant to the underwriting of the 2010 final dividend	22	396
Foreign exchange	–	(15)
Issued ordinary shares, fully paid at 31 December	1,112	8,939
Shares notified to the Australian Securities Exchange	1,116	8,967
Less: Plan shares subject to non-recourse loans, derecognised under Australian GAAP	(4)	(28)
Issued ordinary shares, fully paid at 31 December	1,112	8,939

Ordinary shares in the company have no par value and entitle the holder to participate in dividends and the proceeds on winding up of the company in proportion to the number of shares held. Ordinary shareholders rank after all creditors and are entitled to any residual proceeds.

(B) Treasury shares held in trust

	2012 US$M	2011 US$M
At 1 January	**(2)**	(1)
Purchase of shares	**(27)**	(29)
Shares vested and/or released to participants	**28**	28
Foreign exchange	**–**	–
At 31 December	**(1)**	(2)

Shares in the company may be bought on-market to satisfy future obligations of the company under the various employee share based remuneration plans. Any such shares are held in trust. On consolidation, these shares are recognised as treasury shares held in trust. The balance of the treasury shares held in trust at the balance sheet date represents the cumulative cost of acquiring shares in the company that have not yet been distributed to employees as share based remuneration.

Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2012

26. Equity CONTINUED

(C) Equity component of hybrid securities

	2012 US$M	2011 US$M
At 1 January	132	132
Movement during the period	–	–
Foreign exchange	2	–
At 31 December	134	132

(D) Reserves

	2012 US$M	2011 US$M
Owner occupied property revaluation reserve [1]		
At 1 January	23	19
Valuation increase	1	5
Deferred tax	–	(1)
Foreign exchange	1	–
At 31 December	25	23
Foreign currency translation reserve [2]		
At 1 January	(1,942)	(1,696)
Losses on translation	(29)	(11)
Gains (losses) on hedging transactions	(46)	(184)
Taxation	(16)	(51)
At 31 December	(2,033)	(1,942)
Options reserve [3]		
At 1 January	148	137
Options and conditional rights expense	36	40
Transfers from reserve on vesting of options and conditional rights	(28)	(28)
Taxation	–	(1)
Foreign exchange	3	–
At 31 December	159	148
General reserve [4]		
At 1 January	5	5
Foreign exchange	–	–
At 31 December	5	5
Realised capital profits reserve [5]		
At 1 January	6	6
Foreign exchange	–	–
At 31 December	6	6
Associates [6]		
At 1 January	5	7
Movement in the year	4	(2)
At 31 December	9	5
Premium on purchase of non-controlling interests [7]		
At 1 January	(21)	(5)
Purchase of non-controlling interest	(8)	(16)
Foreign exchange	(1)	–
At 31 December	(30)	(21)
Total reserves at 31 December	(1,859)	(1,776)

1 Used to recognise fair value movements in the carrying value of owner occupied property. Refer note 1(S).
2 Exchange gains and losses arising on translation of a foreign controlled entity and related hedging instruments are taken to the foreign currency translation reserve. Refer note 1(W). In the event of the disposal of a relevant net investment, the movement in the reserve is recognised in the statement of comprehensive income.
3 Used to recognise the fair value of instruments issued as share based payments.
4 Established prior to 1989 for general purposes.
5 Realised capital profits arising prior to the introduction of capital gains tax in Australia.
6 Used to recognise other comprehensive income of associates.
7 Used to recognise the premium paid over net asset value on purchase of a non-controlling interest in a controlled entity.

(E) Capital risk management

QBE's objective when managing capital is to maintain an optimal balance of debt and equity in the capital structure to reduce the cost of capital whilst meeting capital adequacy requirements, providing security for policyholders and continuing to provide returns to shareholders.

Where appropriate, adjustments are made to capital levels in light of changes in economic conditions and risk characteristics of the Group's activities. In order to maintain or adjust the capital structure, the Group has the option to adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares or debt securities with capital characteristics or sell assets to reduce debt.

QBE is subject to, and complies with, various externally imposed regulatory capital requirements, both through its wholly owned insurance subsidiaries and as a consolidated insurance group. These requirements are designed to ensure a sufficient solvency margin is maintained in order to provide adequate protection for policyholders. In addition, the Group aims to maintain a strong credit rating and robust capital ratios in order to support its business objectives and maximise shareholder wealth.

The Group uses a Group-wide economic capital model (ECM) to assess the level of capital required for the underwriting, claims estimation, credit, market, liquidity and operational risks to which it is exposed. Economic capital is determined as the level of capital that the Group needs to ensure that it can, with a pre-specified probability, satisfy its ultimate policyholder obligations in relation to all insurance contracts issued on or before the end of the business plan year. The ECM is used by management to help in the determination of the strategic capital allocation, business planning, underwriting performance, pricing, reinsurance and aggregate management. It also assists in determining regulatory capital. Capital is allocated to business units, divisions and ultimately to underwriting portfolios according to the associated risk. The minimum target risk-adjusted return on capital is 15%. The business plans include net asset projections, dividends, issued share projections and solvency projections as well as the impact of potential acquisitions. In the event of a significant change in the Group's risk profile, the ECM will be recalculated and the results reported to the Group's board.

The Group maintains an ongoing review of its structure to ensure flexibility in the allocation of capital whilst minimising the cost of capital. Active management of the business and its capital has enabled the Group to maintain its financial strength and credit rating and has afforded it with good access to capital markets when needed.

Management monitors the company's and the Group's capital levels on an ongoing basis, with particular focus on the following:

- Since the introduction by APRA in 2008 of a Minimum Capital Requirement (MCR) for Level 2 insurance groups, the Group has actively managed the components of capital in order to maintain a level of regulatory eligible capital (APRA imposes restrictions on the composition of capital eligible to meet the MCR) equal to around 1.5 times the MCR required by APRA.
- During 2012 the Group also considered the implications of APRA's new capital requirements (LAGIC) which become effective on 1 January 2013. Having determined that the current risk appetite of the Group remains appropriate, management has set the target level of regulatory capital for 2013 at around 1.55 – 1.8 times the Prescribed Capital Amount (PCA).
- All regulated wholly-owned entities are subject to local requirements that a minimum level of capital is maintained to meet obligations to policyholders. It is the Group's policy that each regulated entity maintains a capital base appropriate to its size, business mix, complexity and risk profile which fully complies with and meets or exceeds local regulatory requirements.
- The Group aims to maintain the ratio of borrowings to shareholders' funds at around 40%. The ratio of borrowings to shareholders' funds at 31 December 2012 was 43.4% (2011 45.8%).
- The Group believes that insurer financial strength ratings provided by the major rating agencies are an important factor in demonstrating the financial strength and claims paying ability of our wholly-owned insurance entities. All of our wholly-owned insurance entities have a financial strength rating equivalent to A+ or higher at 31 December 2012.

In addition to the management reporting and planning processes, the Group has dedicated staff across its business units and divisions responsible for understanding the regulatory capital requirements of both the operating insurance entities and consolidated operations. The quality of assets (particularly investments and reinsurance recoveries) held by QBE is continuously monitored to ensure any potential issues are identified and remedial action, where necessary, is taken to restore effective capital performance and levels.

27. Dividends

(A) Dividends

	2012	2011	
	INTERIM	FINAL	INTERIM
Dividend per share (Australian cents)	**40.0**	25.0	62.0
Franking percentage	**15%**	25%	10%
Franked amount per share (Australian cents)	**6.00**	6.25	6.20
Dividend payout (A$M)	**473**	279	677
Payment date	**24 Sept 2012**	30 March 2012	23 Sept 2011

On 26 February 2013, the directors declared a 100% franked final dividend of 10 Australian cents per share payable on 28 March 2013. The final dividend payout is A$120 million (2011 A$279 million).

	NOTE	2012 US$M	2011 US$M
Previous year final dividend paid on ordinary shares			
Franked		**72**	73
Unfranked		**216**	656
		288	729
Interim dividend paid on ordinary shares			
Franked		**74**	66
Unfranked		**419**	596
		493	662
Bonus Share Plan dividend forgone	27(C)	**(40)**	(51)
Total dividend paid		**741**	1,340

Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2012

27. Dividends CONTINUED

(B) Dividend Reinvestment and Bonus Share Plans

The company operates a Dividend Reinvestment Plan (DRP) and a Bonus Share Plan (BSP) which allow equity holders to receive their dividend entitlement in the form of QBE ordinary shares.

The last date of receipt of election notices applicable to the DRP and BSP is 8 March 2013.

(C) Bonus Share Plan dividend forgone

The amount paid in dividends during the year has been reduced as a result of certain eligible shareholders participating in the BSP and forgoing all or part of their right to dividends. These shareholders were issued ordinary shares under the BSP. During the year 3,095,513 (2011 3,656,380) ordinary shares were issued under the BSP.

(D) Franking credits

The franking account balance on a tax paid basis at 31 December 2012 was a surplus of A$83 million (2011 A$15 million). After taking into account the impact of franking on the final dividend recommended by the directors since year end, but not recognised as a liability at year end, the franking account balance will be a surplus of A$227 million (2011 A$15 million).

Following the introduction of the conduit foreign income (CFI) rules effective for the Group from 1 January 2006, shareholders not resident in Australia will receive CFI credits for the unfranked portion of the final 2012 dividend. For shareholders not resident in Australia, the dividend will not be subject to Australian withholding tax.

28. Earnings per share

	2012 US$M	2011 US$M
Basic earnings per share	**65.1**	64.9
Diluted earnings per share	**61.6**	61.3

(A) Reconciliation of earnings used in calculating earnings per share

	2012 US$M	2011 US$M
Net profit after income tax attributable to ordinary equity holders of the company, used in calculating basic earnings per share	**761**	704
Add: finance costs of convertible securities	**22**	27
Earnings used in calculating diluted earnings per share	**783**	731

(B) Reconciliation of weighted average number of ordinary shares used in calculating earnings per share

	2012 MILLIONS	2011 MILLIONS
Weighted average number of ordinary shares on issue	**1,172**	1,088
Weighted average number of non-recourse loan shares issued under the Plan	**(3)**	(4)
Weighted average number of ordinary shares used as the denominator in calculating basic earnings per share [1]	**1,169**	1,084
Weighted average number of dilutive potential ordinary shares relating to:		
Shares issued under the Plan	**3**	4
Convertible securities	**99**	105
Weighted average number of ordinary shares used as the denominator in calculating diluted earnings per share	**1,271**	1,193

1 Weighted average number of ordinary shares reflects shares adjusted to derecognise shares issued under the Plan. Basic earnings per share calculated with reference to issued share capital notified to the ASX would have been 64.9 cents (2011 64.7 cents). Refer to note 26(A).

29. Business combinations

(A) Acquisitions

The following entities were acquired during the financial year:

On 1 January 2012, a wholly-owned entity acquired the entire share capital of AFA Limited in Vanuatu. The purchase price was $1 million for net tangible assets of nil.

On 31 January 2012, a wholly-owned entity acquired the businesses of AMA Collection Services, AMA Group Services Pty Limited, Creditfacts Pty Limited and Wilmott Enterprises (No 2) Pty Limited in Australia. The purchase price was $2 million for net tangible assets of nil.

On 8 February 2012, a wholly-owned entity acquired the entire share capital of Optima Insurance Group Inc, in Puerto Rico. The purchase price was $37 million for net tangible assets of $16 million.

On 13 April 2012, a wholly-owned entity acquired the regional UK commercial lines business of Brit Insurance. The purchase price was $61 million for net tangible liabilities of $12 million.

On 2 May 2012, a wholly-owned entity acquired 99.73% of the share capital of HSBC Argentina Holdings SA, an indirect subsidiary of HSBC Holdings plc and writer of general insurance business. This entity was renamed HSBC La Buenos Aires Seguros SA during the year. The purchase price was $212 million for net tangible assets of $30 million.

On 9 July 2012, a wholly-owned entity acquired the entire share capital of the general insurance operations of Hang Seng General Insurance (Hong Kong) Company Limited. This entity was renamed QBE General Insurance (Hong Kong) Limited during the year. The purchase price was $203 million for net tangible assets of $122 million.

The fair value of assets and liabilities arising from acquisitions in the years ended 31 December 2012 and 31 December 2011 were as follows:

	2012				2011			
	HSBC ARGENTINA US$M	HANG SENG US$M	OTHER US$M	TOTAL US$M	BALBOA US$M	RENAISSANCE RE US$M	OTHER US$M	TOTAL US$M
Cash and cash equivalents	2	21	5	28	930	61	7	998
Investments	236	162	33	431	–	209	107	316
Trade and other receivables	122	17	19	158	8	461	5	474
Reinsurance and other recoveries on outstanding claims	57	5	2	64	–	56	10	66
Other assets	–	–	4	4	–	–	–	–
Deferred insurance costs	148	16	12	176	47	33	4	84
Property, plant and equipment	2	–	5	7	8	2	1	11
Deferred tax assets	31	–	–	31	129	33	–	162
Intangible assets	93	44	67	204	622	60	11	693
Total assets	691	265	147	1,103	1,744	915	145	2,804
Trade and other payables	57	19	26	102	147	226	7	380
Current tax liabilities	9	1	–	10	–	8	–	8
Unearned premium	201	33	24	258	651	124	62	837
Outstanding claims	260	33	5	298	249	314	44	607
Provisions	3	–	–	3	–	–	–	–
Deferred tax liabilities	38	13	16	67	80	12	2	94
Borrowings	–	–	5	5	–	–	–	–
Total liabilities	568	99	76	743	1,127	684	115	1,926
Net assets acquired	123	166	71	360	617	231	30	878

Trade and other receivables in the table above are shown at fair value. The gross contractual amounts receivable are as follows:

	2012				2011			
	HSBC ARGENTINA US$M	HANG SENG US$M	OTHER US$M	TOTAL US$M	BALBOA US$M	RENAISSANCE RE US$M	OTHER US$M	TOTAL US$M
Trade and other receivables	124	17	19	160	10	461	3	474

	2012				2011			
	HSBC ARGENTINA US$M	HANG SENG US$M	OTHER US$M	TOTAL US$M	BALBOA US$M	RENAISSANCE RE US$M	OTHER US$M	TOTAL US$M
Purchase consideration								
Cash	212	203	101	516	708	270	36	1,014
Contingent and deferred consideration	–	–	–	–	–	(10)	–	(10)
Total purchase consideration	212	203	101	516	708	260	36	1,004
Fair value of net assets acquired	123	166	71	360	617	231	30	878
Goodwill [1]	89	37	30	156	91	29	6	126

1 "Other" in 2011 is net of a $2 million gain on purchase of a controlled entity.

The above information is presented at the exchange rates prevailing at the date of the acquisition.

In all instances, the goodwill is attributable to the future profitability of the acquisitions and the synergies expected to arise within the Group.

In the US, tax goodwill is deductible on a straight line basis and may arise on either an asset purchase or a stock purchase where an election has been made to treat the stock purchase as an asset purchase for tax. In addition, if there is pre-existing tax goodwill in an entity at the time of acquisition, this will be carried over. The tax value of goodwill may differ from the accounting value of goodwill, with these differences giving rise to deferred tax balances. In the UK, purchased goodwill may be deductible. In most other jurisdictions, goodwill is not deductible and does not give rise to any deferred tax balances.

The third party costs associated with acquisitions in the current year were $3 million.

Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2012

29. Business combinations CONTINUED

(i) Contribution of acquisitions to the Group results

Included in the consolidated results for the Group for the years ended 31 December 2012 and 31 December 2011 are contributions from acquisitions as follows:

	2012				2011			
	HSBC ARGENTINA US$M	HANG SENG US$M	OTHER US$M	TOTAL US$M	BALBOA US$M	RENAISSANCE RE US$M	OTHER US$M	TOTAL US$M
Gross earned premium	331	31	97	459	1,269	674	99	2,042
Net profit (loss) after income tax	3	(32)	(16)	(45)	226	67	(1)	292

(ii) Annualised results of acquisitions

If the acquisitions had occurred on 1 January 2012, consolidated gross earned premium and consolidated net profit after income tax for the year ended 31 December 2012 would have been $18,564 million and $775 million respectively.

(B) Critical accounting estimates and judgments

Accounting estimates and judgments are used to determine the fair values of assets and liabilities purchased in a business combination. Areas requiring a greater degree of judgment or estimation are as follows:

(i) Insurance liabilities

The fair value of insurance liabilities at acquisition is determined using a market assessed risk margin appropriate to the risks inherent in the acquired portfolio.

(ii) Intangible assets

Intangible assets are generally valued at acquisition date by external valuation experts. A number of accepted valuation models exist and these are applied to the valuation of individual intangible assets based on a judgment as to which valuation basis is most appropriate to the type of asset being valued.

30. Share based payments

(A) Share schemes

The company, at its 1981 AGM, approved the issue of shares from time to time under an Employee Share and Option Plan (the Plan), up to 5% of the issued ordinary shares in the capital of the company. Any full-time or part-time employee of the Group or any equally-owned joint venture who is offered shares or options is eligible to participate in the Plan.

Under the Plan, ordinary shares of the company are normally offered at the weighted average market price during the five trading days on the ASX up to the date of the offer. Likewise, the exercise price for options offered under the Plan is usually the weighted average market price during the five trading days up to the date of the offer.

In accordance with the terms of the Plan, for awards made up to and including March 2009 interest-free loans were available to employees to subscribe for shares issued under the Plan. Prior to 20 June 2005, the terms of the loans were either personal recourse or non-recourse. With effect from 20 June 2005, only personal recourse loans were granted to employees to subscribe for shares under the Plan. The loans are repayable in certain circumstances such as termination of employment. The award of options and interest-free loans was discontinued for awards made after March 2009.

Currently equity is awarded on three bases within the Plan as detailed below.

(i) QBE deferred equity plans

QBE Incentive Scheme

The QBE Incentive Scheme (QIS) is an at-risk reward structure that comprises cash and deferred equity awards. It came into effect from 1 January 2010 and is applicable to deferred equity awards made in March 2011 and thereafter.

Executives

Under the QIS, the directors can issue conditional rights to shares to executives who have already achieved predetermined performance targets. The maximum deferred equity award is based on an amount which is the lesser of 80% of the cash award earned or 100% of fixed remuneration at 31 December, in each case for the financial year immediately prior to the year in which the cash award is paid. The deferred equity award is used as the basis for calculating the number of conditional rights as follows:

- conditional rights to the value of 50% of the award will be converted to fully paid ordinary QBE shares after three years; and
- conditional rights to the value of 50% of the award will be converted to fully paid ordinary QBE shares after five years.

Other key senior employees

Other key senior employees of the QBE Group are also eligible to participate in the QIS, with the maximum award restricted to the lesser of 66.67% of the cash award for that year or 100% of base (cash) salary as at 31 December for the financial year prior to the year in which the cash award was paid. The deferred equity award is used as the basis for calculating the number of conditional rights as follows:

- conditional rights to the value of 60% of the award amount will be converted to fully paid ordinary QBE shares after three years; and
- conditional rights to the value of 60% of the award amount will be converted to fully paid ordinary QBE shares after five years.

All QIS participants

Further shares are issued to executives and other key senior employees under the Bonus Share Plan in relation to the conditional rights to reflect dividends paid on ordinary shares of the company in the period commencing from the date of the grant of the conditional rights.

The shares issued pursuant to the conditional rights are issued without payment being made by the recipient (i.e. at a nil exercise price).

The shares issued pursuant to the conditional rights will only vest if the individual has remained in the Group's service throughout the vesting period. The Remuneration Committee has the discretion to pay cash in lieu of shares in certain circumstances such as death, disability, redundancy or retirement if the individual is not subject to disciplinary proceedings or notice to terminate employment on that date. The extent of vesting of the conditional rights may be reduced by any material deterioration of the relevant entity's return on equity during the vesting period.

Deferred Compensation Plan – legacy scheme applicable to the 2009 financial year

The terms of the Deferred Compensation Plan (DCP) for the period from 1 January 2009 applicable to awards in March 2010 are set out below.

Executives

Executives were invited to participate in the DCP, under which they received conditional rights to fully paid ordinary QBE shares. The maximum deferred equity award was based on an amount which was the lesser of 80% of the short-term cash incentive (STI) award earned or 100% of fixed remuneration at 31 December, in each case in the financial year immediately prior to the year in which the cash award was paid. The maximum DCP award used the same formula as described above in relation to the QIS deferred equity award.

Other key senior employees

Other key senior employees of the QBE Group were invited to participate in the DCP, under which they received conditional rights to fully paid ordinary QBE shares. The maximum DCP award was based on an amount which was the lesser of 66.67% of the STI award earned or 100% of base (cash) salary as at 31 December, in each case for the financial year immediately prior to the year in which the cash award is paid. The maximum DCP award was used as a basis for calculating the number of conditional rights using the same formula as described above in relation to the QIS deferred equity award.

All DCP participants

Further shares were issued to executives and other key senior employees under the Board Share Plan in relation to the conditional rights to reflect dividends paid on ordinary shares of the company in the period commencing from the date of the grant of the conditional rights.

The shares issued pursuant to the conditional rights will only vest if the individual has remained in the Group's service throughout the vesting period. The Remuneration Committee has the discretion to pay cash in lieu of shares in certain circumstances such as death, disability, redundancy or retirement if the individual is not subject to disciplinary proceedings or notice to terminate employment on that date. The extent of vesting of the conditional rights may be reduced by any material deterioration of the relevant entity's return on equity during the vesting period.

Deferred Compensation Plan – legacy scheme applicable to 2008 and prior financial years

For DCP awards made in March 2009 and prior, the directors were able to issue conditional rights to shares and options to subscribe for shares to senior management who have already achieved predetermined performance criteria. The terms of the DCP varied to take into account the requirements and market conditions of the locations of senior management, but the general terms of the DCP conditional rights and options for both executives and other key senior employees were as follows:

- The conditional rights entitled relevant employees to receive shares on the third anniversary of the grant of the rights. Further shares were issued under the Bonus Share Plan in relation to the conditional rights to reflect dividends paid on ordinary shares of the company in the period commencing from the date of the grant of the conditional rights.
- The shares issued pursuant to the conditional rights were issued without payment being made by senior management (i.e. at a nil exercise price).
- The options were subject to the terms and conditions of the Plan. Options issued in 2004 and prior were normally exercisable after three years, whilst any options issued in 2005 and thereafter are generally exercisable after five years. They must be exercised within a 12 month period after vesting. Interest-free personal recourse loans were granted to persons who held options to fund the exercise of those options.

The shares issued pursuant to the conditional rights and the options will only vest if the individual has remained in the Group's service throughout the vesting period. The Remuneration Committee has the discretion to pay cash in lieu of shares in certain circumstances such as death, disability, redundancy or retirement if the individual is not subject to disciplinary proceedings or notice on that date.

(ii) Share Incentive Plan

Generally, all full-time or part-time Group employees in Australia, Ireland, New Zealand, the UK and the US with a minimum of one year's service are invited to participate in the Share Incentive Plan (the SIP). Under the SIP, which was introduced in 2005, the directors can provide shares up to A$1,000 to employees without payment being made by employees. The allocation of shares is based on the period of service. The shares are purchased on-market and held in trust for the employee for a minimum of three years or until cessation of employment, whichever is earlier.

(iii) Longer-term incentive plans

Long-Term Incentive (LTI) plan

The Long-Term Incentive (LTI) plan was introduced from 1 January 2010 and replaces the Group Executive Restricted Share Plan (GERSP). Only executives, including the Group Chief Executive Officer, are invited to participate. The LTI plan comprises an award of conditional rights to fully paid ordinary QBE shares without payment by the executive, subject to a five year tenure hurdle, with vesting contingent upon the achievement of two future performance hurdles as follows:

- 50% of the award allocation will be contingent on the Group's average diluted earnings per share increasing by a compound average 7.5% per annum over the five year vesting period; and
- 50% of the award allocation will be contingent on the Group's average return on equity and combined operating ratio being in the top 10% of the top 50 largest global insurers and reinsurers as measured by net earned premium for the five year vesting period.

Further shares will be issued under the Bonus Share Plan in relation to the conditional rights to reflect dividends paid on ordinary shares of the company in the period commencing from the date of the grant of the conditional rights.

The Remuneration Committee will continue to exercise discretion when determining the vesting of awards under the LTI. The committee has the discretion to allocate a pro-rata amount in cash in lieu of shares in certain circumstances such as death, disability, redundancy or retirement. The extent of vesting of the conditional rights may be reduced by any material deterioration of the Group's return on equity during the vesting period.

Group Executive Restricted Share Plan – legacy scheme applicable to 2008 and 2009 financial years

Certain key management personnel were eligible to participate in the GERSP which came into effect from 1 January 2008. Under the GERSP, eligible executives had the opportunity to receive additional equity in the form of conditional rights if the Group exceeded a return on equity target.

The conditional rights entitled relevant executives to receive fully paid ordinary QBE shares on the third anniversary of the grant of the conditional rights. Further shares are issued under the Bonus Share Plan in relation to the conditional rights to reflect dividends paid on ordinary shares of the company in the period commencing from the date of the grant of the conditional rights. The shares issued pursuant to the conditional rights were issued without payment being made by the executive (i.e. at a nil exercise price).

The shares issued pursuant to the conditional rights will only be issued if the individual has remained in the Group's service throughout the vesting period (unless leaving due to death, genuine retirement, incapacity due to total and permanent disability or redundancy) and is not subject to disciplinary proceedings or notice to terminate employment on that date. The extent of vesting of the conditional rights may be reduced by any material deterioration of the Group's return on equity during the vesting period.

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30. Share based payments CONTINUED

(B) Conditional rights

Details of the number of employee entitlements to conditional rights to ordinary shares granted, vested and transferred to employees during the year were as follows:

2012 GRANT DATE	DATE EXERCISABLE	FAIR VALUE PER RIGHT AT GRANT DATE	BALANCE AT 1 JAN 2012	GRANTED IN THE YEAR	DIVIDENDS ATTACHING IN THE YEAR	VESTED AND TRANSFERRED TO EMPLOYEES IN THE YEAR	CANCELLED IN THE YEAR	BALANCE AT 31 DEC 2012
1 January 2009	2 January 2012	A$25.37	24,929	–	–	(24,929)	–	–
6 March 2009	5 March 2012	A$17.57	1,829,735	–	–	(1,802,680)	(27,055)	–
5 March 2010	5 March 2013	A$20.90	1,081,477	–	51,381	(118,584)	(45,235)	969,039
5 March 2010	5 March 2015	A$20.90	1,020,472	–	48,548	(111,982)	(43,213)	913,825
31 March 2010	30 March 2013	A$20.90	55,320	–	1,148	(56,468)	–	–
31 March 2010	30 March 2015	A$20.90	55,320	–	1,148	(56,468)	–	–
1 January 2011	1 January 2014	A$18.44	27,189	–	1,446	–	–	28,635
7 March 2011	6 March 2014	A$17.93	1,171,691	–	56,939	(63,970)	(88,020)	1,076,640
7 March 2011	6 March 2016	A$17.93	1,272,310	–	65,262	–	(68,973)	1,268,599
5 April 2011	4 April 2014	A$17.93	23,823	–	494	(24,317)	–	–
5 April 2011	4 April 2016	A$17.93	86,778	–	4,616	–	–	91,394
1 June 2011	31 March 2014	A$17.48	10,464	–	557	–	–	11,021
1 June 2011	31 March 2016	A$17.48	10,464	–	557	–	–	11,021
1 September 2011	1 March 2015	A$14.03	19,840	–	1,056	–	–	20,896
18 October 2011	31 December 2012	A$14.05	75,814	–	4,034	–	–	79,848
1 January 2012	1 January 2015	A$13.11	–	30,000	1,596	–	–	31,596
7 March 2012	6 March 2015	A$11.78	–	1,155,546	59,950	(28,957)	(45,838)	1,140,701
7 March 2012	6 March 2017	A$11.78	–	1,450,487	76,191	(1,531)	(37,707)	1,487,440
5 April 2012	4 April 2015	A$14.25	–	90,000	2,862	–	–	92,862
1 September 2012	1 March 2013	A$13.03	–	22,474	715	–	–	23,189
1 September 2012	1 March 2014	A$13.03	–	22,473	715	–	–	23,188
1 September 2012	1 March 2015	A$13.03	–	22,473	715	–	–	23,188
			6,765,626	2,793,453	379,930	(2,289,886)	(356,041)	7,293,082

The weighted average share price at the date of vesting of conditional rights during the year ended 31 December 2012 was A$11.88 (2011 A$17.42). The weighted average fair value of conditional rights granted during the year ended 31 December 2012 was A$11.90 (2011 A$17.79).

Details of the number of employee entitlements to conditional rights to ordinary shares granted, vested and transferred to employees during the prior year were as follows:

2011 GRANT DATE	DATE EXERCISABLE	FAIR VALUE PER RIGHT AT GRANT DATE	BALANCE AT 1 JAN 2011	GRANTED IN THE YEAR	DIVIDENDS ATTACHING IN THE YEAR	VESTED AND TRANSFERRED TO EMPLOYEES IN THE YEAR	CANCELLED IN THE YEAR	BALANCE AT 31 DEC 2011
4 March 2008	3 March 2011	A$24.22	1,173,505	–	–	(1,158,591)	(14,914)	–
4 April 2008	4 April 2011	A$27.00	43,660	–	–	(43,660)	–	–
1 January 2009	2 January 2012	A$25.37	22,922	–	2,007	–	–	24,929
6 March 2009	5 March 2012	A$17.57	1,894,592	–	155,001	(118,042)	(101,816)	1,829,735
5 March 2010	5 March 2013	A$20.90	1,166,939	–	95,559	(66,356)	(114,665)	1,081,477
5 March 2010	5 March 2015	A$20.90	1,046,563	–	85,818	(58,101)	(53,808)	1,020,472
31 March 2010	30 March 2013	A$20.90	50,867	–	4,453	–	–	55,320
31 March 2010	30 March 2015	A$20.90	50,867	–	4,453	–	–	55,320
1 January 2011	1 January 2014	A$18.44	–	25,000	2,189	–	–	27,189
7 March 2011	6 March 2014	A$17.93	–	1,169,394	99,781	(35,994)	(61,490)	1,171,691
7 March 2011	6 March 2016	A$17.93	–	1,228,685	106,855	–	(63,230)	1,272,310
5 April 2011	4 April 2014	A$17.93	–	22,766	1,057	–	–	23,823
5 April 2011	4 April 2016	A$17.93	–	82,929	3,849	–	–	86,778
1 June 2011	31 March 2014	A$17.48	–	10,000	464	–	–	10,464
1 June 2011	31 March 2016	A$17.48	–	10,000	464	–	–	10,464
1 September 2011	1 March 2015	A$14.03		18,960	880	–	–	19,840
18 October 2011	31 December 2012	A$14.05	–	75,814	–	–	–	75,814
			5,449,915	2,643,548	562,830	(1,480,744)	(409,923)	6,765,626

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(C) Employee options

No options were granted during the year.

During 2011, the company granted 20,000 options to one executive as part of a five year incentive. The market value of the subject shares at the grant date of the options was A$348,000. The weighted average fair value of the options at the grant date was nil due to their exercise price exceeding QBE's share price.

The market value of all shares underlying the options at the balance date was A$56 million (2011 A$98 million). Details of the number of employee options granted, exercised and cancelled or forfeited during 2012, were as follows:

2012 GRANT DATE	EXERCISE PRICE	BALANCE AT 1 JAN 2012	GRANTED IN THE YEAR	EXERCISED IN THE YEAR	CANCELLED/ FORFEITED IN THE YEAR	BALANCE AT 31 DEC 2012
3 March 2004	**A$11.08**	**23,000**	**–**	**(2,250)**	**–**	**20,750**
2 March 2006	**A$20.44**	**1,454,671**	**–**	**–**	**(1,454,671)**	**–**
7 April 2006	**A$20.44**	**94,771**	**–**	**–**	**(94,771)**	**–**
2 March 2007	**A$20.44**	**20,000**	**–**	**–**	**(20,000)**	**–**
2 March 2007	**A$32.68**	**1,264,521**	**–**	**–**	**(321,305)**	**943,216**
4 April 2007	**A$32.68**	**51,125**	**–**	**–**	**–**	**51,125**
4 March 2008	**A$20.44**	**20,000**	**–**	**–**	**(20,000)**	**–**
4 March 2008	**A$24.22**	**1,863,899**	**–**	**–**	**(183,819)**	**1,680,080**
4 April 2008	**A$27.00**	**74,257**	**–**	**–**	**–**	**74,257**
6 March 2009	**A$20.44**	**20,000**	**–**	**–**	**(20,000)**	**–**
6 March 2009	**A$17.57**	**2,646,399**	**–**	**–**	**(248,607)**	**2,397,792**
5 March 2010	**A$20.44**	**20,000**	**–**	**–**	**(20,000)**	**–**
7 March 2011	**A$20.44**	**20,000**	**–**	**–**	**(20,000)**	**–**
		7,572,643	**–**	**(2,250)**	**(2,403,173)**	**5,167,220**
Weighted average exercise price		**A$22.53**	**–**	**A$11.08**	**A$22.07**	**A$22.75**

The weighted average share price at the date of exercise of options during the year was A$13.74 (2011 A$18.09). The weighted average remaining contractual life of total options outstanding at 31 December 2012 was 1.4 years (2011 1.9 years).

Number of employee options outstanding at 31 December 2012 were as follows:

YEAR OF EXPIRY	DCP/STI	OTHER[1]	TOTAL OPTIONS
2013	**1,579,193**	**–**	**1,579,193**
2014	**1,378,313**	**–**	**1,378,313**
2015	**2,188,964**	**–**	**2,188,964**
2024	**–**	**20,750**	**20,750**
	5,146,470	**20,750**	**5,167,220**
Vested and exercisable at 31 December 2012	**1,320,261**	**20,750**	**1,341,011**

1 Other options were issued to US and Irish employees in 2004 in lieu of shares under the Plan. The options vested immediately and are exercisable until March 2024.

Details of the number of employee options granted, exercised and cancelled or forfeited during 2011 were as follows:

2011 GRANT DATE	EXERCISE PRICE	BALANCE AT 1 JAN 2011	GRANTED IN THE YEAR	EXERCISED IN THE YEAR	CANCELLED/ FORFEITED IN THE YEAR	BALANCE AT 31 DEC 2011
3 March 2004	A$11.08	24,500	–	(1,500)	–	23,000
3 March 2005	A$14.85	127,449	–	(121,654)	(5,795)	–
2 March 2006	A$20.44	1,711,082	–	(2,115)	(254,296)	1,454,671
7 April 2006	A$20.44	94,771	–	–	–	94,771
2 March 2007	A$20.44	20,000	–	–	–	20,000
2 March 2007	A$32.68	1,489,552	–	–	(225,031)	1,264,521
4 April 2007	A$32.68	51,125	–	–	–	51,125
4 March 2008	A$20.44	20,000	–	–	–	20,000
4 March 2008	A$24.22	2,145,693	–	–	(281,794)	1,863,899
4 April 2008	A$27.00	74,257	–	–	–	74,257
6 March 2009	A$20.44	20,000	–	–	–	20,000
6 March 2009	A$17.57	2,891,455	–	(44,801)	(200,255)	2,646,399
5 March 2010	A$20.44	20,000	–	–	–	20,000
7 March 2011	A$20.44	–	20,000	–	–	20,000
		8,689,884	20,000	(170,070)	(967,171)	7,572,643
Weighted average exercise price		A$22.54	A$20.44	A$15.60	A$23.76	A$22.53

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30. Share based payments CONTINUED

Number of employee options outstanding at 31 December 2011 were as follows:

YEAR OF EXPIRY	FUTURE PERFORMANCE	DCP/STI	OTHER	TOTAL OPTIONS
2012	100,000	1,859,791	–	1,959,791
2013	–	1,396,365	–	1,396,365
2014	–	1,611,116	–	1,611,116
2015	–	2,582,371	–	2,582,371
2024	–	–	23,000	23,000
	100,000	7,449,643	23,000	7,572,643
Vested and exercisable at 31 December 2011	100,000	1,642,168	23,000	1,765,168

(D) Fair value of options and conditional rights

The fair value of both options and conditional rights is determined using a binomial model. The fair value is recognised evenly over the service period ending at vesting date. For conditional rights granted during the year to 31 December 2012 and conditional rights and options granted during the year to 31 December 2011, the following significant assumptions were used:

		OPTIONS		CONDITIONAL RIGHTS	
		2012	2011	2012	2011
Share price on grant date	A$	–	17.41	**11.85 - 13.03**	13.67 - 19.00
Fair value of instrument at grant date	A$	–	nil	**11.78 - 14.25**	14.03 - 18.44
Expected life of instrument	Years	–	0.1	**0.5 - 5.0**	1.2 - 5.0

Some of the assumptions are based on historical data which is not necessarily indicative of future trends. Reasonable changes in these assumptions would not have a material impact on the amounts recognised in the financial statements.

(E) Share Incentive Plan

The market value of shares issued under the terms of the SIP is expensed in the period in which the shares are granted. The total number of shares issued to participating employees in the year was 290,635 (2011 280,225). The weighted average market price on the issue date was A$13.17 (2011 A$13.85).

(F) Share based payment expense

Total expenses arising from share based payment transactions during the year included in underwriting expenses were as follows:

	2012 US$M	2011 US$M
Options provided under the Plan	**3**	5
Conditional rights provided under the Plan	**33**	35
Shares provided under the SIP	**4**	4
	40	44

31. Key management personnel

(A) Key management personnel – compensation

	2012 US$000	2011 US$000
Short-term employee benefits	**18,872**	19,508
Post employment benefits	**205**	458
Other long-term employment benefits	**843**	685
Share based payments	**6,064**	8,275
Termination benefits	**9,920**	7,286
	35,904	36,212

Details of key management personnel and their remuneration are shown in the remuneration report on pages 84 to 104.

(B) Key management personnel – equity instruments

(i) Conditional rights and options provided as remuneration

For additional details of equity instruments (conditional rights and options) provided to key management personnel as remuneration and shares issued on the exercise of such instruments, together with the associated terms and conditions, refer to the remuneration report on pages 84 to 104. No equity instruments were provided to non-executive directors.

(ii) QBE deferred equity plans – conditional rights

Details of the movements in the number of conditional rights to ordinary shares in the company provided as remuneration to the key management personnel and issued under the QIS and the DCP are provided below.

2012 NUMBER OF CONDITIONAL RIGHTS	BALANCE AT 1 JAN 2012	GRANTED IN THE YEAR	DIVIDENDS ATTACHING IN THE YEAR	VESTED AND TRANSFERRED IN THE YEAR	CANCELLED/ FORFEITED IN THE YEAR	BALANCE AT 31 DEC 2012[1]
Executive director						
JD Neal	190,706	–	5,467	(87,976)	–	108,197
Other key management personnel						
SP Burns	366,661	63,310	14,107	(164,863)	–	279,215
NG Drabsch	103,489	–	3,520	(37,321)	–	69,688
C Fagen	26,274	–	1,066	(6,226)	–	21,114
J Rumpler	66,531	56,502	6,086	(8,621)	–	120,498
JM Smith	49,757	–	1,728	(17,297)	–	34,188
J Sojo	32,941	22,710	2,496	(8,785)	–	49,362
GB Thwaites	48,212	–	1,702	(16,242)	–	33,672
Former key management personnel						
G Brader	20,122	–	904	(3,127)	–	17,899
D Fogarty	48,633	–	1,510	(20,269)	–	29,874
MJ Goodwin [2]	97,815	–	3,862	(25,257)	–	76,420
BM Nicholls [3]	53,401	–	1,884	(49,134)	–	6,151
FM O'Halloran [4]	237,932	–	4,057	(216,899)	–	25,090
DA Ramsay	61,355	–	2,146	(21,055)	–	42,446

1 None of these conditional rights were vested or exercisable at 31 December 2012.
2 Mr Goodwin ceased as KMP on 27 July 2012. In accordance with the terms of his departure, the conditional rights outstanding at 31 December 2012 were cancelled on 27 January 2013.
3 Mr Nicholls ceased as KMP on 1 May 2012. In accordance with the terms of his departure, the vesting of 31,085 conditional rights was accelerated to 31 October 2012. The conditional rights outstanding at 31 December 2012 will vest on 6 March 2016. These conditional rights will continue to accrue notional dividends under the BSP.
4 Mr O'Halloran ceased as KMP on 17 August 2012. In accordance with the terms of his departure, the vesting of 137,253 conditional rights was accelerated to 28 August 2012. The conditional rights outstanding at 31 December 2012 will vest on 4 April 2016. These conditional rights will continue to accrue notional dividends under the BSP.

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31. Key management personnel CONTINUED

2011 NUMBER OF CONDITIONAL RIGHTS	BALANCE AT 1 JAN 2011	GRANTED IN THE YEAR	DIVIDENDS ATTACHING IN THE YEAR	VESTED AND TRANSFERRED IN THE YEAR	CANCELLED/ FORFEITED IN THE YEAR	BALANCE AT 31 DEC 2011[1]
Executive director						
FM O'Halloran	218,629	45,532	17,431	(43,660)	–	237,932
Other key management personnel						
G Brader	12,862	8,519	1,620	(2,879)	–	20,122
SP Burns	342,692	92,568	29,512	(98,111)	–	366,661
NG Drabsch	97,634	18,834	8,331	(21,310)	–	103,489
C Fagen	19,266	9,484	2,115	(4,591)	–	26,274
D Fogarty	46,873	7,908	3,914	(10,062)	–	48,633
MJ Goodwin	60,203	34,544	7,876	(4,808)	–	97,815
JD Neal	185,571	46,985	15,350	(57,200)	–	190,706
BM Nicholls	47,768	10,740	4,300	(9,407)	–	53,401
DA Ramsay	56,258	12,196	4,941	(12,040)	–	61,355
J Rumpler	32,263	35,268	5,356	(6,356)	–	66,531
JM Smith	45,905	9,632	4,004	(9,784)	–	49,757
GB Thwaites	43,368	9,758	3,882	(8,796)	–	48,212

1 None of these conditional rights were vested or exercisable at 31 December 2011.

(iii) Longer term incentive plans – conditional rights

Details of the movements in the number of conditional rights to ordinary shares in the company provided as remuneration to the key management personnel and issued under the LTI plan are provided below. No conditional rights to ordinary shares in the company were provided to key management personnel under the GERSP legacy scheme.

2012 NUMBER OF CONDITIONAL RIGHTS	BALANCE AT 1 JAN 2012	GRANTED IN THE YEAR	DIVIDENDS ATTACHING IN THE YEAR	VESTED AND TRANSFERRED IN THE YEAR	CANCELLED/ FORFEITED IN THE YEAR	BALANCE AT 31 DEC 2012[1]
Executive director						
JD Neal	–	50,934	2,710	–	–	53,644
Other key management personnel						
SP Burns	12,446	16,956	1,564	–	–	30,966
NG Drabsch	14,994	21,753	1,955	–	–	38,702
C Fagen	–	4,863	259	–	–	5,122
J Rumpler	8,072	12,069	1,072	–	–	21,213
JM Smith	5,389	8,213	724	–	–	14,326
GB Thwaites	5,459	8,213	727	–	–	14,399
Former key management personnel						
G Brader	–	8,595	457	–	–	9,052
D Fogarty	4,424	5,750	542	–	–	10,716
MJ Goodwin[2]	5,127	7,841	690	–	–	13,658
BM Nicholls[3]	6,010	8,663	781	–	–	15,454
FM O'Halloran[4]	62,955	95,501	8,430	–	–	166,886
DA Ramsay	6,824	9,868	889	–	–	17,581

1 None of these conditional rights were vested or exercisable at 31 December 2012.
2 Mr Goodwin ceased as KMP on 27 July 2012. The conditional rights outstanding at 31 December 2012 were cancelled on 27 January 2013.
3 Mr Nicholls ceased as KMP on 1 May 2012. Of the conditional rights outstanding at 31 December 2012, 6,330 will vest on 6 March 2016 and 9,124 will vest on 6 March 2017. These conditional rights will continue to accrue notional dividends under the BSP.
4 Mr O'Halloran ceased as KMP on 17 August 2012. Of the conditional rights outstanding at 31 December 2012, 66,304 will vest on 4 April 2016 and 100,582 will vest on 6 March 2017. Both are subject to Remuneration Committee approval. These conditional rights will continue to accrue notional dividends under the BSP.

2011 NUMBER OF CONDITIONAL RIGHTS	BALANCE AT 1 JAN 2011	GRANTED IN THE YEAR	DIVIDENDS ATTACHING IN THE YEAR	VESTED AND TRANSFERRED IN THE YEAR	CANCELLED/ FORFEITED IN THE YEAR	BALANCE AT 31 DEC 2011[1]
Executive director						
FM O'Halloran	–	60,163	2,792	–	–	62,955
Other key management personnel						
SP Burns	–	11,444	1,002	–	–	12,446
NG Drabsch	–	13,787	1,207	–	–	14,994
D Fogarty	–	4,068	356	–	–	4,424
MJ Goodwin	–	4,715	412	–	–	5,127
BM Nicholls	–	5,526	484	–	–	6,010
DA Ramsay	–	6,274	550	–	–	6,824
J Rumpler	–	7,422	650	–	–	8,072
JM Smith	–	4,955	434	–	–	5,389
GB Thwaites	–	5,020	439	–	–	5,459

1 None of these conditional rights were vested or exercisable at 31 December 2011.

(iv) Other – conditional rights

Details of the movements in the number of conditional rights to ordinary shares in the company provided as remuneration to the key management personnel and issued under special circumstances are provided below.

NUMBER OF CONDITIONAL RIGHTS		BALANCE AT 1 JAN	GRANTED IN THE YEAR	DIVIDENDS ATTACHING IN THE YEAR	VESTED AND TRANSFERRED IN THE YEAR	CANCELLED/ FORFEITED	BALANCE AT 31 DEC[1]
Key management personnel							
JD Neal	2012	**27,189**	**90,000**	**4,308**	**–**	**–**	**121,497**
	2011	–	25,000	2,189	–	–	27,189
NG Drabsch	2012	**75,814**	**–**	**4,034**	**–**	**–**	**79,848**
	2011	–	75,814	–	–	–	75,814

1 None of these conditional rights were vested or exercisable at 31 December 2012 or 31 December 2011.

(v) QBE deferred equity plans – options

Details of the movements in the number of DCP options over ordinary shares in the company provided as remuneration to the key management personnel are provided below.

2012 NUMBER OF OPTIONS	BALANCE AT 1 JAN 2012	GRANTED IN THE YEAR	EXERCISED IN THE YEAR	CANCELLED/ FORFEITED IN THE YEAR	BALANCE AT 31 DEC 2012	VESTED AND EXERCISABLE AT 31 DEC 2012[1]	EXERCISE COST AT 31 DEC 2012 A$000
Executive director							
JD Neal	**187,322**	**–**	**–**	**(50,559)**	**136,763**	**32,066**	**3,166**
Other key management personnel							
SP Burns	**373,553**	**–**	**–**	**(110,515)**	**263,038**	**61,031**	**6,054**
NG Drabsch	**161,549**	**–**	**–**	**(50,460)**	**111,089**	**24,776**	**2,560**
C Fagen	**29,551**	**–**	**–**	**(7,727)**	**21,824**	**4,255**	**498**
J Rumpler	**45,510**	**–**	**–**	**(13,711)**	**31,799**	**7,475**	**741**
JM Smith	**74,332**	**–**	**–**	**(22,566)**	**51,766**	**11,009**	**1,183**
J Sojo	**18,886**	**–**	**–**	**–**	**18,886**	**–**	**364**
GB Thwaites	**53,659**	**–**	**–**	**(7,485)**	**46,174**	**8,545**	**1,037**
Former key management personnel							
G Brader	**9,768**	**–**	**–**	**(4,750)**	**5,018**	**5,018**	**88**
D Fogarty	**83,666**	**–**	**–**	**(25,924)**	**57,742**	**12,298**	**1,311**
MJ Goodwin[2]	**42,006**	**–**	**–**	**(2,076)**	**39,930**	**2,968**	**799**
BM Nicholls[3]	**104,102**	**–**	**–**	**(41,366)**	**62,736**	**62,736**	**1,531**
FM O'Halloran[4]	**347,957**	**–**	**–**	**(94,771)**	**253,186**	**253,186**	**5,921**
DA Ramsay	**90,622**	**–**	**–**	**(26,981)**	**63,641**	**13,807**	**1,459**

1 All options are exercisable at A$32.68 with the exception of Mr Brader's options which are exercisable at A$17.57; Mr Nicholls' options which are exercisable as follows: 21,530 at A$32.68, 15,525 exercisable at A$24.22 and 25,681 exercisable at A$17.57; and Mr O'Halloran's options which are exercisable as follows: 51,125 at A$32.68, 74,257 exercisable at A$27.00 and 127,804 exercisable at A$17.57.
2 In accordance with the terms of Mr Goodwin's departure, the options outstanding at 31 December 2012 were cancelled on 27 January 2013.
3 In accordance with the terms of Mr Nicholls' departure, the vesting of 41,206 options was accelerated to 31 October 2012. All vested options then expire 12 months from this date.
4 In accordance with the terms of Mr O'Halloran's departure, the vesting of 202,061 options was accelerated to 28 August 2012. All vested options then expire 12 months from this date.

Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2012

31. Key management personnel CONTINUED

2011 NUMBER OF OPTIONS	BALANCE AT 1 JAN 2011	GRANTED IN THE YEAR	EXERCISED IN THE YEAR	CANCELLED/ FORFEITED IN THE YEAR	BALANCE AT 31 DEC 2011	NUMBER VESTED AND EXERCISABLE AT 31 DEC 2011[1]	EXERCISE COST AT 31 DEC 2011 A$000
Executive director							
FM O'Halloran	347,957	–	–	–	347,957	94,771	7,858
Other key management personnel							
G Brader	12,921	–	–	(3,153)	9,768	4,750	203
SP Burns	373,553	–	–	–	373,553	110,515	8,313
NG Drabsch	161,549	–	–	–	161,549	50,460	3,591
C Fagen	29,551	–	–	–	29,551	7,727	656
D Fogarty	83,666	–	–	–	83,666	25,924	1,841
MJ Goodwin	42,006	–	–	–	42,006	2,076	842
JD Neal	187,322	–	–	–	187,322	50,559	4,200
BM Nicholls	104,102	–	–	–	104,102	41,366	2,376
DA Ramsay	90,622	–	–	–	90,622	26,981	2,010
J Rumpler	45,510	–	–	–	45,510	13,711	1,022
JM Smith	74,332	–	–	–	74,332	22,566	1,644
GB Thwaites	53,659	–	–	–	53,659	7,485	1,190

1 All options are exercisable at A$20.44 with the exception of Mr Brader's options which are exercisable at A$24.22

(vi) Future performance option holdings

Details of the movements in the number of future performance options over ordinary shares in the company provided as remuneration to the key management personnel are provided below.

NUMBER OF OPTIONS		BALANCE AT 1 JAN	GRANTED IN THE YEAR	EXERCISED IN THE YEAR	CANCELLED/ FORFEITED IN THE YEAR	BALANCE AT 31 DEC	EXERCISE COST AT 31 DEC A$000
Key management personnel							
SP Burns	**2012**	**100,000**	**–**	**–**	**(100,000)**	**–**	**–**
	2011	80,000	20,000	–	–	100,000	2,044

(vii) Shareholdings

The movements during the year in the number of ordinary shares in the company held by the key management personnel, including their personally related parties, are provided in the table below.

2012 NUMBER OF SHARES	INTEREST IN SHARES AT 1 JAN 2012	CONDITIONAL RIGHTS VESTED	OPTIONS EXERCISED	SHARES PURCHASED (SOLD)	DIVIDENDS REINVESTED IN THE YEAR	INTEREST IN SHARES AT 31 DEC 2012	INTEREST IN SHARES AT 31 DEC 2012 SUBJECT TO NON-RECOURSE LOANS
Non-executive directors							
LF Bleasel AM	**98,638**	**–**	**–**	**2,804**	**–**	**101,442**	**–**
DM Boyle	**17,617**	**–**	**–**	**1,402**	**–**	**19,019**	**–**
JA Graf	**–**	**–**	**–**	**15,100**	**–**	**15,100**	**–**
JM Green	**35,856**	**–**	**–**	**1,402**	**–**	**37,258**	**–**
IF Hudson	**11,737**	**–**	**–**	**–**	**–**	**11,737**	**–**
BJ Hutchinson AM	**94,646**	**–**	**–**	**10,502**	**–**	**105,148**	**–**
CLA Irby	**22,889**	**–**	**–**	**–**	**–**	**22,889**	**–**
IYL Lee	**26,749**	**–**	**–**	**–**	**–**	**26,749**	**–**
Executive director							
JD Neal	**52,382**	**87,976**	**–**	**(9,273)**	**7,173**	**138,258**	**–**
Other key management personnel							
SP Burns	**93,948**	**164,863**	**–**	**(199,965)**	**8,046**	**66,892**	**–**
NG Drabsch	**179,395**	**37,321**	**–**	**(35,358)**	**4,000**	**185,358**	**174,880**
C Fagen	**69,862**	**6,226**	**–**	**(10,000)**	**1,574**	**67,662**	**16,615**
J Rumpler	**78,190**	**8,621**	**–**	**(8,621)**	**–**	**78,190**	**56,975**
JM Smith	**32,379**	**17,297**	**–**	**1,402**	**–**	**51,078**	**–**
J Sojo	**3,157**	**8,785**	**–**	**–**	**636**	**12,578**	**–**
GB Thwaites	**40,356**	**16,242**	**–**	**(14,840)**	**2,539**	**44,297**	**2,961**
Former key management personnel							
G Brader	**2,879**	**3,127**	**–**	**–**	**–**	**6,006**	**–**
D Fogarty	**67,374**	**20,269**	**–**	**(20,249)**	**4,018**	**71,412**	**24,790**
MJ Goodwin	**22,413**	**25,257**	**–**	**1,402**	**2,581**	**51,653**	**7,482**
BM Nicholls	**9,407**	**49,134**	**–**	**(8,622)**	**–**	**49,919**	**–**
FM O'Halloran	**1,561,233**	**216,899**	**–**	**(819,196)**	**76,089**	**1,035,025**	**–**
DA Ramsay	**257,460**	**21,055**	**–**	**(20,121)**	**–**	**258,394**	**92,318**

The movements in the number of ordinary shares in the company held by key management personnel, including their personally related parties, in the prior year are provided in the table below.

2011 NUMBER OF SHARES	INTEREST IN SHARES AT 1 JAN 2011	CONDITIONAL RIGHTS VESTED	OPTIONS EXERCISED	SHARES PURCHASED (SOLD)	DIVIDENDS REINVESTED IN THE YEAR	INTEREST IN SHARES AT 31 DEC 2011	INTEREST IN SHARES AT 31 DEC 2011 SUBJECT TO NON-RECOURSE LOANS
Non-executive directors							
LF Bleasel AM	67,604	–	–	31,034	–	98,638	–
DM Boyle	13,437	–	–	4,180	–	17,617	–
JM Green	24,981	–	–	10,875	–	35,856	–
IF Hudson	11,359	–	–	–	378	11,737	–
BJ Hutchinson AM	78,646	–	–	16,000	–	94,646	–
CLA Irby	22,889	–	–	–	–	22,889	–
IYL Lee	26,749	–	–	–	–	26,749	–
Executive director							
FM O'Halloran	1,404,806	43,660	–	2,000	110,767	1,561,233	1,040,411
Other key management personnel							
G Brader	–	2,879	–	–	–	2,879	–
SP Burns	71,142	98,111	–	(83,375)	8,070	93,948	–
NG Drabsch	174,914	21,310	–	(31,683)	14,854	179,395	171,326
C Fagen	60,699	4,591	–	(500)	5,072	69,862	15,600
D Fogarty	61,550	10,062	–	(10,062)	5,824	67,374	23,538
MJ Goodwin	15,801	4,808	–	–	1,804	22,413	7,104
JD Neal	1,354	57,200	–	(10,784)	4,612	52,382	–
BM Nicholls	–	9,407	–	–	–	9,407	–
DA Ramsay	257,460	12,040	–	(12,040)	–	257,460	92,318
J Rumpler	78,190	6,356	–	(6,356)	–	78,190	56,975
JM Smith	22,595	9,784	–	–	–	32,379	–
GB Thwaites	46,397	8,796	–	(18,796)	3,959	40,356	2,655

(C) Key management personnel – loans

Details of the loans made by the Group to the key management personnel are set out below.

(i) Personal recourse share loans

2012	BALANCE AT 1 JAN 2012 A$000	LOANS MADE IN THE YEAR A$000	REPAYMENTS A$000	BALANCE AT 31 DEC 2012 A$000	INTEREST NOT CHARGED[1] A$000	HIGHEST BALANCE IN THE PERIOD A$000
Key management personnel						
C Fagen	**134**	**–**	**–**	**134**	**10**	**134**
J Rumpler	**219**	**–**	**(5)**	**214**	**16**	**219**
GB Thwaites	**216**	**–**	**(85)**	**131**	**12**	**216**
Former key management personnel						
FM O'Halloran (to 17 August 2012)	**3,032**	**–**	**(3,032)**	**–**	**113**	**3,032**
DA Ramsay (to 1 May 2012)	**822**	**–**	**(332)**	**490**	**21**	**822**

1 Former key management personnel – interest not charged is shown for the period that employee was key management personnel.

2011	BALANCE AT 1 JAN 2011 A$000	LOANS MADE IN THE YEAR A$000	REPAYMENTS A$000	BALANCE AT 31 DEC 2011 A$000	INTEREST NOT CHARGED A$000	HIGHEST BALANCE IN THE PERIOD A$000
Executive director						
FM O'Halloran	3,032	–	–	3,032	228	3,032
Other key management personnel						
C Fagen	139	–	(5)	134	10	139
DA Ramsay	948	–	(126)	822	64	948
J Rumpler	229	–	(10)	219	17	229
GB Thwaites	247	–	(31)	216	17	247

(ii) Non-recourse share loans

Prior to 20 June 2005, non-recourse loans were provided by the Group to the executive director and other key management personnel for the purchase of shares in the company. Under Australian accounting standards, non-recourse loans and the related shares are derecognised and are instead treated as options.

Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2012

31. Key management personnel CONTINUED

2012	BALANCE AT 1 JAN 2012 A$000	LOANS MADE IN THE YEAR A$000	REPAYMENTS A$000	BALANCE AT 31 DEC 2012 A$000	INTEREST NOT CHARGED[1] A$000	HIGHEST BALANCE IN THE PERIOD A$000
Key management personnel						
NG Drabsch	1,956	–	(30)	1,926	147	1,956
C Fagen	267	–	–	267	20	267
J Rumpler	316	–	(16)	300	23	316
GB Thwaites	43	–	–	43	3	43
Former key management personnel						
D Fogarty	87	–	–	87	2	87
MJ Goodwin	35	–	–	35	2	35
FM O'Halloran	4,227	–	(4,227)	–	201	4,227
DA Ramsay	806	–	(30)	776	21	806

1 Former key management personnel – interest not charged is shown for the period that employee was key management personnel.

32. Contingent liabilities

Contingent liabilities are disclosed when the possibility of a future settlement of economic benefits is considered to be less than probable but more likely than remote. Under accounting standards, no provision is required for such items if a future transfer of benefits is not probable or cannot be reliably measured. If settlement becomes probable, a provision is required. Refer to note 1(V).

In the normal course of business, the Group is exposed to contingent liabilities in relation to claims litigation arising out of its insurance and reinsurance transactions and may be exposed to the possibility of contingent liabilities in relation to non-insurance litigation. Provisions are made for obligations that are probable and quantifiable. There are no individually significant amounts not provided for and such transactions are not considered likely to have a material impact on the net assets of the Group.

QBE is required to support the underwriting activities of the Group's controlled entities which are corporate members at Lloyd's of London. Funds at Lloyd's are those funds of the Group which are subject to the terms of the Lloyd's Deposit Trust Deed and are required to support underwriting for the following year and the open years of account, determined by a formula prescribed by Lloyd's each year. Letters of credit of $1,361 million (2011 $1,412 million) were issued in support of the Group's participation in Lloyd's, along with cash and investments of $207 million (2011 $44 million). In addition, a controlled entity has entered into various trust and security deeds with Lloyd's in respect of assets lodged to support its underwriting activities. These deeds contain covenants that require the entity to meet financial obligations should they arise in relation to cash calls from syndicate participations. A cash call would be made first on the assets held in syndicate trust funds and would only call on Funds at Lloyd's after syndicate resources were exhausted. Only if the level of these trust funds was not sufficient would a cash call result in a draw down on the letters of credit and other assets lodged with Lloyd's.

Controlled entities have entered into acquisition agreements. The costs of certain of these acquisitions have a contingent consideration component. The Group has made provision for the fair value of the consideration that it expects to settle based on the achievement of specified performance criteria in future years. Details are provided in notes 23 and 29. Further amounts totalling $2 million (2011 $36 million) may be payable in the future.

33. Capital expenditure commitments

	2012 US$M	2011 US$M
Capital expenditure commitments contracted but not provided for in the financial statements (not later than one year)	21	39

34. Operating lease commitments

	2012 US$M	2011 US$M
Payable:		
Not later than one year	69	70
Later than one year but not later than five years	199	164
Later than five years	83	231
Total future minimum lease payments under non-cancellable operating leases	351	465

35. Remuneration of auditors

	2012 US$000	2011 US$000
PricewaterhouseCoopers (PwC) – Australian firm[1]		
Audit or review of financial reports of the ultimate parent entity	**1,417**	1,374
Audit of financial reports of controlled entities	**3,219**	2,844
Audit of statutory returns	**705**	685
Other audit assurance services	**161**	763
Taxation services	**420**	261
Actuarial services	**4**	106
Advisory services	**2,293**	31
	8,219	6,064
Related practices of PwC – Australian firm (including overseas PwC firms)[1]		
Audit of financial reports of controlled entities	**9,072**	8,747
Audit of statutory returns	**2,032**	1,650
Other audit assurance services	**23**	67
Taxation services	**1,393**	1,117
Actuarial services	**337**	720
Advisory services	**706**	3,164
	13,563	15,465
	21,782	21,529
Audit and assurance services	**16,629**	16,130
Other services	**5,153**	5,399
	21,782	21,529
Other auditors		
Audit of financial reports of controlled entities	**638**	626

1 The Board believes some non-audit services are appropriate given the external auditor's knowledge of the Group. QBE may engage the external auditor for non-audit services other than excluded services subject to the general principle that fees for non-audit services should not exceed 50% of all fees paid to the external auditor in any one financial year. External tax services are generally provided by an accounting firm other than the external auditor. Consistent with prior periods, PwC cannot provide the excluded services of preparing accounting records or financial reports, asset or liability valuations, acting in a management capacity, acting as a custodian of assets or acting as share registrar.

36. Related parties

	COUNTRY OF INCORPORATION/ FORMATION	EQUITY HOLDING 2012 %	EQUITY HOLDING 2011 %
(A) Ultimate parent entity			
QBE Insurance Group Limited	Australia		
(B) Controlled entities[1]			
AFA Limited	Vanuatu	**100.00**	–
AIS Green Slip Group Pty Limited	Australia	**100.00**	100.00
Anex Jenni & Partner AG	Switzerland	**100.00**	100.00
Atlasz Real Estate and Management Company Limited (in liquidation)	Hungary	**100.00**	100.00
Austral Mercantile Collections Pty Limited	Australia	**100.00**	100.00
Australian Aviation Underwriting Pool Pty Limited	Australia	**100.00**	100.00
BCO Surplus Lines Inc	US	**100.00**	100.00
Blue Ridge Indemnity Company	US	**100.00**	100.00
Burnett & Company Inc	US	**100.00**	100.00
Business Debtorinsure (Brokers) Pty Limited (in liquidation)	Australia	**100.00**	100.00
CHU Underwriting Agencies (UK) Limited	UK	**100.00**	100.00
CHU Underwriting Agencies Pty Limited	Australia	**100.00**	100.00
Colonial Insurance Agency Inc	Puerto Rico	**100.00**	–
Community Association Underwriters of America Inc	US	**100.00**	100.00
Corporate Underwriting Agencies Pty Limited	Australia	**100.00**	100.00
Deep South Surplus Inc	US	**100.00**	100.00
Deep South Surplus of Texas Management LLC	US	**100.00**	100.00
Deep South Surplus of Texas LP[3]	US	**–**	–
Elders Insurance (Underwriting Agency) Pty Limited	Australia	**75.00**	75.00
Elders Insurance Agencies Pty Limited	Australia	**100.00**	100.00
Elders Insurance Limited	Australia	**100.00**	100.00
Equator Reinsurances Limited	Bermuda	**100.00**	100.00

Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2012

36. Related parties CONTINUED

	COUNTRY OF INCORPORATION/ FORMATION	EQUITY HOLDING 2012 %	EQUITY HOLDING 2011 %
FAI Insurances (Fiji) Limited	Fiji	**100.00**	100.00
General Casualty Company of Wisconsin	US	**100.00**	100.00
General Casualty Insurance Company	US	**100.00**	100.00
Greenhill Baia Underwriting GmbH	Germany	**100.00**	100.00
Greenhill International Insurance Holdings Limited	UK	**100.00**	100.00
Greenhill Sturge Underwriting Limited	UK	**100.00**	100.00
Greenhill Underwriting Espana Limited	UK	**100.00**	100.00
Hoosier Insurance Company	US	**100.00**	100.00
HSBC La Buenos Aires Seguros SA	Argentina	**99.86**	–
Hyfield Company Limited [2]	Thailand	**99.96**	49.46
Invivo Medical Pty Limited	Australia	**50.00**	50.00
Lantana Insurance Limited	Bermuda	**100.00**	100.00
Lifeco Re Limited	UK	**100.00**	100.00
Lifeco SRO	Czech Republic	**100.00**	100.00
Limit Corporate Members Limited	UK	**100.00**	100.00
Limit Holdings Limited	UK	**100.00**	100.00
Limit No 2 Limited	UK	**100.00**	100.00
Limit No 7 Limited	UK	**100.00**	100.00
Limit No 10 Limited	UK	**100.00**	100.00
Mantis Reef II Limited [3]	Cayman Is	**–**	–
Mantis Reef II Pledge Limited [3]	Cayman Is	**–**	–
Mortgage & Auto Solutions Inc	US	**100.00**	100.00
MMIA Pty Limited	Australia	**100.00**	100.00
MMWC Pty Limited	Australia	**100.00**	100.00
National Credit Insurance (Brokers) NZ Limited	NZ	**100.00**	100.00
National Credit Insurance (Brokers) Pty Limited	Australia	**100.00**	100.00
National Farmers Union Property and Casualty Company	US	**100.00**	100.00
NAU Country Insurance Company	US	**100.00**	100.00
NAU Holding Company LLC	US	**100.00**	100.00
NCI Brokers (Asia) Pte Limited	Singapore	**100.00**	100.00
New Century Finance Corporation	Puerto Rico	**100.00**	–
Newport Management Corporation	US	**100.00**	100.00
North Pointe Financial Services Inc	US	**100.00**	100.00
North Pointe Insurance Company	US	**100.00**	100.00
Operador Logistico de Soat-Ols SA	Ecuador	**75.48**	50.99
Optima Insurance Group Inc	Puerto Rico	**100.00**	–
P&C Claim Care Limited	US	**100.00**	100.00
P&C Claim Care Management LLC	US	**100.00**	100.00
Permanent LMI Pty Limited	Australia	**50.08**	50.08
Pitt Nominees Pty Limited	Australia	**100.00**	100.00
Praetorian Insurance Company	US	**100.00**	100.00
PT Asuransi QBE Pool Indonesia	Indonesia	**55.00**	60.00
QBE (Jersey) GP Limited	Jersey	**100.00**	100.00
QBE (Jersey) GP II Limited	Jersey	**100.00**	100.00
QBE (PNG) Limited	PNG	**100.00**	100.00
QBE (Singapore) Pte Ltd	Singapore	**100.00**	100.00
QBE A&H LLC (formerly SLG Benefits and Insurance LLC)	US	**100.00**	100.00
QBE Agencies Americas Holdings Inc	US	**100.00**	100.00
QBE Agencies Australia Holdings Pty Limited	Australia	**100.00**	100.00
QBE Agencies Holdings Pty Limited	Australia	**100.00**	100.00
QBE Americas Inc	US	**100.00**	100.00
QBE Argentina Aseguradora de Riesgos del Trabajo SA	Argentina	**100.00**	100.00
QBE Asegurando LTDA (formerly RGM Asegurando LTDA)	Colombia	**75.50**	51.00
QBE Atlantic LLC	US	**100.00**	100.00
QBE Atlasz Ingatlankezelo zrt	Hungary	**100.00**	100.00
QBE Brasil Seguros SA	Brazil	**99.99**	99.99
QBE Capital Funding LP [3]	Jersey	**–**	–

	COUNTRY OF INCORPORATION/ FORMATION	EQUITY HOLDING 2012 %	2011 %
QBE Capital Funding II LP [3]	Jersey	–	–
QBE Capital Funding III Limited	Jersey	100.00	100.00
QBE Capital Funding IV Limited	Jersey	100.00	100.00
QBE Compania Argentina de Seguros SA	Argentina	100.00	100.00
QBE Corporate Limited	UK	100.00	100.00
QBE Denmark A/S	Denmark	100.00	100.00
QBE de Mexico Compania de Seguros SA de CV	Mexico	99.99	99.99
QBE Chile Seguros Generales	Chile	100.00	100.00
QBE Employee Share Trust [3]	Australia	–	–
QBE European Operations plc	UK	100.00	100.00
QBE European Services Limited	UK	100.00	100.00
QBE European Underwriting Services (Australia) Pty Limited	Australia	100.00	100.00
QBE Europe Holdings Services Agent de Asigurare SRL (in liquidation)	Romania	100.00	100.00
QBE Financial Institution Risk Services Inc	US	100.00	100.00
QBE FIRST Enterprises LLC	US	100.00	100.00
QBE FIRST Insurance Agency Inc	US	100.00	100.00
QBE FIRST Property Tax Solutions LLC	US	100.00	100.00
QBE Funding V Limited	Jersey	100.00	100.00
QBE Funding Trust V [3]	Jersey	–	–
QBE General Insurance (Hong Kong) Limited	Hong Kong	100.00	–
QBE Group Shared Services Limited	UK	100.00	–
QBE Holdings (AAP) Pty Limited	Australia	100.00	100.00
QBE Holdings (Americas) Pty Limited	Australia	100.00	100.00
QBE Holdings (EO) Limited	UK	100.00	100.00
QBE Holdings (Europe) Limited	UK	100.00	100.00
QBE Holdings (UK) Limited	UK	100.00	100.00
QBE Holdings Inc	US	100.00	100.00
QBE Hongkong & Shanghai Insurance Limited	Hong Kong	74.47	74.47
QBE Hu KFT (in liquidation)	Hungary	100.00	100.00
QBE Insurance (Australia) Limited	Australia	100.00	100.00
QBE Insurance (Europe) Limited	UK	100.00	100.00
QBE Insurance (Fiji) Limited	Fiji	100.00	100.00
QBE Insurance (International) Limited	Australia	100.00	100.00
QBE Insurance (Malaysia) Berhad	Malaysia	100.00	100.00
QBE Insurance (Philippines) Inc	Philippines	59.00	59.00
QBE Insurance (PNG) Limited	PNG	100.00	100.00
QBE Insurance (Thailand) Co Limited [2]	Thailand		
Thai resident entities		24.83	23.67
Non-Thai resident entities		46.29	24.87
QBE Insurance (Vanuatu) Limited	Vanuatu	100.00	100.00
QBE Insurance (Vietnam) Company Limited	Vietnam	100.00	100.00
QBE Insurance Company (UK) Limited (in liquidation)	UK	100.00	100.00
QBE Insurance Corporation	US	100.00	100.00
QBE Insurance Holdings Pty Limited	Australia	100.00	100.00
QBE International Holdings Limited	Hong Kong	100.00	100.00
QBE Investment Management (UK) Limited	UK	100.00	100.00
QBE Investment Management Pty Limited	Australia	100.00	100.00
QBE Investments (Australia) Pty Limited	Australia	100.00	100.00
QBE Investments (North America) Inc	US	100.00	100.00
QBE Irish Share Incentive Plan [3]	Ireland	–	–
QBE Latin America Insurance Holdings SL	Spain	100.00	100.00
QBE Lenders' Mortgage Insurance Limited	Australia	100.00	100.00
QBE Life (Australia) Limited (formerly CUNA Mutual Life Australia Limited)	Australia	100.00	100.00
QBE Makedonija	Macedonia	65.23	65.23
QBE Management (Ireland) Limited	Ireland	100.00	100.00
QBE Management (Bermuda) Limited	Bermuda	100.00	100.00
QBE Management Inc	US	100.00	100.00

Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2012

36. Related parties CONTINUED

	COUNTRY OF INCORPORATION/ FORMATION	EQUITY HOLDING 2012 %	EQUITY HOLDING 2011 %
QBE Management Services (Philippines) Pty Limited	Australia	**100.00**	100.00
QBE Management Services (UK) Limited	UK	**100.00**	100.00
QBE Management Services Pty Limited	Australia	**100.00**	100.00
QBE Marine and Energy Services Pte Limited	Singapore	**100.00**	100.00
QBE Marine Underwriting Agency Pte Limited	Singapore	**100.00**	100.00
QBE Mortgage Insurance (Asia) Limited	Hong Kong	**100.00**	100.00
QBE of California Insurance Services Inc (formerly Deep South of California Inc)	US	**100.00**	100.00
QBE Optima Insurance Company	Puerto Rico	**100.00**	–
QBE Re (Europe) Limited (formerly QBE Reinsurance (UK) Limited)	UK	**100.00**	100.00
QBE Re Services Pty Limited	Australia	**100.00**	100.00
QBE Regional Companies (NA) Inc	US	**100.00**	100.00
QBE Reinsurance (Bermuda) Limited	Bermuda	**100.00**	100.00
QBE Reinsurance Corporation	US	**100.00**	100.00
QBE Seguros SA	Colombia	**97.88**	97.76
QBE Seguros Colonial SA	Ecuador	**100.00**	100.00
QBE Services Inc	Canada	**100.00**	100.00
QBE SK SRO	Slovakia	**100.00**	100.00
QBE Specialty Insurance Company	US	**100.00**	100.00
QBE SRO	Czech Republic	**100.00**	100.00
QBE Stonington Insurance Company (formerly Stonington Lloyd's Insurance Company)	US	**100.00**	100.00
QBE Stonington Insurance Holdings Inc	US	**100.00**	100.00
QBE Stonington Services Inc	US	**100.00**	100.00
QBE UK Finance III Limited	UK	**100.00**	100.00
QBE UK Finance IV Limited	UK	**100.00**	100.00
QBE UK Share Incentive Plan [3]	UK	**–**	–
QBE Ukraine	Ukraine	**50.00**	50.00
QBE Underwriting Limited	UK	**100.00**	100.00
QBE Underwriting Services (Ireland) Limited	Ireland	**100.00**	100.00
QBE Underwriting Services (UK) Limited	UK	**100.00**	100.00
QBE Underwriting Services Limited	UK	**100.00**	100.00
QBE US Agencies Inc	US	**100.00**	100.00
QBE Workers Compensation (NSW) Limited	Australia	**100.00**	100.00
QBE Workers Compensation (SA) Limited	Australia	**100.00**	100.00
QBE Workers Compensation (VIC) Limited	Australia	**100.00**	100.00
QBEMM Pty Limited	Australia	**100.00**	100.00
Queensland Insurance (Investments) Limited	Fiji	**100.00**	100.00
Regent Insurance Company	US	**100.00**	100.00
Residentsline Limited	UK	**100.00**	100.00
Ridgwell Fox & Partners (Underwriting Management) Limited	UK	**100.00**	100.00
Seattle Specialty Insurance Services Inc	US	**100.00**	100.00
Sinkaonamahasarn Company Limited [2]	Thailand	**49.00**	49.00
SIU LLC	US	**100.00**	100.00
Southern Fire & Casualty Company	US	**100.00**	100.00
Southern Guaranty Insurance Company	US	**100.00**	100.00
Southern Pilot Insurance Company	US	**100.00**	100.00
Southern National Risk Management Inc	US	**100.00**	100.00
Standfast Corporate Underwriters Limited	UK	**100.00**	100.00
Star Trust [3]	Cayman Is	**–**	–
Stonington Insurance Company	US	**100.00**	100.00
Strakh-Consult (in liquidation)	Ukraine	**100.00**	100.00
The MiniBus & Coach Club Limited	UK	**100.00**	100.00
Trade Credit Underwriting Agency NZ Limited	NZ	**100.00**	–
Trade Credit Underwriting Agency Pty Limited	Australia	**100.00**	–
Travelon Pty Limited	Australia	**100.00**	100.00
Underwriting Agencies of Australia (Holdings) Pty Limited	Australia	**100.00**	97.50
Underwriting Agencies of Australia Pty Limited	Australia	**100.00**	97.50

	COUNTRY OF INCORPORATION/ FORMATION	EQUITY HOLDING 2012 %	EQUITY HOLDING 2011 %
Unigard Indemnity Company	US	**100.00**	100.00
Unigard Insurance Company	US	**100.00**	100.00
Universal Underwriting Agencies Pty Limited	Australia	**100.00**	100.00
Westwood Insurance Agency	US	**100.00**	100.00

1 All controlled entities have a 31 December year end.

2 Although the Group has less than a 50% equity interest in the following entities, they have been included in the Group's consolidated financial statements for the following reasons:
- For accounting purposes, the Group has management control of QBE Insurance (Thailand) Co Limited by reference to management agreements.
- The issued share capital of Hyfield Company Limited and Sinkaonamahasarn Company Limited owned by the Group is held by various controlled entities. Other controlled entities have the right to acquire the remaining share capital.

3 Deep South Surplus of Texas LP, Mantis Reef II Limited, Mantis Reef II Pledge Limited, QBE Employee Share Trust, QBE Irish Share Incentive Plan, QBE UK Share Incentive Plan, Star Trust, the QBE Funding Trusts, QBE Capital Funding LP and QBE Capital Funding LP II have been included in the consolidated financial statements as these entities are special purpose entities that exist for the benefit of the Group.

4 All equity in controlled entities is held in the form of shares or through contractual arrangements.

(C) Associates

	COUNTRY OF INCORPORATION	INVESTMENT 2012 %	INVESTMENT 2011 %
Pacific Re Limited	Papua New Guinea	**30.97**	30.97
QBE Del Istmo Reinsurance Company Inc	Panama	**38.37**	38.37
Raheja QBE General Insurance Company	India	**26.00**	26.00

(D) Related party disclosures

All material information required to be disclosed under AASB 124: Related Party Disclosures has been included in the financial statements as follows:

	REFERENCE
Tax sharing agreement	Note 9(B)
Remuneration of key management personnel	Directors' report and note 31
Retirement allowances of key management personnel	Directors' report
Shares and options held by key management personnel	Note 31
Defined benefit plans	Note 24
Guarantees in respect of related parties	Note 32

In the ordinary course of business, various controlled entities receive dividends and purchase and sell investments in public entities in which directors of the company are directors and shareholders.

Notes to the financial statements CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2012

37. Ultimate parent entity financial information

(A) Summarised financial data of QBE Insurance Group Limited (the company)

	COMPANY 2012 US$M	COMPANY 2011 US$M
Profit for the year	**463**	969
Other comprehensive income for the year	**8**	11
Total comprehensive income	**471**	980
Assets due within 12 months[1]	**528**	325
Shares in controlled entities	**17,911**	17,410
Total assets	**18,439**	17,735
Liabilities payable within 12 months[2]	**2,987**	3,153
Borrowings	**2,148**	2,133
Total liabilities	**5,135**	5,286
Net assets	**13,304**	12,449
Share capital	**10,002**	8,939
Equity component of hybrid securities	**134**	132
Options reserve	**100**	90
Retained profits	**3,068**	3,288
Total equity	**13,304**	12,449

1 Includes amounts due from QBE Group companies of $463 million (2011 $304 million).
2 Includes amounts due to QBE Group companies of $2,649 million (2011 $2,956 million).

(B) Guarantees and contingent liabilities

The company had the following contingent liabilities:

	COMPANY 2012 US$M	COMPANY 2011 US$M
Letters of credit issued in support of the Group's participation in Lloyd's of London	**1,361**	1,412
Letters of credit issued in support of insurance provisions of controlled entities	**1,939**	1,175
Guarantees to investors in hybrid securities	**908**	885
Guarantees to investors in capital securities	**1,037**	1,016

Details of the guarantees to investors in hybrid securities and capital securities and security arrangements in respect of borrowings are provided in note 25.

(C) Contractual commitments

The company did not have any contractual commitments in relation to the acquisition of property, plant and equipment at 31 December 2012 (2011 nil).

Directors' declaration

In the directors' opinion:

(a) the financial statements and notes set out on pages 108 to 172 are in accordance with the *Corporations Act 2001*, including:

(i) complying with accounting standards, the Corporations Regulations 2001 and other mandatory professional reporting requirements; and

(ii) giving a true and fair view of the Group's financial position as at 31 December 2012 and of its performance for the financial year ended on that date; and

(b) there are reasonable grounds to believe that the company will be able to pay its debts as and when they become due and payable.

Note 1(A) confirms that the financial statements also comply with International Financial Reporting Standards as issued by the International Accounting Standards Board.

The directors have been given the declarations by the Group Chief Executive Officer and Group Chief Financial Officer required by section 295A of the *Corporations Act 2001*.

Signed in SYDNEY this 26th day of February 2013 in accordance with a resolution of the directors.

BJ Hutchinson AM
Director

JD Neal
Director

Independent auditor's report

TO THE MEMBERS OF QBE INSURANCE GROUP LIMITED

Report on the financial report

We have audited the accompanying financial report of QBE Insurance Group Limited (the company), which comprises the balance sheet as at 31 December 2012, and the income statement, the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year ended on that date, a summary of significant accounting policies, other explanatory notes and the directors' declaration for the QBE Insurance Group (the consolidated entity). The consolidated entity comprises the company and the entities it controlled at the year's end or from time to time during the financial year.

Directors' responsibility for the financial report

The directors of the company are responsible for the preparation of the financial report that gives a true and fair view in accordance with Australian Accounting Standards and the *Corporations Act 2001* and for such internal control as the directors determine is necessary to enable the preparation of the financial report that is free from material misstatement, whether due to fraud or error. In note 1, the directors also state, in accordance with Accounting Standard AASB 101 Presentation of Financial Statements, that the financial statements comply with International Financial Reporting Standards.

Auditor's responsibility

Our responsibility is to express an opinion on the financial report based on our audit. We conducted our audit in accordance with Australian Auditing Standards. These Auditing Standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the financial report is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial report.

Our procedures include reading the other information in the annual report to determine whether it contains any material inconsistencies with the financial report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Independence

In conducting our audit, we have complied with the independence requirements of the *Corporations Act 2001*.

Auditor's opinion

In our opinion:

(a) the financial report of QBE Insurance Group Limited is in accordance with the *Corporations Act 2001*, including:

(i) giving a true and fair view of the consolidated entity's financial position as at 31 December 2012 and of its performance for the year ended on that date; and

(ii) complying with Australian Accounting Standards (including the Australian Accounting Interpretations) and the Corporations Regulations 2001; and

(b) the financial report and notes also comply with International Financial Reporting Standards as disclosed in note 1.

Report on the Remuneration Report

We have audited the remuneration report included in pages 84 to 104 of the directors' report for the year ended 31 December 2012. The directors of the company are responsible for the preparation and presentation of the remuneration report in accordance with section 300A of the *Corporations Act 2001*. Our responsibility is to express an opinion on the remuneration report, based on our audit conducted in accordance with Australian Auditing Standards.

Auditor's opinion

In our opinion, the remuneration report of QBE Insurance Group Limited for the year ended 31 December 2012, complies with section 300A of the *Corporations Act 2001*.

Matters relating to the electronic presentation of the audited financial report

This auditor's report relates to the financial report and remuneration report of QBE Insurance Group Limited (the company) for the year ended 31 December 2012 included on the QBE Insurance Group Limited web site. The company's directors are responsible for the integrity of the QBE Insurance Group Limited web site. We have not been engaged to report on the integrity of this web site. The auditor's report refers only to the financial report and remuneration report named above. It does not provide an opinion on any other information which may have been hyperlinked to/from the financial report or the remuneration report. If users of this report are concerned with the inherent risks arising from electronic data communications they are advised to refer to the hard copy of the audited financial report and remuneration report to confirm the information included in the audited financial report and remuneration report presented on this web site.

PricewaterhouseCoopers

PricewaterhouseCoopers

K.G. Smith

KG Smith
Partner

Sydney
26 February 2013

Shareholder information

QBE is incorporated in Australia, is listed on the Australian Securities Exchange (ASX) and trades under the code "QBE".

Annual General Meeting (AGM)

Time: 10am Wednesday, 27 March 2013
Wesley Conference Centre, 220 Pitt Street,
Sydney NSW 2000, Australia

Online proxy voting is available through the Link investor service centre website.

Voting rights of ordinary shares

The constitution provides for votes to be cast:

- on a show of hands, one vote for each shareholder; and
- on a poll, one vote for each fully paid ordinary share.

Shareholder information and enquiries

Most enquiries and correspondence regarding shareholdings can be directed to QBE's share registrar:

Link Market Services Limited (Link)
Locked Bag A14
Sydney South NSW 1235 Australia

Level 12, 680 George Street
Sydney NSW 2000 Australia

Telephone: 1800 680 188 (within Australia)
Telephone: +61 1800 680 188 (outside Australia)
Facsimile: +61 2 9287 0303

Website: www.linkmarketservices.com.au
(Link investor service centre website)
Email: qbe@linkmarketservices.com.au

For security purposes, please quote your Securityholder Reference Number (SRN) or Holder Identification Number (HIN).

If you are broker (CHESS) sponsored, queries relating to incorrect registrations and changes to name and/or address can only be processed by your stockbroker. Link cannot assist you with these changes.

Relevant interests register

Orient Capital Pty Limited of Level 12, 680 George Street, Sydney NSW 2000, Australia, maintains QBE's register of information about relevant interests. The register contains any responses from custodians on and after 1 January 2005 to searches relating to the beneficial ownership of QBE's shares. Shareholders and other parties can telephone Orient Capital on +61 2 8280 6000 or facsimile on +61 2 8280 6001 if they wish to inspect this register.

Shareholding details online

View your shareholdings and update your details online either through investor login or the portfolio login at the Link investor service centre website. By registering your portfolio, you can consolidate multiple shareholdings in various companies managed by Link Market Services under one login. Updating holding details is simplified under the portfolio login.

You may receive dividend statements, notices of meetings, annual reports and major company announcements electronically by registering your email address at the Link investor service centre website. For more information, please go to Link's website: www.linkmarketservices.com.au.

Annual report mailing list

Amendments to the *Corporations Act 2001* have removed the obligation for companies to mail an annual report to shareholders. To improve efficiency, save costs and reduce our impact on the environment by minimising unnecessary use of paper and printing resources, the annual report is published on our website at www.qbe.com.

If you wish to receive a hard copy of the annual report, please notify Link in writing or select the annual report option under "communications" on the Link investor service centre website.

The half yearly results summary to 30 June 2013 will be mailed with the interim dividend. The next annual report for the year ending 31 December 2013 will be distributed in March 2014. QBE does not produce a concise financial report.

Tax File Number (TFN), Australian Business Number (ABN) or exemption – Australian residents

You can confirm whether you have lodged your TFN, ABN or exemption by visiting the Link investor service centre website. If you choose not to lodge these details, QBE is obliged to deduct tax at the highest marginal rate (plus the Medicare levy) from the unfranked portion of dividends paid. Australian shareholders living abroad should advise Link of their resident status. TFN forms are available from Link or can be downloaded from either the QBE or Link websites.

Dividends

QBE encourages shareholders to have cash dividends credited directly to a bank, building society or credit union account in either Australia or New Zealand to eliminate delays in funds clearance and to significantly reduce the risk of loss or theft. A dividend advice confirming the deposit details is either mailed to you or is available online on the payment date.

Eligible shareholders can participate in QBE's Dividend Reinvestment Plan (DRP) and Bonus Share Plan (BSP) when the plans are active. The DRP enables you to subscribe for additional shares. The BSP is a bonus share plan whereby the dividend entitlement is forgone for bonus shares in lieu of the dividend. In order to participate in either the DRP or BSP, you must have a minimum shareholding of 100 shares.

Participants may change their election to participate in the DRP and BSP at any time. DRP/BSP election cut-off dates and application forms are available from QBE's website.

Conduit foreign income (CFI)

Shareholders not resident in Australia will receive CFI credits in respect of the whole unfranked portion of QBE dividends. These credits exempt non-resident shareholders from Australian withholding tax.

Unpresented cheques/unclaimed money

Under the Unclaimed Moneys Act, unclaimed dividends must be given to the New South Wales state treasury. It is very important that shareholders bank outstanding dividend cheques promptly and advise Link immediately of changes of address or bank account details.

Shareholder information CONTINUED

American Depository Receipts (ADRs)

BNY Mellon sponsors QBE's level 1 American Depository Receipts Program (ADR) in the United States of America. QBE's ADRs are traded on the over-the-counter (OTC) securities market in the US under the symbol QBIEY and CUSIP: 74728G605. One ADR represents one ordinary share in QBE. US OTC market information is available at:
www.otcmarkets.com/stock/QBIEY/quote.

QBE's ADR information with BNY Mellon can also be viewed at:
http://www.adrbnymellon.com/dr_profile.jsp?cusip=74728G605#

ADR holders seeking information on their shareholding should contact:

BNY Mellon Shareowner Services
P.O. Box 358516
Pittsburgh, PA 15252-8516

International callers telephone: +1-201-680-6825
Email: shrrelations@bnymellon.com

Toll free telephone number for callers within USA:
1-888-BNY-ADRS (1-888-269-2377)

Privacy legislation

Chapter 2C of the *Corporations Act 2001* requires information about you as a security holder (including your name, address and details of the securities you hold) to be included in QBE's share register. These details must continue to be included in the public register even if you cease to be a security holder. A copy of the privacy policy is available on Link's website.

Registered office

QBE Insurance Group Limited
Level 2, 82 Pitt Street
Sydney NSW 2000 Australia

Telephone: +61 2 9375 4444
Facsimile: +61 2 9235 3166
Website: www.qbe.com

QBE website

QBE's website provides investors with information about QBE including annual reports, half yearly reports and announcements to the ASX. The website also offers regular QBE share price updates, a calendar of events, a history of QBE's dividends, access to standard forms (change of address, direct credit advice and more) and online access to your shareholding details via the share registry.

Recent QBE dividends

DATE PAID	TYPE	RECORD DATE	AUSTRALIAN CENTS PER SHARE	FRANKING %
14 September 2006	interim	1 September 2006	40	60
2 April 2007	final	14 March 2007	55	60
21 September 2007	interim	10 September 2007	57	60
26 March 2008	final	6 March 2008	65	50
17 September 2008	interim	1 September 2008	61	20
31 March 2009	final	11 March 2009	65	20
22 September 2009	interim	1 September 2009	62	20
30 March 2010	final	10 March 2010	66	20
22 September 2010	interim	30 August 2010	62	15
11 April 2011	final	10 March 2011	66	10
23 September 2011	interim	31 August 2011	62	10
30 March 2012	final	9 March 2012	25	25
24 September 2012	interim	30 August 2012	40	15

Top 20 shareholders as at 31 January 2013

NAME	NUMBER OF SHARES	% OF TOTAL[1]
HSBC Custody Nominees (Australia) Limited	378,774,874	31.65
JP Morgan Nominees Australia Limited	162,845,129	13.61
National Nominees Limited	138,477,348	11.57
BNP Paribas Noms Pty Ltd	74,996,676	6.27
Citicorp Nominees Pty Limited	67,769,329	5.66
AMP Life Limited	7,660,211	0.64
Australian Foundation Investment Company Limited	6,911,891	0.58
QIC Limited	4,616,927	0.39
Argo Investments Limited	4,228,499	0.35
UBS Wealth Management Australia Nominees Pty Ltd	4,018,430	0.34
Bond Street Custodians Limited	3,852,043	0.32
Navigator Australia Ltd	3,164,053	0.26
Milton Corporation Limited	2,705,729	0.23
Nulis Nominees (Australia) Limited	2,415,970	0.20
RBC Investor Services Australia Nominees Pty Limited	1,812,221	0.15
Diversified United Investment Limited	1,575,000	0.13
Questor Financial Services Limited	1,566,789	0.13
Avanteos Investments Limited	1,527,701	0.13
Djerriwarrh Investments Limited	1,486,303	0.12
Australian United Investment Company Limited	1,450,000	0.12
Total	871,855,123	72.85

1 Percentage of total at date of notice.

Shareholder information CONTINUED

QBE substantial shareholders as at 31 January 2013

NAME	NUMBER OF SHARES	% OF TOTAL[1]	DATE OF NOTICE
Aberdeen Asset Management plc (and its associated entities)	166,606,820	13.92	8 January 2013
Commonwealth Bank of Australia Limited	111,084,158	9.28	19 December 2012

1 Percentage of total at date of notice.

Distribution of shareholders and shareholdings as at 31 January 2013

SIZE OF HOLDING	NUMBER OF SHAREHOLDERS	%	NUMBER OF SHARES	%
1 to 1,000	88,471	55.92	40,313,394	3.37
1,001 to 5,000	59,113	37.37	126,626,488	10.58
5,001 to 10,000	6,903	4.36	47,711,807	3.99
10,001 to 100,000	3,545	2.24	73,903,019	6.17
100,001 and over	174	0.11	908,192,874	75.89
Total	158,206	100.00	1,196,747,582	100.00

Shareholdings of less than a marketable parcel as at 31 January 2013

	SHAREHOLDERS		SHARES	
	NUMBER	% OF TOTAL	NUMBER	% OF TOTAL
Holdings of 42 or fewer shares	4,530	2.86	99,791	0.01

Financial calendar

Financial calendar

YEAR	MONTH	DAY	ANNOUNCEMENT
2013	February	26	• Notice of meeting and proxy form mailed to shareholders
		26	• Profit and dividend announcement for the year ended 31 December 2012 annual report available on website
	March	4	• Shares begin trading ex-dividend
		8	• Record date for determining shareholders' entitlement to 2012 final dividend
		27	• Annual General Meeting
		28	• 2012 final dividend paid
	June	30	• Half year end
	August	20 *	• Profit and dividend announcement for the six months ending 30 June 2013
		27 *	• Shares begin trading ex-dividend
	September	2 *	• Record date for determining shareholders' entitlement to 2013 interim dividend
		23 *	• 2013 interim dividend paid
	December	31	• Year end

* Dates shown are provisional and may be subject to change.

Material announcements to the ASX

YEAR	MONTH	DAY	ANNOUNCEMENT
2013	January	9	• Appointment of Chief Executive Officer, QBE Asia Pacific Operations
2012	December	12	• Announced issue of US$500 million subordinated debt
	November	12	• Market update on Superstorm Sandy and 2012 forecast result
	October	24	• Citi Australian investment conference presentation
		15	• QBE European Operations investor and analyst day presentation
		12	• QBE North American Operations investor and analyst day presentation
		5	• Announced former CEO to join Steadfast board
	September	20	• Issued provisional 2013 financial calendar
		7	• Announced interim dividend details
	August	17	• Announced appointment of John Neal as Group Chief Executive Officer following the retirement of Frank O'Halloran
		17	• Announced half year result
		15	• Announced Group Chief Executive Officer's exit arrangements
		14	• Announced non-executive director changes
	July	9	• Announced completed acquisition in Hong Kong
	May	3	• Announced completed acquisition in Argentina
		2	• Announced Group Executive structure changes
	April	12	• Announced issuance of shares under the share purchase plan
	March	21	• Trading policy update
		19	• Announced final dividend and dividend pricing details
		7	• Announced acquisition in Latin America and Hong Kong
		6	• Settlement of institutional placement
		5	• AGM notice of meeting
	February March April	29 28 4	• Announced A$150 million share purchase plan and subsequent updates
	February	29	• Announced completion of A$450 million institutional share placement
		28	• Announced 2011 results
		28	• Announced Group Chief Executive Officer succession
	January April May November	25 5/13 3/10 23	• Announced changes to directors' interests in the company
	January February March August November	12 28 6 17 12	• Market updates
	January February	12 28	• Announced trading halts

10 year history

FOR THE YEAR ENDED 31 DECEMBER

		2012	2011	2010	2009	2008	2007	2006	2005	2004	2003
Gross written premium	US$M	**18,434**	18,291	13,629	11,239	11,015	10,391	7,839	7,171	6,484	5,407
Gross earned premium	US$M	**18,341**	17,840	13,432	10,943	10,773	10,353	7,610	6,990	6,340	5,061
Net earned premium	US$M	**15,798**	15,359	11,362	9,446	9,293	8,552	6,166	5,630	5,016	3,909
Claims ratio	%	**66.0**	68.2	59.9	60.3	57.6	54.3	55.8	59.9	61.3	63.3
Commission ratio	%	**16.2**	14.9	15.5	16.2	17.2	18.5	17.0	16.9	17.5	18.2
Expense ratio	%	**14.9**	13.7	14.3	13.1	13.7	13.1	12.5	12.3	12.4	12.3
Combined operating ratio	%	**97.1**	96.8	89.7	89.6	88.5	85.9	85.3	89.1	91.2	93.8
Investment income											
before investment gains/losses	US$M	**712**	957	660	838	1,237	839	575	470	421	252
after investment gains/losses	US$M	**1,216**	776	659	1,159	1,199	1,132	732	631	486	323
Financing and other costs	US$M	**324**	275	222	191	223	189	115	87	102	56
Insurance profit	US$M	**1,262**	1,085	1,703	1,609	1,830	1,895	1,351	982	686	406
Insurance profit to net earned premium	%	**8.0**	7.1	15.0	17.0	19.7	22.2	21.9	17.4	13.7	10.4
Operating profit											
before income tax	US$M	**941**	868	1,551	1,891	2,028	2,135	1,521	1,161	825	495
after income tax and non-controlling interests	US$M	**761**	704	1,278	1,532	1,558	1,612	1,121	832	634	370
Number of shares on issue [1]	millions	**1,197**	1,116	1,052	1,025	987	886	819	794	745	672
Shareholders' funds	US$M	**11,358**	10,386	10,311	9,164	7,834	7,435	4,962	3,735	3,155	2,491
Total assets	US$M	**50,762**	46,737	41,386	36,723	33,967	34,737	25,079	21,753	19,592	15,372
Net tangible assets per share [1]	US$	**4.47**	3.92	4.76	4.63	4.02	5.99	4.70	3.49	3.21	3.14
Borrowings to shareholders' funds [1]	%	**43.4**	45.8	31.5	29.1	32.9	40.8	37.6	41.8	44.8	40.3
Basic earnings per share [1]	US cents	**64.9**	64.7	123.2	152.1	174.1	187.7	139.7	108.6	91.1	56
Diluted earnings per share	US cents	**61.6**	61.3	119.6	149.9	172.2	181.8	131.1	99.7	80.7	50.2
Return on average shareholders' funds	%	**7.0**	6.8	13.1	18.0	22.3	26.0	25.8	24.2	22.5	17.8
Dividend per share	Australian cents	**50**	87	128	128	126	122	95	71	54	42
Dividend payout	A$M	**593**	956	1,336	1,306	1,187	1,068	774	556	392	281
Cash flow from operations	US$M	**2,753**	2,139	1,362	1,344	1,886	1,988	1,541	1,514	1,561	1,353
Total investments and cash [2]	US$M	**31,525**	28,024	25,328	22,448	19,995	21,552	15,755	12,891	11,709	8,888

1 Reflects shares notified to the Australian Securities Exchange.

2 Includes financial assets at fair value through the income statement, cash and cash equivalents, investment properties and property held for sale.

Glossary of insurance terms

Accident year experience	The matching of all claims occurring (regardless of when reported or paid) during a given 12 month period with all premium earned over the same period.
Acquisition cost	The total of net commission and operating expenses incurred in the generation of net earned premium and often expressed as a percentage of net earned premium. The operating expenses are after the transfer of direct costs for claims settlement expenses which are included in net incurred claims expense.
Attritional claims ratio	Total of all claims with a net cost of less than $2.5 million as a percentage of net earned premium.
Admitted insurance	Insurance written by an insurer that is admitted (or licensed) to do business in the (US) state in which the policy was sold.
Agent	One who negotiates contracts of insurance or reinsurance as an insurance company's representative i.e. the agent's primary responsibility is to the insurance carrier, not the insurance buyer.
Broker	One who negotiates contracts of insurance or reinsurance on behalf of an insured party, receiving a commission from the insurer or reinsurer for placement and other services rendered. In contrast with an agent, the broker's primary responsibility is to the insurance buyer not the insurance carrier.
Capacity	In relation to a Lloyd's member, the maximum amount of insurance premiums (gross of reinsurance but net of brokerage) which a member can accept. In relation to a syndicate, the aggregate of each member's capacity allocated to that syndicate.
Casualty insurance	Insurance that is primarily concerned with the losses resulting from injuries to third persons or their property (i.e. not the policyholder) and the resulting legal liability imposed on the insured. It includes, but is not limited to, general liability, employers' liability, workers' compensation, professional liability, public liability and motor liability insurance.
Catastrophe reinsurance	A reinsurance contract (often in the form of excess of loss reinsurance) that, subject to specified limits and retention, compensates the ceding insurer for losses related to an accumulation of claims resulting from a catastrophe event or series of events.
Claim	The amount payable under a contract of insurance or reinsurance arising from a loss relating to an insured event.
Claims incurred	The aggregate of all claims paid during an accounting period adjusted by the change in the claims provision for that accounting period.
Claims provision	The estimate of the most likely cost of settling present and future claims and associated claims adjustment expenses plus a risk margin to cover possible fluctuation of the liability.
Claims ratio	Net claims incurred as a percentage of net earned premium.
Combined operating ratio	The sum of the claims ratio, commission ratio and expense ratio. A combined operating ratio below 100% indicates profitable underwriting results. A combined operating ratio over 100% indicates unprofitable underwriting results.
Commercial lines	Refers to insurance for businesses, professionals and commercial establishments.
Commission	Fee paid to an agent or broker as a percentage of the policy premium. The percentage varies widely depending on coverage, the insurer and the marketing methods.
Commission ratio	Net commission expense as a percentage of net earned premium.
Credit spread	The difference in yield between a corporate bond and a reference yield (e.g. LIBOR, BBSW or a fixed sovereign bond yield).
Credit spread duration	The weighted average term of cash flows for a corporate bond. It is used to measure the price sensitivity of a bond to changes in credit spreads.
Deductible	The amount or proportion of some or all losses arising under an insurance contract that the insured must bare.
Deferred acquisition costs	Acquisition costs relating to the unexpired period of risk of contracts in force at the balance sheet date which are carried forward from one accounting period to subsequent accounting periods.
Excess of loss reinsurance	A form of reinsurance in which, in return for a premium, the reinsurer accepts liability for claims settled by the original insurer in excess of an agreed amount, generally subject to an upper limit.
Expense ratio	Underwriting and administrative expenses as a percentage of net earned premium.
Facultative reinsurance	The reinsurance of individual risks through a transaction between the reinsurer and the cedant (usually the primary insurer) involving a specified risk.
General insurance	Generally used to describe non-life insurance business including property and casualty insurance.
Gross claims incurred	The amount of claims incurred during an accounting period before deducting reinsurance recoveries.

Gross earned premium (GEP)	The total premium on insurance earned by an insurer or reinsurer during a specified period on premiums underwritten in the current and previous underwriting years.
Gross written premium (GWP)	The total premium on insurance underwritten by an insurer or reinsurer during a specified period, before deduction of reinsurance premium.
Incurred but not reported (IBNR)	Claims arising out of events that have occurred before the end of an accounting period but have not been reported to the insurer by that date.
Insurance profit	The sum of the underwriting result and investment income on assets backing policyholders' funds.
Insurance profit margin	The ratio of insurance profit to net earned premium.
Inward reinsurance	The reinsurance or assumption of risks written by another insurer.
Large individual risk and catastrophe claims ratio	The aggregate of claims each with a net cost of $2.5 million or more as a percentage of net earned premium.
Lenders' mortgage insurance (LMI)	A policy that protects the lender (e.g. a bank) against non-payment or default on a residential property loan.
Lead/non-lead underwriter	A lead underwriter operates in the subscription market and sets the terms and price of a policy. The follower or non-lead is an underwriter of a syndicate or an insurance company that agrees to accept a proportion of a given risk on terms set by the lead underwriter.
Lender-placed insurance (LPI)	Coverage obtained by the lender when the customer's voluntary home building insurance has lapsed, been cancelled or proof of the customer's insurance has not been received. Coverage is required by the mortgage contract to protect the lender's interest in the property if damage was to occur and the customer had not maintained adequate coverage.
Letters of credit (LoC)	Written undertaking by a financial institution to provide funding if required.
Lloyd's	Insurance and reinsurance market in London. It is not a company but is a society of individuals and corporate underwriting members.
Lloyd's managing agent	An underwriting agent which has permission from Lloyd's to manage one or more syndicates and carry on underwriting and other functions for a member.
Long tail	Classes of insurance business involving coverage for risks where notice of a claim may not be received for many years and claims may be outstanding for more than one year before they are finally quantifiable and settled by the insurer.
Managing General Agent (MGA)	A wholesale insurance agent with the authority to accept placements from (and often to appoint) retail agents on behalf of an insurer. MGAs generally provide underwriting and administrative services such as policy issuance on behalf of the insurers they represent. Some may handle claims.
Maximum event retention (MER)	An estimate of the largest claim to which an insurer will be exposed (taking into account the probability of that loss event at a return period of one in 250 years) due to a concentration of risk exposures, after netting off any potential reinsurance recoveries and inward and outward reinstatement premiums.
Multi-peril crop scheme	US federally regulated crop insurance protecting against crop yield losses by allowing participating insurers to insure a certain percentage of historical crop production.
Net claims incurred	The amount of claims incurred during an accounting period after deducting reinsurance recoveries.
Net claims ratio	Net claims incurred as a percentage of net earned premium.
Net earned premium (NEP)	Net written premium adjusted by the change in net unearned premium for a year.
Net investment income	Gross investment income net of foreign exchange gains and losses and investment expenses.
Net written premium (NWP)	The total premium on insurance underwritten by an insurer during a specified period after the deduction of premium applicable to reinsurance.
Outstanding claims provision	The amount of provision established for claims and related claims expenses that have occurred but have not been paid.
Personal lines	Insurance for individuals and families, such as private motor vehicle and homeowners insurance.
Policyholders' funds	Those financial assets held to fund the insurance provisions of the Group.
Premium	Amount payable by the insured or reinsured in order to obtain insurance or reinsurance protection.
Prescribed Capital Amount (PCA)	This comprises the sum of the capital charges for asset risk, asset concentration risk, insurance concentration risk and operational risk as required by APRA. The PCA must be disclosed at least annually.
Probability of adequacy	A statistical measure of the level of confidence that the outstanding claims provision will be sufficient to pay claims as and when they fall due.

Glossary of insurance terms CONTINUED

Proportional reinsurance	A type of reinsurance in which the original insurer and the reinsurer share claims in the same proportion as they share premiums.
Prudential Capital Requirement (PCR)	The sum of the Prescribed Capital Account (PCA) plus any supervisory adjustment determined by APRA. The PCR may not be disclosed.
Recoveries	The amount of claims recovered from reinsurance, third parties or salvage.
Reinsurance	An agreement to indemnify a primary insurer by a reinsurer in consideration of a premium with respect to agreed risks insured by the primary insurer. The enterprise accepting the risk is the reinsurer and is said to accept inward reinsurance. The enterprise ceding the risks is the cedant or ceding company and is said to place outward reinsurance.
Reinsurance to close	A reinsurance agreement under which members of a syndicate, for a year of account to be closed, are reinsured by members who comprise that or another syndicate for a later year of account against all liabilities arising out of insurance business written by the reinsured syndicate.
Reinsurer	The insurer that assumes all or part of the insurance or reinsurance liability written by another insurer. The term includes retrocessionaires, being insurers that assume reinsurance from a reinsurer.
Retention	That amount of liability for which an insurance company will remain responsible after it has completed its reinsurance arrangements.
Retrocession	Reinsurance of a reinsurer by another reinsurance carrier.
Short tail	Classes of insurance business involving coverage for risks where claims are usually known and settled within 12 months.
Solvency ratio	Ratio of net tangible assets to net earned premium. This is an important industry indicator in assessing the ability of general insurers to settle their existing liabilities.
Stop loss reinsurance	A form of excess of loss reinsurance which provides that the reinsurer will pay some or all of the reassured's losses in excess of a stated percentage of the reassured's premium income, subject (usually) to an overall limit of liability.
Surplus (or excess) lines insurers	In contrast to "admitted insurers", every US state also allows non-admitted (or "surplus" or "excess lines") carriers to transact business where there is a special need that cannot or will not be met by admitted carriers. The rates and forms of non-admitted carriers generally are not regulated in that state, nor are the policies back-stopped by the state insolvency fund covering admitted insurance. Brokers must inform insurers if their insurance has been placed with a non-admitted insurer.
Survival ratio	A measure of how many years it would take for dust disease claims to exhaust the current level of claims provision. It is calculated on the average level of claims payments in the last three years.
Syndicate	A member or group of members, underwriting insurance business at Lloyd's through the agency of a managing agent.
Treaty reinsurance	Reinsurance of risks in which the reinsurer is obliged by agreement with the cedant to accept, within agreed limits, all risks to be underwritten by the cedant within specified classes of business in a given period of time.
Underwriting	The process of reviewing applications submitted for insurance or reinsurance coverage, deciding whether to provide all or part of the coverage requested and determining the applicable premium.
Underwriting expenses	The aggregate of policy acquisition costs, excluding commissions, and the portion of administrative, general and other expenses attributable to underwriting operations.
Underwriting result	The amount of profit or loss from insurance activities exclusive of net investment income and capital gains or losses.
Underwriting year	The year in which the contract of insurance commenced or was underwritten.
Unearned premium	The portion of a premium representing the unexpired portion of the contract term as of a certain date.
Written premium	Premiums written, whether or not earned, during a given period.

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