



QBE INSURANCE GROUP  
ANNUAL REPORT DECEMBER 2011

A clear vision supporting a  
diversified, entrepreneurial, specialist, global business.



QBE has grown and evolved over its long history and achieved its objective to become internationally recognised as a highly successful general insurance and reinsurance Group.

The markets in which we operate are constantly changing and conditions impacting the global insurance industry will continue to be challenging. With our many years of experience and a strong entrepreneurial culture, we are confident that we have the flexibility, resilience and resources to successfully navigate the terrain ahead of us.

As we enter 2012, we have refreshed our vision, setting ourselves new aspirational goals reflecting the Group's scale and diversity.

## OUR VISION

To be the most successful global insurer and reinsurer in the eyes of our customers, our people, our shareholders and the community.

- We will grow and deliver market-leading profitability in all our chosen businesses.
- We will excel in the design and delivery of our products and services.
- We will develop “can do” people who live our essential behaviours in everything they do.
- We will increase the long-term wealth of our shareholders.

## OUR VISION IS UNDERPINNED BY OUR FOUNDATIONAL VALUES

Our values which underpin the unique QBE culture are demonstrated through QBE's nine essential behaviours known by the acronym OPENUP QBE. These behaviours and attitudes, as applied by QBE people on a day to day basis, are the common threads binding together the diversity of our worldwide organisation.

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# 2011 IN REVIEW

## GROSS WRITTEN PREMIUM

2011	18,291
2010	13,629
2009	11,239
2008	11,015
2007	10,391

US\$18,291 million, up 34%

## NET EARNED PREMIUM

2011	15,359
2010	11,362
2009	9,446
2008	9,293
2007	8,552

US\$15,359 million, up 35%

## UNDERWRITING PROFIT

2011	494
2010	1,168
2009	981
2008	1,069
2007	1,204

US\$494 million, down 58%

## CASH FLOW FROM OPERATIONS

2011	2,139
2010	1,362
2009	1,344
2008	1,886
2007	1,988

US\$2,139 million, up 57%

## NET PROFIT AFTER INCOME TAX

2011	704
2010	1,278
2009	1,532
2008	1,558
2007	1,612

US\$704 million, down 45%

## SHAREHOLDERS' FUNDS

2011	10,386
2010	10,311
2009	9,164
2008	7,834
2007	7,435

US\$10,386 million, up 1%

## GROUP OPERATING PERFORMANCE

FOR THE YEAR ENDED 31 DECEMBER		2011	2010	% CHANGE
Gross written premium	US\$M	18,291	13,629	34
Net earned premium	US\$M	15,359	11,362	35
Combined operating ratio (COR)	%	96.8	89.7	
Insurance profit	US\$M	1,085	1,703	(36)
Insurance profit to net earned premium	%	7.1	15.0	
Underwriting profit	US\$M	494	1,168	(58)
Net investment income (including foreign exchange gains)	US\$M	776	659	18
Cash flow from operations	US\$M	2,139	1,362	57

## PROFIT AND DIVIDEND

FOR THE YEAR ENDED 31 DECEMBER		2011	2010	% CHANGE
Net profit after income tax	US\$M	704	1,278	(45)
Return on average shareholders' funds	%	6.8	13.1	
Basic earnings per share <sup>(1)</sup>	US cents	64.7	123.2	(47)
Diluted earning per share	US cents	61.3	119.6	(49)
Dividend per share	Australian cents	87.0	128.0	(32)
Dividend payout	A\$M	956	1,336	(28)

(1) Reflects shares notified to the Australian Securities Exchange.

# Chairman's report

“ Insurance has always been a cyclical business. Whilst we are disappointed by the reduction in net profit in 2011, the outlook for 2012 is positive due to increasing premium rates, reduced exposure to certain catastrophe-prone business and our comprehensive reinsurance protections. ”

**BELINDA HUTCHINSON AM** CHAIRMAN

## SHAREHOLDERS' HIGHLIGHTS

FOR THE YEAR ENDED 31 DECEMBER		2011	2010
Underwriting profit	US\$M	494	1,168
Net profit after income tax	US\$M	704	1,278
Basic earnings per share <sup>(1)</sup>	US cents	64.7	123.2
Diluted earnings per share	US cents	61.3	119.6
Dividend payout	A\$M	956	1,336
Dividend per share <sup>(1)</sup>	Australian cents	87.0	128.0
Net tangible assets per share <sup>(1)</sup>	US\$	3.92	4.76
Cash flow from operations	US\$M	2,139	1,362
Total investments and cash <sup>(2)</sup>	US\$M	28,024	25,328
Total assets	US\$M	46,737	41,386
Shareholders' funds	US\$M	10,386	10,311
Return on average shareholders' funds	%	6.8	13.1
Borrowings to shareholders' funds	%	45.8	31.5
Capital adequacy multiple		1.5	1.6

(1) Reflects shares notified to the Australian Securities Exchange.

(2) Includes financial assets, cash, investment properties and property held for sale.



NET PROFIT  
AFTER INCOME TAX

**US\$704M**

Down **45%** from last year

DIVIDEND PER SHARE

**87 Australian cents**

Down **32%** from last year

CASH FLOW  
FROM OPERATIONS

**US\$2,139M**

Up **57%** from last year

## 2011 RESULTS

QBE and the general insurance industry globally faced significant challenges in 2011 due to an abnormally large number of natural disasters and difficult investment market conditions resulting from the European debt problems. Your board and management are disappointed to report a reduction in net profit after income tax from US\$1,278 million in 2010 to US\$704 million.

The major contributor to this result was the increased frequency and severity of natural disasters around the world, which led to a record level of catastrophe claims for QBE and the industry. The major events impacting QBE included the two Christchurch earthquakes; the Japanese earthquake and tsunami; in Australia, storms and bushfires; in the US, tornadoes, hurricanes, wildfires and floods; and the major Thailand floods. Munich Re has estimated that the global economic cost of these catastrophes in 2011 was around US\$380 billion, with the cost to the insurance industry around US\$105 billion – the largest amount in the history of the industry.

In summary, catastrophe claims cost QBE US\$1,733 million in 2011 compared with US\$580 million in 2010. The detailed financial impact of these events is provided in the chief executive officer's report.

As a general insurer, QBE is in the business of managing risk. QBE manages its underwriting risk from catastrophe claims through the processes of business selection; setting of premium rates and terms and conditions; and through reinsurance. Over the last 10 years, this risk management strategy has been effective in protecting the Group from large individual risks and catastrophe claims. In 2011, large individual risk and catastrophe claims were 15.3% of QBE's net earned premium. This led to the Group reporting a combined operating ratio of 96.8% compared with its target of below 90%. Although QBE failed to meet its internally set objectives, it outperformed the majority of its global competitors that have reported to date.

In 2011, the Group implemented a new, more comprehensive multi-year reinsurance program which provided additional benefits of US\$219 million when compared with the 2010 reinsurance program had it been in place in 2011.

QBE has always reviewed its experience from catastrophes and implemented actions to improve the reward from risks underwritten. Following the 2011 catastrophes, further action has been taken to reduce QBE's catastrophe-exposed business in certain areas; increase premium rates and deductibles; and purchase additional reinsurance cover to the extent available in the market. Based on experience, it is unlikely that QBE would be faced with a similar frequency of catastrophes in 2012; however, the Group has now reduced its potential exposure to a similar set of occurrences.

In addition to the increased cost of catastrophe claims, the Group was impacted by the deterioration in global investment markets in the second half of the year due to the European sovereign and bank debt problems. QBE's result was impacted in two ways. Firstly, QBE's underwriting profit was reduced by approximately US\$252 million due to the significant reduction in risk-free rates used to discount outstanding claims. Under Australian accounting standards, insurers are required to discount claims provisions, with lower risk-free rates reducing reported profit. QBE's competitors in Europe and the US are not required to discount their claims provisions as they report under different financial reporting standards.

Profit was also impacted by lower investment yields and increased credit spreads on the Group's high quality bond portfolio. QBE holds around US\$19 billion in cash and fixed interest securities to support its obligations to policyholders. A substantial proportion of these are denominated in US dollars, sterling and euros due to our operations in the US and Europe where local regulators require investments to be held in these local currencies. The gross yield on our investments and cash, including foreign exchange gains, was 3.1%, compared with 2.9% last year. Overall, net investment income was US\$776 million compared with US\$659 million last year.

Net investment income of US\$776 million was reduced by US\$241 million of mark to market losses due to rising credit spreads on the Group's bond portfolio. Under Australian accounting standards, insurers are required to fair value investments backing policyholders' funds through the income statement. QBE's competitors based in the US and Europe are not subject to the same requirement.

On a positive note, QBE's conservative investment strategy has meant that it has again recorded no permanent diminution in the value of its fixed income securities, despite ongoing turmoil in the fixed income markets. In addition, QBE reduced its exposure to equities which minimised the potential for losses from the portfolio.

In summary, the record catastrophes claims, lower risk-free rates used for discounting outstanding claims and lower investment income reduced QBE's insurance profit margin to 7.1% from 15.0% in 2010 and significantly reduced net profit after tax.

Diluted earnings per share fell 49% to 61.3 US cents per share in 2011 from 119.6 US cents per share last year due to the lower net profit after tax. The return on average shareholders' funds for the year was 6.8% compared with 13.1% in 2010. QBE's five year average return on shareholders' funds of 16.0% and combined operating ratio of 90.9% outperformed the majority of the top 50 global insurers and reinsurers.

### DIVIDEND AND DIVIDEND POLICY

In response to the impact of the record level of catastrophes and lower interest rates on net profit after tax, the directors took the difficult but prudent decision to reduce the final dividend to 25 Australian cents per share from 66 Australian cents per share in 2010. This decision was made to preserve capital and allow for future growth. The major international rating agencies have confirmed QBE's existing ratings. The final dividend will be franked at 25% compared with 10% for the 2010 final dividend.

The total dividend for the year is 87 Australian cents per share compared with 128 cents last year. The total dividend, before reinvestment under the dividend reinvestment plans, is A\$956 million, down 28% from A\$1,336 million last year.

The directors consider that the dividend policy going forward should be a payout ratio of up to 70% of reported net profit after tax. This ratio will enable the Group to retain capital for growth and maintain its capital adequacy levels to meet the more stringent requirements being imposed by regulators and rating agencies. This is discussed in more detail under the heading "Capital position".

### QBE SHARE PRICE PERFORMANCE

Reflecting the difficult conditions for the Group and the industry, it has been a disappointing year in terms of QBE's share price performance. Including reinvestment of dividends, QBE shares decreased in value by 22.5% in the year compared with the Australian All Ordinaries Accumulation Index which recorded a decrease in 2011 of 11.5%. Over the longer term, QBE shares outperformed the index with a compound annual average growth rate of 10.6% over 10 years and 13.9% over 20 years compared with 6.3% and 8.9% respectively for the index.

### ACQUISITIONS

QBE has a longstanding and successful strategy of growth by acquisition. Our experience of past economic upheavals, such as the one we are currently experiencing in Europe, is that merger and acquisition activity in the insurance sector is likely to increase with further market consolidation as companies seek to protect capital and reduce risk. Group and divisional executives constantly review the market for opportunities to expand and diversify QBE's business within strict parameters around financial returns. In particular, potential acquisitions must be earnings per share accretive in year one. Our focus at this time is limited to securing bolt-on acquisitions in the markets in which we operate to take advantage of current pricing and to achieve synergies and economies in combining acquisitions with our existing businesses.

The acquisitions made in 2010 and 2011 have exceeded our expectations for profitability. Further details are included in the chief executive officer's report.

### BORROWINGS

QBE has a conservative and carefully structured debt portfolio. The maturity profile of borrowings is 11% payable within one year, 52% in one to five years and 37% payable beyond five years. The portfolio has a mix of senior and hybrid debt with 29% of borrowings having the potential for conversion into QBE shares, providing the board with substantial flexibility for the future.

During the year, we were able to take advantage of a window of opportunity in debt markets to lock in the issue of US\$1.0 billion and £325 million of subordinated debt securities. These securities have a 30 year tenure at a fixed rate of 7.3% for the US component and 7.5% for the sterling component, with a call at year 10. The securities are treated as allowable capital for regulatory and rating agencies. As a consequence, our ratio of borrowings to shareholders' funds is now 45.8%, up from 31.5% last year, but within the Group's policy of borrowings not exceeding 50% of shareholders' funds. Total borrowings at 31 December 2011 were US\$4,757 million. During 2012, we expect to reduce borrowings to less than 40% of shareholders' funds. The weighted average cost of our borrowings at 31 December 2011 was 5.9% compared with 5.3% at 31 December 2010.

### CAPITAL POSITION

The board and management continue to focus on ensuring that the financial strength of all of QBE's operating entities is maintained at a level adequate to meet obligations to our policyholders and requirements of counterparties, regulatory authorities and rating agencies. The financial strength rating of our major insurance entities has recently been confirmed by the major rating agencies at A+ or equivalent with an A credit rating for the parent company.

QBE's regulatory capital and solvency levels remain sound for the various regulated insurance entities around the world and the consolidated Group. QBE calculates its minimum capital requirement using the Australian Prudential Regulation Authority's (APRA) risk-based capital approach for Australian insurance groups. On this basis, the Group's capital adequacy multiple at 31 December 2011, after allowing for the anticipated reinvestment of the final dividend, was 1.5 times or US\$2.5 billion in excess of the minimum capital requirement of US\$5.0 billion. The QBE board considers excess regulatory capital to be necessary in providing flexibility for the future.





## QBE WORKPLACE DIVERSITY

QBE's workforce diversity policy is aligned with the essential behaviours that form our corporate culture, in particular maintaining absolute integrity in all we do. Our aim is to create a workforce that is fair and inclusive and to attract and retain the best people to do the job.

Through our Group vision to develop "can do" people who live our essential behaviours in everything they do, we will achieve positive business outcomes through the efforts of a strong, cohesive and committed workforce across our global network.

To help achieve our workplace diversity initiatives in 2012 and beyond, QBE has established a workforce diversity committee, headed by the chief executive officer of global underwriting operations. The committee is responsible for monitoring of progress against agreed objectives and reporting to the board to ensure the implementation of this strategic objective in line with the Group's vision.

## GLOBAL MANAGEMENT STRUCTURE

Given the increasing size and complexity of QBE's global business, a number of organisational changes were made in 2011. Firstly, the position of chief executive officer of global underwriting operations was established and filled by John Neal, who was previously the chief underwriting officer of QBE's European operations. In this role, reporting directly to the Group chief executive officer, Mr Neal is responsible for overseeing QBE's operating divisions and for ensuring the sharing of knowledge and experience between QBE's businesses around the world. Global forums have been established covering underwriting, reinsurance, shared services and information technology to improve the Group's financial and operational performance, especially cost efficiency.

Given the growth in QBE's Australian business, Australian operations, which was previously part of the Australia and Asia Pacific division, was set up as a standalone division of the Group under the leadership of Colin Fagen. In addition, an Australian operations board has been established with Mr Nick Greiner AC as chairman, together with three independent directors, Mr John Gilbert, Mr Tony McGrath and Ms Jann Skinner, to provide oversight of this business. QBE already has regional boards in the US and Europe which provide valuable oversight of, and advice to, the operations in these regions. QBE's Asia Pacific operations is also now a standalone division with Michael Goodwin being the divisional chief executive officer.

The board wishes to thank Vince McLenaghan, who was the chief executive officer of Australia and Asia Pacific until the restructure described above, for his loyal contribution to QBE over many years.

QBE's Latin American businesses have grown substantially over the past five years with operations in Argentina, Colombia, Brazil, Ecuador, Mexico and, more recently, Chile and Puerto Rico. In recognition of the scale of this business, Latin America will now operate as a standalone division under the divisional chief executive officer, Jose Sojo.

## GLOBAL WORKPLACE DIVERSITY

With operations in 52 countries, QBE recognises that workforce diversity is critical to building and maintaining a workplace that is fair and inclusive. Through QBE's vision, values and essential behaviours, the Group seeks to retain and attract the best people to do the job and to enable them to achieve sustainable high performance. We believe that drawing upon the wide variety of capabilities, ideas and insights of our employees enhances the quality of decision making and entrepreneurship.

The guiding principles of workplace diversity within QBE have been in place for some years. In 2011, QBE undertook a survey of its top 2,500 managers around the world on workplace diversity. As a result of this survey, QBE is planning to introduce a range of initiatives including a new workplace flexibility policy, manager education programs and development of a "keeping in touch" program for those taking parental leave.

## QBE FOUNDATION

The QBE Foundation was launched in April 2011 and is QBE's major global corporate responsibility initiative. The philosophy of the foundation is to support vocational opportunities globally.

QBE believes that through work, an individual's ultimate ability and potential can be realised. With vocational goals in mind, the foundation seeks to support individuals and groups across many countries, including providing support for community-based initiatives in the developing world such as micro-loans for small business entrepreneurs.

The objectives of the QBE Foundation are to:

- make a difference in key areas that align with QBE's vision and values;
- drive employee engagement by developing networking and a strong team-based culture; and
- maximise the return and impact for any collection, distribution and allocation of philanthropic resources.



## THE QBE FOUNDATION

The QBE Foundation was launched in April 2011 and is QBE's major corporate responsibility initiative. The intention of the QBE Foundation is to extend beyond philanthropy and to create a platform for QBE and its employees to engage with the communities in which we operate.

The activities of the foundation encompass a co-ordinated approach to grants, employee matching and volunteer opportunities. The philosophy of the foundation is to support vocational opportunities globally.

With vocational goals in mind, the foundation seeks to support individuals and groups to live more independently, successfully and productively. As such, the QBE Foundation sets out to support women and men, both the young and the mature worker, to overcome disadvantage and expand on their abilities.

Our philosophy also mirrors our insurance role in the community where we are uniquely placed to assist people when they find themselves in need through accident or misadventure.

The foundation was supported by an initial commitment of US\$5 million. Further amounts are set aside each year, equal to 0.5% of the Group's pre-tax profit. In 2011, we provided support to over 80 organisations globally. Our partnerships with these organisations have been supplemented with matched giving and volunteer days.

## EXECUTIVE REMUNERATION

Details of remuneration arrangements for key management personnel, including the directors, are set out in the remuneration report on pages 61 to 86 of the annual report.

The guiding principles adopted by the board are to ensure a transparent, simple and easy to understand performance and reward strategy; performance-based targets linking individual outcomes to the achievement of financial targets, objectives and business strategies; and the alignment of reward to shareholders' interests through the achievement of short-term and long-term financial targets based on risk adjusted return on equity, insurance profit and investment performance.

QBE's net profit and return on equity in 2011 will mean that many of the executive managers and staff will receive much reduced or no incentive awards despite QBE outperforming most of its global peers. This clearly shows that the remuneration programs are closely aligned with shareholders' interests.



## OUTLOOK FOR 2012

The outlook for 2012 is positive. Net earned premium is expected to increase slightly due to a forecast 5% overall average increase in premium rates and the acquisitions announced to date. This growth will be partly offset by a reduction of premium income in certain catastrophe-exposed classes. Our underlying internal targets for the combined operating ratio and insurance profit margin have not changed from those previously advised to the market; however, due to uncertainty about risk-free rates used to discount outstanding claims and credit spreads, our financial targets are for a combined operating ratio of less than 90% and an insurance profit margin of 13% or better.

Although there are signs of economic recovery in the US, the ongoing debt and economic issues in Europe are likely to continue to create uncertainty and volatility in investment markets. As a result, QBE will maintain its conservative investment strategy with the yield on cash and fixed income securities expected to remain at around 3%. QBE will not take on the additional risk to its profits that can arise from investing in higher yielding but lower rated securities.

The above targets for 2012 are set out in more detail in the chief executive officer's report. The achievement of these targets is subject to no material adverse movement in budgeted foreign exchange rates; large individual risk and catastrophe claims not exceeding the substantial allowance in our business plans; and stable debt and equity markets.

Our prospects for the future have been, and will continue to be, influenced by changes in global economic and environmental conditions. To minimise the risks relating to our insurance and investment operations, and to protect the interests of all our stakeholders, management has in place an efficient and effective business planning process. Management has taken action to reduce exposure to catastrophe-exposed business, increase premium rates, improve terms and conditions and increase reinsurance coverage. Although it is highly unlikely that the industry will experience a repeat of the high frequency of catastrophes seen in 2011, QBE is now better positioned as a result of actions taken.

## CONCLUSION

The natural disasters of 2011 have created enormous suffering and hardship for many individuals, families and communities around the world, to whom we express our deep sympathy. QBE has sought to do its part in the face of these disasters by responding efficiently to the numerous claims from our policyholders. On behalf of the board, I wish to particularly thank our claims teams in Australia, New Zealand, the US and Thailand for their hard work and dedication following the Queensland and Victorian storms, cyclone Yasi in Australia, the Christchurch earthquakes, the record number of tornadoes in the US and the Thailand floods.

On behalf of the board, I wish to acknowledge the hard work and contribution of all the QBE staff around the world during 2011. In a year of record catastrophes, QBE is fortunate to have its highly professional, experienced and competent team of managers ably led by the chief executive officer, Frank O'Halloran. Achieving a combined operating ratio of 96.8% in this environment is a real credit to the discipline and underwriting skills of this team.

Finally, I wish to thank my fellow directors for their valuable direction and advice to management in response to the challenges QBE and the industry faced in 2011. The directors have been especially diligent in providing increased oversight and support to the Group.

**Belinda Hutchinson AM**  
Chairman

# Chief executive officer's report

“ In 2011, the global insurance and reinsurance industry experienced the worst year on record for catastrophes with insured losses from major catastrophes currently estimated at around US\$105 billion. ”

**FRANK O'HALLORAN** CHIEF EXECUTIVE OFFICER

2011 was a challenging year. We were not immune to the record level of catastrophe losses experienced by the global insurance industry, particularly given our sizeable commercial lines operations in Australia, Asia and New Zealand. We also experienced losses from lower risk-free rates used for discounting claims and widening credit spreads, largely driven by the European debt crisis.

The record level of catastrophe claims, which primarily occurred in businesses we have owned for many years, and the reduction in risk-free interest rates when compared with 2010 contributed 6.2% and 1.4% respectively, or 7.6% in total, to the higher combined operating ratio.

Our combined operating ratio for 2011 was 96.8%, which is a solid performance considering the market conditions and when compared with the majority of our global peers. Our strategy of diversity by product and geographic spread assisted and, despite the unprecedented level of catastrophes and lower discount rates, 45 of our 52 countries produced an underwriting profit.

Insurance profit was 7.1% of net earned premium compared with 15.0% last year. In addition to the items impacting the combined operating ratio, widening credit spreads adversely impacted the insurance profit margin by 1.1%.

The growth in operating cash flow of 57% to US\$2.1 billion was very pleasing given the level of catastrophe claims paid during the year.

Fundamentally, the Group's underlying underwriting margin and profitability remain sound and have been enhanced over recent months by significant premium rate increases in our property classes, increased deductibles and actions taken to reduce exposures in a number of areas. The current accident year attritional claims ratio was a pleasing 49.2% of net earned premium, down from 50.0% last year. Our extensive worldwide reinsurance programs reduced the overall cost of reinsurance and provided significant protection against the increased cost of large individual risk and catastrophe claims, assisting profit by around US\$219 million compared with the impact of the 2010 program, had the 2010 program been in place in 2011.

In periods of increased frequency and severity of claims, there is limited market capacity to purchase cost effective reinsurance cover for a frequency of catastrophes. If it is available, it is often far too expensive.

Even though we produced an underwriting profit in a year of record catastrophes, we are disappointed with the overall result and are implementing changes to our various property and commercial package portfolios to improve the rewards for our shareholders going forward.



#### GROSS WRITTEN PREMIUM

**US\$18,291M**

Up **34%** from last year

#### CATASTROPHE CLAIMS

**US\$1,733M**

Up **199%** from last year

#### INSURANCE PROFIT

**US\$1,085M**

Down **36%** from last year

## RESULTS

Insurance profit, which includes investment income on policyholders' funds, was US\$1,085 million, down 36% from US\$1,703 million in 2010.

Net profit after tax was US\$704 million compared with US\$1,278 million in 2010. The 2011 result benefited from significant premium growth and solid profit from acquisitions completed over the past 18 months.

The gross and net investment yields on policyholders' funds, excluding foreign exchange gains, were 2.3% gross and 2.2% net compared with 2.6% and 2.4% respectively in 2010.

Net investment income on policyholders' funds was up 10% to US\$591 million due to acquisitions and slightly higher operational foreign exchange gains.

Details of significant items affecting the result before tax are set out in the table below.

### SIGNIFICANT ITEMS IN PROFIT BEFORE TAX

#### FOR THE YEAR ENDED 31 DECEMBER

	2011 US\$M	2010 US\$M
Unrealised losses on cash and fixed interest securities	(241)	(24)
Impact of lower risk-free discount rates	(252)	(25)
Cost of large individual risk and catastrophe claims (net)	(2,355)	(1,080)
Savings on prior year central estimates	64	49
Foreign exchange gains	188	141

## LARGE INDIVIDUAL RISK AND CATASTROPHE CLAIMS IN 2011

Large individual risk and catastrophe claims amounted to 15.3% of net earned premium for the year compared with 9.5% in 2010. The average over the past seven years to 2010 was 8.1%. There were 40 large catastrophes during 2011 compared with 31 in 2010.

2011 and 2010 large individual risk and catastrophe claims net of reinsurances, defined as those claims with a cost of US\$2.5 million and above, are included in the tables on page 10.

## CHIEF EXECUTIVE OFFICER'S REPORT CONTINUED

### SUMMARY OF LARGE INDIVIDUAL RISK AND CATASTROPHE CLAIMS

CATASTROPHE	2011	
	COST US\$M	% OF NET EARNED PREMIUM
Thailand floods (October–November)	261	1.7
19 severe US tornadoes (April–August)	243	1.6
Christchurch earthquakes (22 February, 13 June)	222	1.5
Japan earthquake and tsunami (11 March)	154	1.0
Queensland storms (January)	142	0.9
Cyclone Yasi (2 February)	138	0.9
Victorian hail and storms (9 January, 8 February and 25 December)	98	0.6
Hurricane Irene (26 August)	50	0.3
Western Australia bushfires (5 February)	31	0.2
Copenhagen floods (July)	11	0.1
Crop flood and hail claims (multiple events)	319	2.1
Other catastrophes	64	0.4
Total catastrophes	1,733	11.3
Large individual risk claims (including IBNR)	622	4.0
<b>Total large individual risk and catastrophe claims</b>	<b>2,355</b>	<b>15.3</b>

CATASTROPHE	2010	
	COST US\$M	% OF NET EARNED PREMIUM
Perth storm (21 March)	108	1.0
Chilean earthquake (27 February)	83	0.7
Christchurch earthquake (10 September)	81	0.7
Melbourne storm (7 March)	74	0.6
Four severe US tornadoes (April–June)	60	0.5
Queensland storm (24 December)	46	0.4
Arizona hail storm (5 October)	20	0.2
Kalgoorlie earthquake (24 April)	12	0.1
Cyclone Ului (20 March)	11	0.1
Other catastrophes	85	0.8
Total catastrophes	580	5.1
Large individual risk claims (including IBNR)	500	4.4
<b>Total large individual risk and catastrophe claims</b>	<b>1,080</b>	<b>9.5</b>

The analysis below compares the number and average gross and net cost of catastrophe claims (excluding crop claims) analysed by size, demonstrating the increased frequency and severity during 2011.

### CATASTROPHE CLAIMS MIX<sup>(1)</sup>

FOR THE YEAR ENDED 31 DECEMBER	2011			2010		
	CLAIMS NUMBER	AVERAGE GROSS COST US\$M	AVERAGE NET COST US\$M	CLAIMS NUMBER	AVERAGE GROSS COST US\$M	AVERAGE NET COST US\$M
US\$2.5M – US\$10M	17	6	5	18	5	4
US\$10M – US\$50M	15	22	19	8	16	14
US\$50M – US\$100M	3	56	47	1	90	74
US\$100M – US\$200M	–	–	–	3	181	78
Above US\$200M	5	386	177	1	219	83

(1) Excludes crop claims and general IBNR.

### INSURANCE PROFITABILITY

The combined operating ratio was 96.8% compared with 89.7% in 2010. The increase was mainly due to the record level of catastrophes and the impact of lower risk-free rates used to discount outstanding claims, which added 6.2% and 1.4% respectively. QBE's combined operating ratio compared well against the majority of our peer group, with many of our competitors around the world reporting combined operating ratios well in excess of 100%.

## HISTORICAL OVERVIEW – GROUP

FOR THE YEAR ENDED 31 DECEMBER		2011	2010	2009	2008	2007
Gross written premium	US\$M	<b>18,291</b>	13,629	11,239	11,015	10,391
Net earned premium	US\$M	<b>15,359</b>	11,362	9,446	9,293	8,552
Combined operating ratio	%	<b>96.8</b>	89.7	89.6	88.5	85.9
Insurance profit	US\$M	<b>1,085</b>	1,703	1,609	1,830	1,895
Insurance profit margin	%	<b>7.1</b>	15.0	17.0	19.7	22.2

## KEY RATIOS – GROUP

FOR THE YEAR ENDED 31 DECEMBER		2011	2010
Claims ratio	%	<b>68.2</b>	59.9
Commission ratio	%	<b>14.9</b>	15.5
Expense ratio	%	<b>13.7</b>	14.3
Combined operating ratio	%	<b>96.8</b>	89.7

## SUMMARY INCOME STATEMENT

FOR THE YEAR ENDED 31 DECEMBER		2011 US\$M	2010 US\$M
Gross written premium		<b>18,291</b>	13,629
Gross earned premium		<b>17,840</b>	13,432
Net earned premium		<b>15,359</b>	11,362
Net claims incurred		<b>(10,466)</b>	(6,807)
Net commission		<b>(2,291)</b>	(1,759)
Underwriting and other expenses		<b>(2,108)</b>	(1,628)
Underwriting profit		<b>494</b>	1,168
Net investment income on policyholders' funds		<b>591</b>	535
Insurance profit		<b>1,085</b>	1,703
Net investment income on shareholders' funds		<b>185</b>	124
Financing and other costs		<b>(275)</b>	(222)
Share of net profit of associates		<b>6</b>	5
Amortisation of intangibles and impairment of goodwill/intangibles		<b>(133)</b>	(59)
Profit before income tax		<b>868</b>	1,551
Income tax expense		<b>(149)</b>	(257)
Profit after income tax		<b>719</b>	1,294
Net profit attributable to non-controlling interests		<b>(15)</b>	(16)
Net profit after income tax		<b>704</b>	1,278

## MARKET CONDITIONS

In the last few months of 2011, we saw encouraging signs of a positive turn in the insurance cycle outside of Europe. There was a strong increase in premium rates during the last quarter of 2011, driven by the level of catastrophes and the higher cost of reinsurance as insurers and reinsurers adjusted pricing and terms and conditions to reflect significant catastrophe claims incurred over the past two years.

QBE's portfolios continued to achieve high customer retention ratios despite the increase in premium rates and the implementation of changes in deductibles. We achieved an overall average premium rate increase on QBE's renewed business of 3.6%, which was higher than we anticipated due to the rate increases being imposed. We are seeing positive signs of further increases in premium rates in the US, particularly in personal lines, property and workers' compensation classes of business. Australia is experiencing solid rate increases in all property exposed classes and small rate increases in other classes. Our European operations continues to see rate increases in commercial motor, marine and energy, inward reinsurance and international property. Competition remains strong for regional UK and mainland European business, and premium rates remain flat in these markets.

The record level of natural catastrophe events in 2011 impacted most insurers and reinsurers apart from those operating solely in Europe, where it was a relatively benign year for catastrophes. Many of our competitors and major reinsurers have already reported substantial underwriting losses and are taking positive action with more rational competition and pricing. Reinsurance capacity has been reduced in certain areas due to the level of claims, particularly due to catastrophes during the year that were not previously factored into pricing models.

The European debt crisis has caused significant anxiety and investment market volatility around the world, resulting in impairment of a number of balance sheets as insurers and banks revalue their investment portfolios and related assets to market value. The consequential increase in merger and acquisition activity has created acquisition opportunities for QBE but, to date, none of them have met our strict criteria.

## CHIEF EXECUTIVE OFFICER'S REPORT CONTINUED

### ACQUISITIONS

During 2011, we considered a number of acquisition opportunities and the table below details the major acquisitions that we finalised in the year.

#### 2011 ACQUISITIONS

ACQUISITIONS	BUSINESS	ANNUALISED GWP US\$M	ACQUISITION DATE
US operations of Renaissance Re	Mainly crop	<b>618</b>	1 January 2011
Balboa in the US	Lender placed homeowners business	<b>1,852</b>	1 April 2011
CUNA Mutual Australia	Credit, general insurance and term life	<b>82</b>	1 April 2011

The acquisitions exceeded our premium and profit expectations for 2011. In addition to these acquisitions, we obtained licences to write general insurance business in Chile and Norway in 2011, and we completed the acquisition of Optima Insurance Group in Puerto Rico in February 2012.

### PREMIUM INCOME

Gross written premium was up 34% to US\$18,291 million. Premium growth was largely achieved from the acquisitions in 2011 and in late 2010, including the US crop insurer, NAU Country, the Belgian reinsurer, Secura NV, Colonial Compania de Seguros in Ecuador and the CNA workers' compensation business in Argentina. Premium income was also assisted by the weaker US dollar and higher premium rates for US crop insurance due to rising commodity prices.

Net earned premium was up 35% to US\$15,359 million, slightly higher than growth in gross written premium due to a lower reinsurance expense ratio as a result of new worldwide reinsurance covers.

Premium income was assisted by a higher than expected overall average increase in premium rates on renewed business of 3.6%. An average increase of over 5% was achieved in Australia, around 4% in Asia Pacific, 2% in Europe, 3% in the US and 6% in Latin America.

Reinsurance expense reduced from 15.4% to 13.9% of gross earned premium. The lower ratio was mainly due to an overall reduction in the cost of our new worldwide reinsurance arrangements and reduced proportional reinsurance, partly offset by additional reinsurance protections purchased for Balboa and Equator Re, additional Group aggregate cover and increased cessions to the US Federal Government crop pool. The reinsurance expense ratio was higher than our original target of 12.0%, mainly due to additional cessions for US crop insurance business and additional covers purchased during the year.

Our maximum event retention from our largest single natural catastrophe scenario is currently around 3.2% of forecast 2012 net earned premium compared with 4.0% at 31 December 2010. This is expected to increase during the year to around 3.8% as we approach the US windstorm season. This reflects the benefits of our extensive reinsurance covers and actions taken to reduce exposures in higher risk areas. The worldwide reinsurance program provided substantial benefits for the year through the lower cost of claims and reinstatement premiums. The consolidation of numerous reinsurance programs and elimination of working layers provided significant savings and efficiencies in managing large individual risk and catastrophe claims. As indicated earlier, we estimate that the 2011 arrangements improved underwriting profit by US\$219 million compared with the 2010 reinsurance program.

Approximately 65% of our reinsurance expense is excess of loss reinsurance, protecting our large individual risk and catastrophe claims ratio. The majority of the balance comprises proportional reinsurance required by our US program business partners and cessions to the US Federal Government crop pool. Around 50% of the excess of loss cost relates to the worldwide programs where the increase in our outward reinsurance cost will be broadly matched by growth in inward premium income in 2012 and 2013. Proportional reinsurance expense is, by definition, in proportion to the gross premium written.

Reinsurance is an extremely important part of the management of the Group's exposure to large individual risk and catastrophe claims. As already noted, there is a limit to the amount of reinsurance capacity that is available, particularly for a frequency of catastrophe events as experienced by the industry in 2011. QBE is fortunate that it has been able to reduce its maximum event retention in 2011 and 2012 whilst maintaining a highly competitive reinsurance cost structure.

### INCURRED CLAIMS

The net incurred claims ratio increased from 59.9% to 68.2%, mainly due to the record level of catastrophe claims and the impact of lower risk-free rates used for discounting outstanding claims. Set out below is an analysis of our 2011 net claims ratio.

#### ANALYSIS OF NET CLAIMS RATIO

FOR THE YEAR ENDED 31 DECEMBER	2011 %	2010 %
Attritional claims	<b>49.2</b>	50.0
Large individual risk and catastrophe claims	<b>15.3</b>	9.5
Claims settlement costs	<b>2.5</b>	2.7
Claims discount	<b>(1.7)</b>	(3.6)
Net incurred claims ratio – current accident year	<b>65.3</b>	58.6
Savings on prior accident year central estimate	<b>(0.4)</b>	(0.4)
Other including claims settlement costs, discount and risk margins	<b>3.3</b>	1.7
Net incurred claims ratio – current financial year	<b>68.2</b>	59.9

The attritional claims ratio was 0.8% lower than 2010, which means that our claims with a cost of less than US\$2.5 million continue to be under control.

Large individual risk and catastrophe claims for the 2011 accident year increased by 5.8% of net earned premium compared with last year as a result of the frequency and severity of catastrophes referred to earlier. The ratio of large individual risk claims to net earned premium was slightly improved in 2011 at 4.0% compared with 4.4% last year. Large catastrophe claims increased from 5.1% to 11.3%.

The weighted average risk-free interest rate used to discount our outstanding claims was 2.10%, substantially lower than 3.22% at 31 December 2010. These record low weighted average risk-free interest rates had a negative impact on the claims ratio, increasing the net claims incurred ratio by 1.4%.

## RECONCILIATION OF UNDISCOUNTED CENTRAL ESTIMATE TO DISCOUNTED NET INCURRED CLAIMS

	YEAR ENDED 31 DECEMBER 2011			YEAR ENDED 31 DECEMBER 2010		
	CURRENT ACCIDENT YEAR US\$M	PRIOR ACCIDENT YEARS US\$M	TOTAL US\$M	CURRENT ACCIDENT YEAR US\$M	PRIOR ACCIDENT YEARS US\$M	TOTAL US\$M
Undiscounted central estimate	9,912	(64)	9,848	6,774	(49)	6,725
Movement in discount	(264)	646	382	(413)	318	(95)
Movement in risk margins	401	(525)	(124)	447	(569)	(122)
Claims settlement costs and other movements	385	(25)	360	300	(1)	299
Net incurred claims – discounted	10,434	32	10,466	7,108	(301)	6,807

## COMMISSIONS AND EXPENSES

The combined commission and expense ratio was 28.6% of net earned premium compared with 29.8% last year. The main reasons for the reduction were: a change in the mix of business, principally the Balboa lender placed homeowners business and substantial growth in crop business in the US where the commission and expense ratio was much lower than the Group average; the rationalisation and re-engineering of systems in European operations and the Americas; and lower incentives to staff due to the reduced profit before tax.

The commission ratio was 14.9% compared with 15.5% last year, reflecting the change in mix of business and a higher net earned premium due to reduced proportional reinsurance in acquired businesses. The expense ratio reduced from 14.3% to 13.7%, mainly due to growth in US crop business, reduced incentive payments to staff due to lower profits and efficiencies from new systems.

## AGENCIES

QBE now underwrites the majority of the business generated by its underwriting agencies, with only a relatively small net agency income from third party sources. As a result, we no longer consider it appropriate to identify the agency results at the divisional level as they are now fully integrated into their respective businesses.

## CONTRIBUTIONS BY REGION

FOR THE YEAR ENDED 31 DECEMBER	GROSS WRITTEN PREMIUM		NET EARNED PREMIUM		COMBINED OPERATING RATIO		INSURANCE PROFIT BEFORE INCOME TAX	
	2011 US\$M	2010 US\$M	2011 US\$M	2010 US\$M	2011 %	2010 %	2011 US\$M	2010 US\$M
North American operations	7,529	4,606	4,018	2,555	90.6	89.1	440	356
Latin American operations	768	559	620	454	89.7	93.4	101	56
European operations	4,828	4,156	3,150	2,593	95.5	90.5	298	376
Australian operations	4,486	3,707	3,767	3,033	99.3	89.2	243	516
Asia Pacific operations	680	601	442	420	92.1	86.7	59	77
Equator Re	3,807	2,479	3,362	2,307	104.5	90.1	(56)	322
Elimination – internal reinsurance	(3,807)	(2,479)	–	–	–	–	–	–
Group	18,291	13,629	15,359	11,362	96.8	89.7	1,085	1,703
Direct and facultative	16,342	12,167	13,741	10,188	95.3	90.4	1,171	1,445
Inward reinsurance <sup>(1)</sup>	1,949	1,462	1,618	1,174	109.8	84.1	(86)	258
Group	18,291	13,629	15,359	11,362	96.8	89.7	1,085	1,703

(1) Inward reinsurance has averaged a combined operating ratio of 91.4% over the past seven years.

## CHIEF EXECUTIVE OFFICER'S REPORT CONTINUED

### WORLDWIDE PORTFOLIO MIX

GROSS EARNED PREMIUM FOR THE YEAR ENDED 31 DECEMBER	2011 %	2010 %
Property	<b>32.8</b>	29.7
Motor and motor casualty	<b>14.2</b>	14.5
Agricultural and bloodstock	<b>12.7</b>	6.9
Public/product liability	<b>11.7</b>	13.9
Marine, energy and aviation	<b>7.2</b>	8.9
Workers' compensation	<b>7.1</b>	7.7
Financial and credit	<b>5.1</b>	6.2
Professional indemnity	<b>4.2</b>	5.3
Accident and health	<b>3.6</b>	5.3
Other	<b>1.4</b>	1.6

### SEGMENTAL ANALYSIS

GROSS EARNED PREMIUM FOR THE YEAR ENDED 31 DECEMBER	2011 %	2010 %
North American operations	<b>41.7</b>	34.0
European operations	<b>26.0</b>	29.8
Australian operations	<b>24.4</b>	27.7
Latin American operations	<b>4.2</b>	4.1
Asia Pacific operations	<b>3.7</b>	4.4

### INVESTMENTS

Investment income was lower than anticipated mainly due to widening credit spreads on corporate bonds in the second half of the year, following negative market sentiment from global economic uncertainty and concerns surrounding European sovereign debt.

Throughout the year, we successfully avoided permanent impairment of any securities issued by sovereign and financial market issuers that were downgraded, who defaulted or were subject to restructuring fears with a consequent impact on market value. Our fixed interest and cash portfolios remain highly liquid with an average credit quality of Aa.

Notwithstanding the very high quality of our substantial holdings of investment grade credit, our bond holdings were subject to the adverse movement in credit spreads incurring unrealised losses of US\$241 million at the balance date. The majority of these securities are floating rate and were acquired to take advantage of the unusually wide credit spreads and so provide an attractive exposure to historically high yields, without the prospect of losing value when the interest rate cycle eventually turns. We continue to have no permanent impairment of any one of our securities.

We retained a modest holding in equities of around 1% of the total investments and cash at year end. We maintain a defensive bias in our equity portfolio construction and will take advantage of market movements where practical. We are unlikely to increase our equity weighting above 2.5% due to volatile market conditions. Our equity return for the year was a loss of US\$2 million including dividend income.

We continue to adopt a very cautious approach to investing our assets backing policyholders' and shareholders' funds, and prefer to focus on the quality of securities and issuers rather than yield, particularly in Europe. The global economic outlook remains uncertain and volatility in markets is expected to continue.

### INVESTMENT INCOME

FOR THE YEAR ENDED 31 DECEMBER	POLICYHOLDERS' FUNDS		SHAREHOLDERS' FUNDS		TOTAL INVESTMENT INCOME	
	2011 US\$M	2010 US\$M	2011 US\$M	2010 US\$M	2011 US\$M	2010 US\$M
Equity income	-	-	(2)	(6)	(2)	(6)
Income on fixed interest securities, short-term money and cash	<b>423</b>	414	<b>191</b>	153	<b>614</b>	567
Foreign exchange gains	<b>188</b>	141	-	-	<b>188</b>	141
Property income	-	-	<b>13</b>	(4)	<b>13</b>	(4)
Other income	<b>1</b>	-	<b>3</b>	2	<b>4</b>	2
Gross investment income	<b>612</b>	555	<b>205</b>	145	<b>817</b>	700
Gain on repurchase of debt securities	-	-	<b>2</b>	-	<b>2</b>	-
Investment expenses	<b>(21)</b>	(20)	<b>(22)</b>	(21)	<b>(43)</b>	(41)
Net investment income	<b>591</b>	535	<b>185</b>	124	<b>776</b>	659

### GROSS AND NET YIELD

FOR THE YEAR ENDED 31 DECEMBER	YIELD ON INVESTMENT ASSETS BACKING POLICYHOLDERS' FUNDS		YIELD ON INVESTMENT ASSETS BACKING SHAREHOLDERS' FUNDS		TOTAL	
	2011 %	2010 %	2011 %	2010 %	2011 %	2010 %
Gross <sup>(1)</sup>	<b>3.4</b>	3.4	<b>2.4</b>	1.9	<b>3.1</b>	2.9
Net <sup>(2)</sup>	<b>3.3</b>	3.3	<b>2.1</b>	1.6	<b>2.9</b>	2.8
Gross excluding foreign exchange gains	<b>2.3</b>	2.6	<b>2.4</b>	1.9	<b>2.4</b>	2.3
Net excluding foreign exchange gains	<b>2.2</b>	2.4	<b>2.1</b>	1.6	<b>2.2</b>	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 and fixed interest securities. The remaining investments, including all equities, are allocated to shareholders' funds.

## TOTAL INVESTMENTS AND CASH

AS AT	31 DECEMBER 2011			31 DECEMBER 2010		
	INVESTMENT ASSETS BACKING POLICYHOLDERS' FUNDS US\$M	INVESTMENT ASSETS BACKING SHAREHOLDERS' FUNDS US\$M	TOTAL US\$M	INVESTMENT ASSETS BACKING POLICYHOLDERS' FUNDS US\$M	INVESTMENT ASSETS BACKING SHAREHOLDERS' FUNDS US\$M	TOTAL US\$M
Cash	1,001	456	1,457	1,157	529	1,686
Short-term money	4,918	2,240	7,158	4,794	2,189	6,983
Fixed interest securities and other	13,041	5,941	18,982	11,181	5,109	16,290
Equities	-	326	326	-	303	303
Investment properties <sup>(1)</sup>	-	101	101	-	66	66
Total investments and cash	18,960	9,064	28,024	17,132	8,196	25,328

(1) Includes US\$73 million (2010 nil) of property reclassified to assets held for sale on 31 December 2011.

## CASH AND FIXED INTEREST INVESTMENTS – SECURITY GRADING

AS AT	31 DEC 2011 %	31 DEC 2010 %
<b>Moody's rating</b>		
Aaa	23	22
Aa	56	63
A	17	12
<A	4	3

## CURRENCY MIX – MARKET VALUE OF EQUITIES

AS AT	31 DEC 2011 %	31 DEC 2010 %
Australian dollar	46	53
US dollar	30	34
Euro	12	5
Sterling	11	5
Other	1	3

Due to the global nature of our business, foreign exchange gains and losses arise on operational transactions and are recorded in investment income in accordance with our accounting policy and the requirements of accounting standards. In managing our profits in various currencies, we seek to lock in future profits at times when foreign exchange rates are favourable compared with our budgeted rates. Due to the substantial volatility in foreign exchange rates in the year, we were able to generate operational foreign exchange gains of US\$188 million compared with US\$141 million last year.

## CURRENT AAA CASH RATE – WEIGHTED AVERAGE YIELD

AS AT	31 DEC 2011 %	31 DEC 2010 %
Australian dollar	4.7	4.4
US dollar	0.3	0.3
Sterling	0.5	0.5
Euro	1.3	1.0
Other	2.2	1.3
Weighted average yield	2.0	1.9
QBE actual yield achieved	2.3	2.5

## CURRENCY MIX – MARKET VALUE OF TOTAL INVESTMENTS AND CASH

AS AT	31 DEC 2011 %	31 DEC 2010 %
US dollar	36	33
Australian dollar	33	35
Sterling	15	15
Euro	8	9
Other	8	8

Total investments and cash were up US\$2.7 billion to US\$28.0 billion from US\$25.3 billion at the end of 2010. The increase was due to acquisitions completed during the year, net operating cash inflow and our increase in borrowings. Around 79% of our cash and fixed interest investments are rated Aa3 or better by Moody's. Around 98% of investments are considered liquid.

We invest in sovereign, semi-government and supranational bonds mainly due to regulatory requirements. These securities represent around 11% of the total cash and fixed interest securities in investment portfolios.

## CHIEF EXECUTIVE OFFICER'S REPORT CONTINUED

### IMPACT OF EXCHANGE RATE MOVEMENTS

	2011 ACTUAL	2011 AT 2010	EXCHANGE RATE IMPACT	
	US\$M	EXCHANGE RATES <sup>(1)</sup>	US\$M	%
Gross written premium	18,291	17,571	720	4
Gross earned premium	17,840	17,148	692	4
Net earned premium	15,359	14,714	645	4
Net profit after income tax	704	691	13	2
Total investments and cash	28,024	28,354	(330)	(1)
Total assets	46,737	47,287	(550)	(1)
Gross outstanding claims provision	20,677	21,128	(451)	(2)
Total liabilities	36,299	36,965	(666)	(2)

(1) Income statement items are restated to 31 December 2010 cumulative average rates of exchange and balance sheet items to 31 December 2010 closing rates of exchange.

### BALANCE SHEET

The summary balance sheet below demonstrates the Group's significant financial strength.

#### SUMMARY BALANCE SHEET

AS AT	31 DECEMBER 2011 US\$M	31 DECEMBER 2010 US\$M
Investments and cash <sup>(1)</sup>	28,024	25,328
Trade and other receivables	5,514	4,704
Reinsurance recoveries – outstanding claims	2,412	1,741
Reinsurance recoveries – IBNR	1,281	1,478
Deferred insurance costs	2,432	2,003
Intangibles	6,065	5,387
Other assets	1,009	745
<b>Total assets</b>	<b>46,737</b>	<b>41,386</b>
Outstanding claims	20,677	18,236
Unearned premium	8,069	6,788
Borrowings	4,757	3,243
Other liabilities	2,796	2,726
<b>Total liabilities</b>	<b>36,299</b>	<b>30,993</b>
Net assets	10,438	10,393
Non-controlling interests	52	82
<b>Shareholders' funds</b>	<b>10,386</b>	<b>10,311</b>

(1) Includes US\$73 million (2010 nil) of property reclassified as held for sale at 31 December 2011.

Shareholders' funds at 31 December 2011 were US\$10,386 million, up from US\$10,311 million at 31 December 2010. Details of the movements in the year are set out in the table below.

#### RECONCILIATION OF SHAREHOLDERS' FUNDS

	US\$M
Shareholders' funds at 31 December 2010	10,311
Net profit after income tax	704
2010 final dividend and 2011 interim dividend	(1,391)
Shares issued pursuant to the underwriting of the 2010 final dividend	396
Foreign exchange movements	(210)
Other reserve movements	(53)
Dividend reinvestment	629
<b>Shareholders' funds at 31 December 2011</b>	<b>10,386</b>

### CAPITAL ADEQUACY

Our capital for regulatory purposes for all of our regulated entities throughout the world is in excess of minimum capital requirements. QBE's financial strength rating for its main operating subsidiaries was confirmed during the year at A+ or equivalent, with an A credit rating for the parent company.

We have around 80 licensed entities within our global network which are subject to local prudential regulations and guidelines. In addition, various rating agencies assess QBE's financial strength and credit rating at both the entity and the Group level.

## MINIMUM CAPITAL REQUIREMENT

Applying the Australian Prudential Regulation Authority ("APRA") risk-based criteria for conglomerates in determining the Group's capital adequacy, we calculate that we held 1.5 times the minimum capital requirement (MCR) at 31 December 2011. This multiple is equivalent to US\$2.5 billion of capital in excess of the minimum requirement. Losses due to lower risk-free interest rates and widening credit spreads adversely impacted capital in the second half of the year by around US\$350 million.

In most markets we are experiencing an increase in regulatory oversight and potential changes to regulations that indicate a move towards higher minimum capital requirements. In Australia, APRA has continued its review of capital standards for life and general insurance companies, aimed at introducing a more risk-sensitive capital framework. APRA has stated that its proposals are not designed to increase required capital levels generally, but rather to move to a more tailored approach which more accurately reflects the risks borne by an individual insurer or insurance group. QBE is well prepared for any such changes, with capital at 1.5 times the MCR and the capacity to convert up to US\$1,350 million of borrowings into QBE shares, if required, to enhance regulatory and ratings capital levels.

The following table sets out details of our assessment of QBE's regulatory capital base and the MCR applying APRA's risk-based criteria applicable to Australian non-operating holding companies.

### MINIMUM CAPITAL REQUIREMENT

AS AT	31 DECEMBER 2011 US\$M	31 DECEMBER 2010 US\$M
<b>Tier 1</b>		
Share capital and reserves <sup>(1)</sup>	10,238	10,367
Perpetual securities	164	179
Excess risk margins (net of tax)	954	1,129
Deductions	(6,072)	(5,394)
	5,284	6,281
<b>Tier 2</b>		
Subordinated debt and hybrid securities	2,218	722
Total capital base	7,502	7,003
Insurance risk charge	3,182	2,699
Concentration risk charge	610	539
Investment risk charge	1,038	959
Reinsurance risk charge	138	131
Minimum capital requirement	4,968	4,328
Excess capital	2,534	2,675
Capital adequacy multiple	1.5	1.6

(1) 31 December 2010 includes capital of US\$462 million as a result of the underwriting of the final 2010 dividend.

## RECEIVABLES AND REINSURANCE RECOVERIES

Trade and other receivables increased since 31 December 2010 mainly due to the impact of the 2011 acquisitions. Premium and reinsurance receivables over 90 days remain low, with minimal bad debt experience and prudent provisions held for potential non-payment. Premium receivables and outstanding reinsurance recoverables are reported net of provisions for doubtful debts of US\$158 million compared with US\$143 million at 31 December 2010.

Reinsurance recoveries increased from US\$3.2 billion at 31 December 2010 to US\$3.7 billion, largely due to the impact of large catastrophe claims in the period and the recent acquisitions. Reinsurance recoveries include US\$1.3 billion of recoveries on claims incurred but not reported (2010 US\$1.5 billion).

The credit rating of our reinsurance counterparties at 31 December 2011 is set out in the table below.

### OUTSTANDING REINSURANCE RECOVERIES – S&P RATING

AS AT	31 DEC 2011 %	31 DEC 2010 %
AAA	1	2
AA	58	44
A	35	46
BBB or lower	2	3
Non-rated	4	5

## CHIEF EXECUTIVE OFFICER'S REPORT CONTINUED

### INTANGIBLES

Intangibles increased from US\$5,387 million at 31 December 2010 to US\$6,065 million mainly due to the impact of the Balboa and Renaissance Re acquisitions in the US which added US\$802 million to intangibles. In particular, the Balboa acquisition and distribution agreement which was effective from 1 April 2011 resulted in the recognition of US\$622 million of identifiable intangibles that have an estimated useful life of 10 years. In accordance with our accounting policy, identifiable intangibles are written off over their expected useful lives, subject to impairment testing.

Further details on our intangible assets are included in note 19 to the financial statements.

### BORROWINGS

The ratio of borrowings to shareholders' funds was 45.8%, up from 31.5% at 31 December 2010. The US\$1.5 billion increase in borrowings was largely due to the issue of US\$1.0 billion and £325 million of subordinated debt securities. These securities meet lower tier 2 capital regulatory and ratings criteria. Further details are included in note 25 to the financial statements. The increased borrowings were primarily used to finance the settlement of short-term borrowings, to assist the funding of the US acquisitions and to provide capital support for expected premium growth.

Borrowing costs were US\$275 million compared with US\$222 million last year. The weighted average annualised cost of borrowings at 31 December 2011 was 5.9% compared with 5.3% at 31 December 2010.

#### BORROWINGS MATURITY

AS AT	31 DEC 2011 %	31 DEC 2010 %
Less than one year	11	16
One to five years	52	74
More than five years	37	10

#### BORROWINGS PROFILE

AS AT	31 DEC 2011 %	31 DEC 2010 %
Subordinated debt	49	26
Senior debt	28	42
Hybrid securities	18	26
Capital securities	4	5
Bank loans	1	1

### INSURANCE LIABILITIES

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

#### INSURANCE LIABILITIES

AS AT	31 DECEMBER 2011 US\$M	31 DECEMBER 2010 US\$M	31 DECEMBER 2009 US\$M	31 DECEMBER 2008 US\$M
Outstanding claims	16,984	15,017	12,864	11,346
Unearned premium net of deferred insurance costs <sup>(1)</sup>	5,929	4,785	4,374	3,608
	<b>22,913</b>	19,802	17,238	14,954
Central estimate – outstanding claims	15,783	13,747	11,847	10,504
Central estimate – unearned premium	5,062	3,901	3,487	2,931
Risk margin – outstanding claims	1,201	1,270	1,017	842
Risk margin – unearned premium	867	884	887	677
	<b>22,913</b>	19,802	17,238	14,954
Risk margin in excess of 75% probability of adequacy using APRA's risk weighted capital adequacy model	1,152	1,353	1,198	816

(1) 2011 net unearned premium has been grossed up by US\$292 million relating to the future costs associated with multi-year outwards reinsurance contracts.

At 31 December 2011, the probability of adequacy of outstanding claims was 86.3% compared with 89.8% at 31 December 2010. The lower probability of adequacy and risk margins in outstanding claims were due to a significant reduction in the weighted average risk-free discount rate, down to 2.10% compared with 3.22% at 31 December 2010. The lower discount rate reduced risk margins in outstanding claims by US\$200 million.

As required under 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 achieved in our quality investment portfolios. The probability of adequacy of total insurance liabilities was 92.6% compared with 95.5% at 31 December 2010.

## OUTLOOK FOR 2012

The record level of catastrophes during 2011 resulted in insurers and reinsurers increasing premium rates for property exposed classes of business. QBE has already implemented significant increases to premium rates and deductibles, as well as changes to terms and conditions, for property and commercial package classes in Australia, New Zealand, North America, Latin America and parts of Asia. Further rate increases will be achieved in 2012 to cover the rising cost of reinsurance and increased level of catastrophes. We are currently estimating overall average premium rate increases to be around 5%, subdued by the flat premium rates in the UK and mainland Europe.

Our target for the underlying combined operating ratio has not changed from that previously announced to the market; however, due to uncertainty on risk-free rates used to discount outstanding claims, our financial target is for a combined operating ratio of less than 90.0%. We believe we can achieve this target in the current market conditions; however, there are many variables to consider such as those experienced in 2011.

We expect that premium rate increases will further reduce the attritional claims ratio. As a consequence of the catastrophe claims, we have made a number of changes to our exposures to improve the reward for the risks we undertake. This will result in lower premium income in some areas. Our models assume that events similar to those in 2011 could recur. These changes include cancelling certain business, increasing deductibles, eliminating certain coverages and raising prices. These changes, together with the purchase of additional aggregate reinsurance, additional protection for crop hail and a lower maximum event retention, support our targeted large individual risk and catastrophe claims ratio of 10% to 11% for 2012.

Our underlying target for the combined operating ratio assumes that risk-free interest rates for discounting outstanding claims will remain at their record low levels. A 0.5% increase in risk-free interest rates reduces the claims ratio and the combined operating ratio by around 0.6%.

We expect that the combined commission and expense ratio will be less than 29.5% including a full year's earning of the Balboa lender placed homeowners business and the normalisation of short-term and long-term incentive payments from an improvement in underwriting profitability.

Our target gross and net written premium will depend on acquisitions during 2012. Our action to reduce exposure to catastrophes and increase prices may result in lower premium income in some areas. At this stage, we are on track for low single digit growth. Our underlying cost of reinsurance is expected to remain around current levels.

We will continue our conservative investment strategy, focusing on high quality and liquid securities. We will maintain a short duration strategy for fixed interest securities to protect capital and maintain liquidity. We have had no permanent impairment in our cash and fixed interest portfolio in the past four difficult years, which is a reflection of our focus on quality. We are targeting a 3.0% yield on our total cash and fixed interest portfolio, which includes substantial investments in European, UK, US and Australian fixed interest securities to match our liabilities in those currencies, and an allowance for a slight reduction in credit spreads. A 25 basis points increase in credit spreads is equivalent to a loss of investment income of US\$88 million.

Due to the expectation that regulators and rating agencies will increase the capital charge on equity investments, we will maintain a relatively small exposure to physical equities. Since 31 December 2011, we have increased our exposure to around 2% of our total investment portfolio.

Our insurance businesses around the world are in good shape and are well positioned to take advantage of improving market conditions, including the increase in premium rates and changes to exposures in a number of our portfolios. Our recent acquisitions have exceeded our expectations. We have a strong culture based on our OPENUP QBE essential behaviours. We have maintained our internal target requirement for a minimum 15% return on allocated capital for each product, each country and each division, despite the market conditions.

QBE has made over 140 acquisitions in the past 30 years to grow the business from gross written premium of US\$185 million to US\$18 billion in 2011. We now operate in 52 countries around the world and we focus on selected businesses where we believe we can outperform. We will continue to look for opportunities to build our business and deliver returns to our shareholders. We expect 2012 to be a year of lower growth than the past five years as we focus on consolidating our existing businesses, identifying smaller bolt-on acquisitions and taking action on selected portfolios to improve performance.

I would like to acknowledge and thank our claims staff who worked tirelessly to manage the substantially increased claims arising from catastrophes during 2011. Our policy is to pay valid claims promptly and that is what we have been able to achieve, with excellent feedback from the vast majority of our intermediaries and our direct clients. QBE management and our hard-working teams around the world are disappointed with the financial result even though we continue to outperform most of our peers and produce an underwriting profit in the most difficult year that the insurance industry has experienced for some time. I appreciate the enormous support they and the Group executive have given to me over the past 12 months.

I also acknowledge the contributions of Terry Ibbotson and Vince McLenaghan who left QBE during 2011 after many years of loyal service. It is a tribute to them and our succession planning that the positions on the Group executive have been filled by very capable and long-serving QBE trained executives.

You will note from the inside front cover of the annual report that we have refreshed our vision to reflect the growth of the company over the past 17 years since the vision was first introduced. Over this period, we have achieved many of our goals. Our core values are unchanged; however, our refreshed vision sets us new aspirational goals reflecting the Group's increased scale and diversity. We are updating the strategies to support our refreshed vision for implementation in the year ahead.

We are confident that our culture and business model will enable us to continue our proven track record of growth, disciplined underwriting and uncompromising focus on outperformance, and allow us to return to growth in profit.

**Frank O'Halloran**  
Chief executive officer

# 2012 TARGETS

## GROSS EARNED PREMIUM GROWTH

Low  
single digit

## NET EARNED PREMIUM GROWTH

Low  
single digit

## COMBINED OPERATING RATIO

Less  
than **90%**

## INSURANCE PROFIT MARGIN

**13%** of net  
earned premium  
or better

# Group financial targets and performance goals

## 2011 FINANCIAL PERFORMANCE

TARGETS*	ACTUAL
<ul style="list-style-type: none"> <li>An insurance profit margin of between 15% and 18%</li> </ul>	<ul style="list-style-type: none"> <li>Insurance profit of 7.1%</li> </ul>
<ul style="list-style-type: none"> <li>A combined operating ratio of between 87% and 90%</li> </ul>	<ul style="list-style-type: none"> <li>Combined operating ratio of 96.8%</li> </ul>
<ul style="list-style-type: none"> <li>Gross earned premium growth of around 19% to 22%</li> <li>Net earned premium growth of around 22% to 25%</li> </ul>	<ul style="list-style-type: none"> <li>Gross and net earned premium growth of 33% and 35% respectively</li> </ul>
<ul style="list-style-type: none"> <li>A reinsurance ratio of around 12% of gross earned premium</li> </ul>	<ul style="list-style-type: none"> <li>Reinsurance expense ratio of 13.9%</li> </ul>
<ul style="list-style-type: none"> <li>An attritional claims ratio of around 49% on an accident year basis</li> </ul>	<ul style="list-style-type: none"> <li>Attritional claims ratio of 49.2%</li> </ul>
<ul style="list-style-type: none"> <li>An income tax expense rate of around 23%</li> </ul>	<ul style="list-style-type: none"> <li>Income tax expense of 17.2%</li> </ul>
<ul style="list-style-type: none"> <li>Maintain Group capital adequacy multiple of more than 1.5 times APRA's minimum requirement</li> </ul>	<ul style="list-style-type: none"> <li>MCR multiple of 1.5 times</li> </ul>
<ul style="list-style-type: none"> <li>Gross investment yield of 3.3% to 3.5%</li> </ul>	<ul style="list-style-type: none"> <li>Gross investment yield of 3.1%</li> </ul>

## 2011 OPERATIONAL PERFORMANCE

PERFORMANCE GOALS	ACTUAL
<ul style="list-style-type: none"> <li>Target overall premium rate increase of 2% and high retention rate on renewed business</li> </ul>	<ul style="list-style-type: none"> <li>Retention rates remained high with overall average premium rate increase of 3.6% on renewed business</li> </ul>
<ul style="list-style-type: none"> <li>Integrate the acquired businesses of Renaissance Re and Balboa in the US</li> </ul>	<ul style="list-style-type: none"> <li>Integration of both acquisitions well progressed</li> </ul>
<ul style="list-style-type: none"> <li>Continue to look for acquisition opportunities that meet our strict earnings criteria</li> </ul>	<ul style="list-style-type: none"> <li>During 2011, completed five acquisitions expected to generate GWP of US\$2.6 billion in a full year</li> </ul>
<ul style="list-style-type: none"> <li>Complete funding arrangements to support lower Tier 2 capital and maintain key balance sheet ratios at levels that provide security and flexibility for growth</li> </ul>	<ul style="list-style-type: none"> <li>Issued US\$1.0 billion and £325 million of subordinated debt securities which meet lower tier 2 capital criteria</li> <li>MCR of 1.5 times, consistent with our minimum benchmark</li> </ul>
<ul style="list-style-type: none"> <li>Target a return on average shareholders' funds in excess of 15%</li> </ul>	<ul style="list-style-type: none"> <li>Achieved a return on average shareholders' funds of 6.8%</li> </ul>

\* Targets assume: large individual risk and catastrophe claims do not exceed the significant allowance in our business plans; no overall reduction in premium rates; no significant fall in equity markets and interest rates; no major movement in budgeted foreign exchange rates; and no material change to key inflation and economic growth forecasts. Foreign exchange rates used in the determination of 2012 targets are A\$/US\$1.008, £/US\$1.583 and €/US\$1.360.

## 2012 FINANCIAL PERFORMANCE

### TARGETS\*

- An insurance profit margin of 13% of net earned premium or better
- A combined operating ratio of less than 90%
- Low single digit gross and net earned premium growth
- Reinsurance expense ratio of around 12.5% of gross earned premium
- Combined commission and expense ratio of less than 29.5%
- Claims ratio of less than 60.5%
- Income tax expense of around 23%
- MCR multiple more than 1.5 times APRA's minimum requirement
- Gross investment yield on policyholders' funds of around 3.0%

## 2012 OPERATIONAL PERFORMANCE

### PERFORMANCE GOALS

- Achieve overall premium rate increase on renewal business of 5%
- Reduce ratio of borrowings to shareholders' funds to less than 40%
- Identify bolt-on acquisitions that meet our strict criteria
- Maintain key balance sheet ratios at levels that provide security and flexibility for growth
- Achieve a return on average shareholders' funds of 13% to 15% with a target return on allocated capital for insurance products of at least 15%

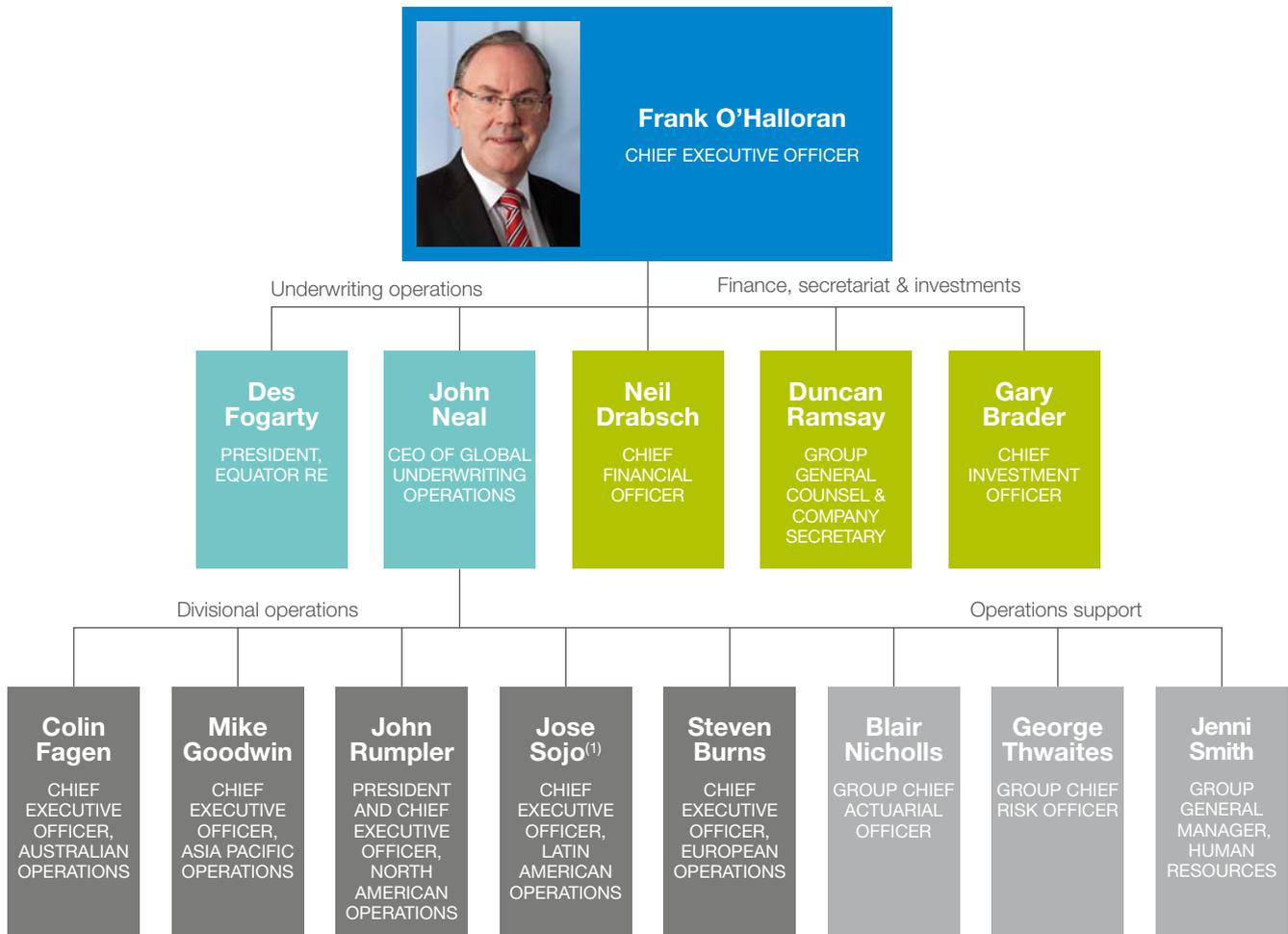
# QBE executive team

“QBE’s head office executive team provides company secretarial, finance, investment, legal and operations support to the Group chief executive officer and divisional operations. The divisional and head office teams have frequent interaction to enable cohesive business planning and successful delivery of the Group’s vision and strategies.”

**FRANK O’HALLORAN** CHIEF EXECUTIVE OFFICER

The QBE executive reporting structure is set out below. There are six operating divisions: North America, Latin America, Europe, Australia, Asia Pacific and Equator Re. Each of these divisions is a substantial business in its own right, with a divisional chief executive officer. The chief executive officer of global underwriting operations is responsible for the day-to-day management of the underwriting performance of these divisions.

## GROUP EXECUTIVE STRUCTURE



(1) Appointed to the Group executive in 2012.



### **JOHN NEAL**

CHIEF EXECUTIVE OFFICER OF GLOBAL UNDERWRITING OPERATIONS  
AGE 47

Mr Neal has worked at QBE for seven years and was appointed to the role of chief executive officer of global underwriting operations with effect from 1 January 2011. He joined QBE in 2004 following QBE's acquisition of his successful Ensign commercial motor operations. Since joining the Group, he has served in several senior management roles within QBE's European operations, including as chief operating officer and chief underwriting officer.



### **NEIL DRABSCH**

CHIEF FINANCIAL OFFICER  
FCA, FAICD, FCIS  
AGE 63

Mr Drabsch has worked at QBE for 20 years and was appointed chief financial officer in 1994. He joined QBE in 1991 and was the Group company secretary from 1992 to 2001. Mr Drabsch has over 45 years experience in insurance and reinsurance management, finance and accounting, including 24 years as a practising chartered accountant.



### **DUNCAN RAMSAY**

GROUP GENERAL COUNSEL & COMPANY SECRETARY  
B Comm, LLB, LLM, FANZIIF, FCIS  
AGE 50

Mr Ramsay has worked at QBE for 18 years, joining as Group general counsel in 1993, and was appointed Group general counsel and company secretary in 2001. Prior to joining QBE, Mr Ramsay spent seven years working for Freehills, an Australian law firm, in the general commercial and litigation areas.



### **GARY BRADER**

CHIEF INVESTMENT OFFICER  
B Comm  
AGE 45

Mr Brader has worked at QBE for eight years and was appointed Group chief investment officer in January 2011. He joined QBE in 2003, becoming head of fixed income shortly thereafter. He came to the Group from Alliance Capital in London and has 19 years prior investment experience, including time with AXA Investment Managers in London and AXA Australia.



### **JENNI SMITH**

GROUP GENERAL MANAGER, HUMAN RESOURCES  
MBA  
AGE 49

Ms Smith has worked at QBE for eight years as Group general manager, human resources. She was formerly general manager HR, international at Telstra Corporation Limited, based in Sydney with specific Asia-Pacific responsibilities. Ms Smith has extensive business and human resources experience in the UK in the advertising and television industries.



# Risk management and regulatory developments

Our ability to manage risk is central to the success of our business. We have a flexible framework and tools, developed over many years, which allow us to identify and manage key areas of risk and provide a view of the risk position of QBE at entity level and as a consolidated entity. As QBE and the environment in which we operate changes, we will continue to enhance and tailor our framework and tools to suit our needs.



**GEORGE THWAITES**  
GROUP CHIEF RISK OFFICER

## QBE'S RISK MANAGEMENT

To create wealth for our shareholders, QBE must pursue opportunities that involve risk. We seek to take on only risks which fall within the Group's stated risk appetite and to achieve an optimal return from those risks. The Group risk management framework is designed to support this approach and enhance risk-based decision making.

2011 was a year which tested the resilience of QBE's risk management framework and processes. A record level of natural catastrophes impacted QBE's underwriting result and conditions in global credit markets reduced the profit contribution from our investment portfolio. We exceeded the allowance for large individual risk and catastrophe claims which had been set in our planning process at a level above the average for the previous seven years. Overall returns were well below target levels and outside our risk appetite on a one year basis.

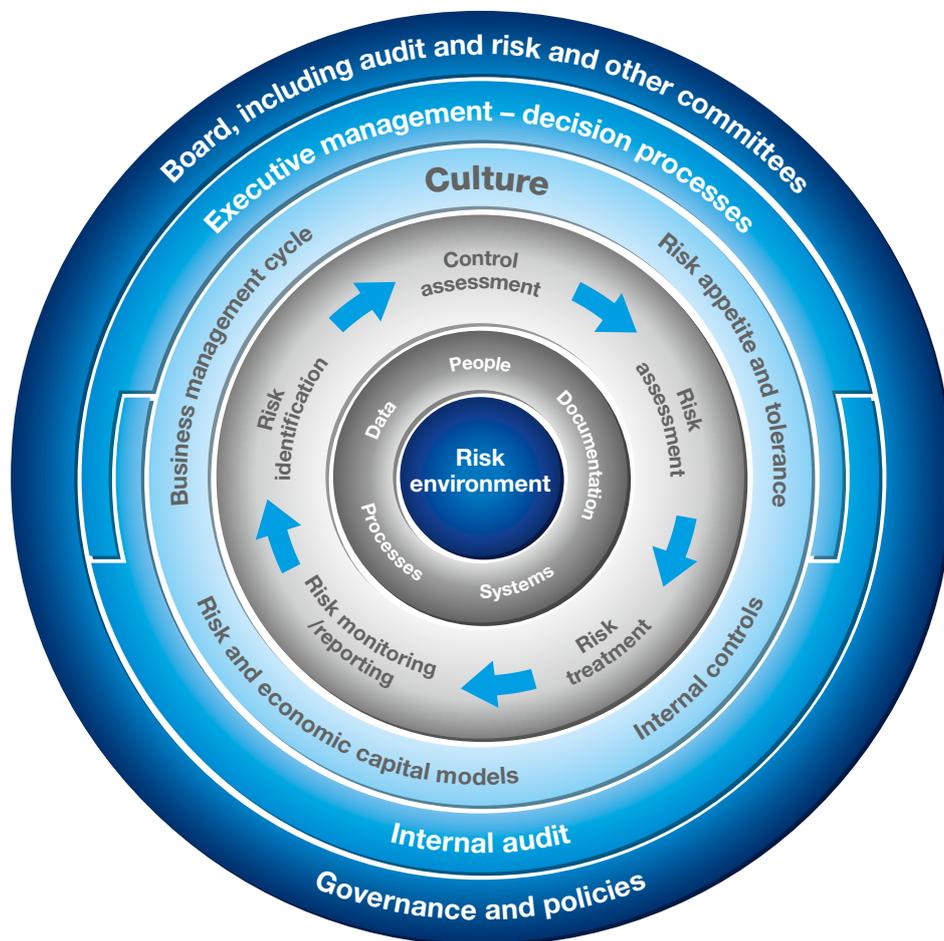
The impact of these combined factors was significantly mitigated by the range of initiatives that were already in place coming into 2011 or were brought into play as the year progressed. Although we are disappointed with the overall result, we did not exceed our expected losses for any single event during 2011; we did not experience a permanent diminution in value of any investment holding; and our core insurer financial strength and issuer credit ratings remain unchanged.

Aggregate management, reinsurance and diversification are key pillars of QBE's underlying approach to insurance risk management.

Our insurance portfolio management process, including aggregate management, identifies and corrects those areas of the business which underperform, enabling us to adjust exposures when risk-adjusted return hurdles are not met. This ongoing process of portfolio re-engineering has resulted in a range of actions to reduce exposures and increase rates for 2012. As a result of this process, and changes in reinsurance, the Group's maximum event retention for a natural catastrophe has reduced to 3.2% of projected net earned premium for 2012. This is expected to increase during the year to around 3.8% as we approach the US windstorm season.

Our inward reinsurance portfolios provide a natural hedge against the impact of the rising costs of outward reinsurance. This, together with the multi-year worldwide outward reinsurance program put in place for 2011 to 2013, will protect the overall insurance margin for 2012. For 2011, the worldwide program provided a benefit to profit of US\$219 million when compared with how the 2010 program would have performed in the year.

Acquisitions are a core source of diversification for QBE and all recent acquisitions have performed as well as, or better than, expected. Acquisitions provided support to the result of the overall business in a year where there was a significant frequency of losses across a wide geographic spread. The process of acquiring and appropriately integrating businesses is a core competency of QBE, and the risks and opportunities associated with every acquisition are closely assessed and monitored.



Despite the investment portfolio being impacted by increased credit spreads, our focused credit management process resulted in no permanent diminution in the value of our investments during 2011. There remain significant systemic risks in global credit markets and our approach to portfolio management continues to be heavily focused on credit quality. Management of inflation risk in relation to claims means that we continue to run the investment portfolio at a duration shorter than the average term to settlement of our claims provision. In a falling interest rate environment, this objective impacts investment return but the approach remains appropriate mid to long-term.

Management incentives are closely aligned to shareholders' interests through the use of return on equity measures and the allocation of capital at a portfolio level by reference to the relative risk. This provides a strong link between appropriate risk taking and reward. Performance hurdles on incentive programs also require adherence to the Group risk management framework.

QBE's risk management framework will continue to evolve as the business and the environment in which we operate changes. Recent challenges have resulted in enhancements to our framework, but have not identified significant weaknesses in how the business manages risk. We will continue to be proactive in managing risk throughout the Group within a framework that supports informed and controlled decision making and allows us to effectively identify and deal with opportunities and issues.

The diagram above shows how the elements of QBE's risk framework fit together around the risk environment.

QBE's culture, as embodied in the nine essential behaviours, remains central to our approach to risk management. 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.

Governance is key to ensuring that the framework continues to be fit for purpose and properly applied, and takes place at many levels throughout the organisation. The QBE board of directors is responsible to shareholders for the performance of the Group and, as such, undertakes a critical role in ensuring that an effective risk management strategy is established and maintained. QBE's Group chief risk officer (CRO) has primary responsibility for developing and maintaining the risk management framework and strategy. This role is supported at Group level by the Group risk and capital forum, which includes the chief executive officer of global underwriting operations, the divisional CROs and other senior executives as appropriate. Within each division, responsibility for the practical and proper implementation of the framework and strategy by management is assigned to the divisional CRO.

Each risk applicable to a division and business unit is assigned a risk owner, being the person with accountability and authority for managing the risk.

Newly acquired operations are required to be substantially compliant with the QBE risk management policy and strategy within 12 months of acquisition or as approved by the Group chief executive officer based on the complexities of the business.

Key risk management information is provided to the Group audit and risk committee, including the assessment of QBE risks, risk management activities, internal fraud and other management issues. Appropriate reporting is also maintained within each division, aligned to the relevant organisational structure, including each division's audit and/or risk committees.

Further details on QBE's corporate governance are provided in the statement of corporate governance on page 51.

## RISK MANAGEMENT AND REGULATORY DEVELOPMENTS CONTINUED



**BLAIR NICHOLLS**  
GROUP CHIEF  
ACTUARIAL OFFICER

Independent assurance on the management of risk is gained in several ways, including:

- The Group's outstanding claims provision is reviewed by experienced internal actuarial staff. Actuarial staff are involved in forming their own view, separate from management, of the central estimate and the probability of adequacy of the outstanding claims provision. Actuarial staff also review the probability of adequacy of premium liabilities, premium rates and other matters.
- Around 90% of QBE's central estimate is also reviewed by external actuaries annually.
- QBE's internal audit function reports to the Group audit and risk committee to provide independent assurance that the design and operation of controls across the Group are effective.
- The external auditor issues an audit opinion on the Group's annual financial statements and a review report on the half year financial statements in accordance with Australian auditing standards. The external auditor also reports annually to APRA as to the level of compliance of QBE's APRA licensed insurance entities with the statements made in their respective risk management and reinsurance management strategy documents.

### RISK MANAGEMENT FRAMEWORK

The Group has classified material business risks into the following key areas of exposure:

- Strategic risk – the current and prospective impact on earnings and/or capital arising from strategic business decisions, implementation of decisions and responsiveness to external change, including reputational risk.
- 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. It includes underwriting, catastrophe and estimation risks.
- Credit risk – the risk of default by borrowers and transactional counterparties as well as the loss of value of assets due to deterioration in credit quality. Exposure to credit risk results from financial transactions with securities issuers, debtors, borrowers, brokers, policyholders, reinsurers and guarantors.
- 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.
- Liquidity risk – 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.
- Operational risk – the risk of financial loss resulting from inadequate or failed internal processes, people and systems or from external events (including legal risk).

The risk assessment and monitoring framework involves ongoing:

- identification and review of the key risks to the Group, including the identification of emerging risks and definition of the acceptable level of risk appetite and tolerance;
- assessment of identified risks throughout the Group in terms of the acceptable level of risk (risk tolerance) and the residual risk remaining after having considered risk treatment;
- determination of the need for any action required to optimise exposure to risk, including action 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 the risks.

Note 5 to the financial statements provides further information and quantification of risk across each of the non-strategic risk areas and note 4 provides sensitivities around key financial measures.

### RISK APPETITE AND TOLERANCE

Risk appetite is the level of risk that the board and management are prepared to take in pursuit of the Group's strategic objectives. At Group level, risk appetite is expressed as follows:

- through the board-approved risk appetite statements and risk tolerances for each of the QBE risk categories, including the Group's maximum tolerance for 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 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 annually and approved by the Group board. An important input into setting the overall tolerance is the allowance for large individual risk and catastrophe claims in the business plan as outlined above.

The Group has assessed its major insurance exposure to be a catastrophe loss that may impact more than one class of business and more than one of the Group's operating divisions. This is estimated through a rigorous assessment methodology that includes realistic disaster scenarios, commercial catastrophe loss models and in-house catastrophe loss assessment tools. The outcomes contribute to the setting of reinsurance levels required by QBE and, in conjunction with QBE's risk appetite and tolerance, determine the amount of risk that is retained by the Group in any one geographic region for a particular peril.

## ALLOCATION OF CAPITAL

QBE uses a Group-wide economic capital model (ECM) to help assess risk and determine an appropriate level of risk-based capital to allocate to the insurance, credit, market, liquidity and operational risks to which the Group is exposed. This capital allocation is used in determining the required returns on equity for QBE incentive schemes.

The allocation of risk-based capital helps to ensure that the risk taken by the business 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. The ECM is used by management:

- to help determine the strategic capital allocation;
- for business planning, underwriting performance measurement, pricing, reinsurance and aggregate management; and
- in determining regulatory capital.

## REGULATORY DEVELOPMENTS

As part of QBE's approach to risk management, QBE takes a proactive approach to managing and mitigating regulatory risk globally. As a global insurance group, QBE's regulatory environment can be highly dynamic with developments, impacts and implementation dates all subject to frequent change. Consequently, QBE continually monitors regulatory developments on both an international and local basis to ensure that any potential impact to QBE's operations is dealt with effectively.

Regular discussions with third parties such as rating agencies and regulators from various jurisdictions indicate a positive view of QBE's general management approach and risk framework. One such forum for discussion was the inaugural QBE supervisory college hosted in Sydney by APRA in early 2011 which was attended by many of QBE's regulators. We believe such meetings serve to promote awareness amongst supervisors of QBE's global and robust approach to risk management and executive management's approach to key stakeholders.

Although the global financial crisis did not generally impact insurers to the same degree as the banking sector, many regulators, governments, and other organisations (such as the G20 and the International Monetary Fund) have cited the financial crisis as highlighting a need for more effective governance and risk management across all financial sectors. For example, the US National Association of Insurance Commissioners (NAIC) has publicly stated that the reasons for its reforms include the need to address "issues identified during this most recent economic downturn".

The International Association of Insurance Supervisors (a G20 mandated organisation for establishing consistent insurance regulatory standards worldwide) released a suite of insurance core principles in October 2011. We expect these will have a significant impact on both the form and extent of prudential regulation globally whilst providing a fresh impetus to a number of reforms already under way.

A key focus of a number of these reforms is dealing with a number of relatively recent changes in the global insurance market, such as the introduction of more sophisticated insurance products and the utilisation of more complex financing structures, both on a cross-sector and cross-border basis. In addition, the current insurance regulatory regime has been generally perceived by supranational governmental organisations such as the Financial Stability Board as too concentrated on a local, operating entity basis and lacking a focus on group-wide risks. It is therefore likely that provisions for increased supervision on a "whole-group" basis, including formal coordination between supervisors, will be a key feature of many reforms.

One such reform, Europe's Solvency II directive, is now expected to come into effect in January 2014. Although there is the possibility of transitional provisions applying to certain aspects of the directive, insurers have been advised by EU authorities that they should aim to be compliant before this date. An important part of Solvency II for QBE is the concept of "equivalence" which aims to determine whether non-EU regulatory regimes provide a similar level of policyholder and beneficiary protection as Solvency II. As a non-EU domiciled Group with significant operations within the EU, "equivalence" could have a material impact on capital and other compliance requirements for QBE. QBE is actively engaged with regulators to seek a balanced and smooth transition to this new regime.

The US is also beginning to see the impact of significant change in the approach to insurance regulation. In addition to the creation of a Federal Insurance Office which has authority over international agreements on insurance matters, state level changes implemented by the NAIC represent a fundamental shift in emphasis. In a move away from regulating specific transactions and relationships to regulating risks on a 'group-wide' basis, the NAIC has introduced the concept of "enterprise risk" which requires a group-wide enterprise risk report along with stricter standards for intra-group transactions and provisions to promote cooperation between US and non-US regulators, including a provision for participation in supervisory colleges at the insurers' cost.

In Australia, APRA has continued its review of capital standards for life and general insurance companies (LAGIC) aimed at introducing a more risk-sensitive capital framework. APRA has stated that its proposals are not designed to increase required capital levels generally, but rather to move to a more tailored approach which more accurately reflects the risks borne by an insurer or insurance group. APRA has also indicated that, during 2012, it intends to release further proposals for the supervision of conglomerate (i.e. cross-sector) groups. QBE actively engages with APRA on a continual basis, both directly and through local industry bodies, on these and other regulatory issues.

QBE will continue to monitor and actively engage in the regulatory process. We anticipate that there will continue to be significant changes and increased burdens from the various regulatory developments, and QBE's risk management framework is well placed to deal with this.

# Operations overview

With the exception of Equator Re, all operating divisions produced underwriting profits in a record year for catastrophe claims.

## North American operations

General insurance and reinsurance in the US and Bermuda, through five specialist business units: reinsurance, intermediary, program, crop and financial institutions.

	2011	2010
Gross written premium US\$M	<b>7,529</b>	4,606
Gross earned premium US\$M	<b>7,431</b>	4,563
Net earned premium US\$M	<b>4,018</b>	2,555
Combined operating ratio %	<b>90.6</b>	89.1
Staff numbers	<b>6,754</b>	5,048

Major events impacting our North American operations in 2011:

- acquisition of the Balboa insurance portfolio, a significant book of lender placed homeowners business, effective 1 April;
- acquisition of both the crop and program portfolios of Renaissance Re's US operations effective 1 January, further expanding our crop segment;
- hurricane Irene and the record frequency of tornadoes;
- realignment of our business into five major segments including the creation of QBE FIRST, the combined operations of our legacy Sterling and acquired Balboa lender placed businesses; and
- 2010 and 2011 acquisitions exceeded expectations.

## Latin American operations

General insurance operations in seven countries throughout Central and South America, focusing mainly on specialised classes of business.

	2011	2010
Gross written premium US\$M	<b>768</b>	559
Gross earned premium US\$M	<b>752</b>	554
Net earned premium US\$M	<b>620</b>	454
Combined operating ratio %	<b>89.7</b>	93.4
Staff numbers	<b>1,044</b>	1,040

Major events impacting our Latin American operations in 2011:

- successful merger of CNA and QBE ART in Argentina which now represents 13% of the local SME workers' compensation market;
- strong rate increases in the SME portfolios in Argentina and Mexico in challenging market conditions;
- enhancement of our commercial strategy in Colombia;
- 2010 acquisitions exceeded expectations;
- start-up of QBE Chile, a company focused on SME property and casualty business; and
- signing of agreements to purchase Optima Insurance Group in Puerto Rico.

## European operations

Comprises commercial insurance and reinsurance in both the Lloyd's market as well as in the UK, Ireland and mainland Europe.

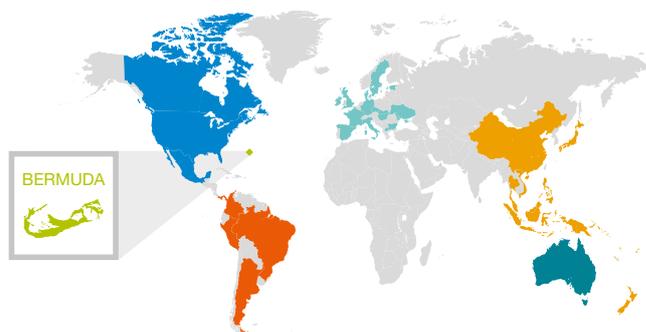
	2011	2010
Gross written premium US\$M	<b>4,828</b>	4,156
Gross earned premium US\$M	<b>4,635</b>	4,008
Net earned premium US\$M	<b>3,150</b>	2,593
Combined operating ratio %	<b>95.5</b>	90.5
Staff numbers	<b>2,716</b>	2,759

Major events impacting our European operations in 2011:

- achievement of a COR of 95.5% despite record catastrophe experience and difficult trading conditions;
- significant progress of our IT and operational change programs with benefits realised, including the decommissioning of four legacy underwriting systems;
- post acquisition review of the 2010 Secura acquisition completed with results exceeding expectations;
- impact of Solvency II preparations, which are nearing finality, with many of the underlying projects being moved into business as usual; and
- continued strengthening of our product model.

KEY

- North America
- Latin America
- Europe
- Australia
- Asia Pacific
- Equator Re



## Australian operations

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

	2011	2010
Gross written premium US\$M	<b>4,486</b>	3,707
Gross earned premium US\$M	<b>4,355</b>	3,720
Net earned premium US\$M	<b>3,767</b>	3,033
Combined operating ratio %	<b>99.3</b>	89.2
Staff numbers	<b>4,382</b>	4,337

Major events impacting our Australian operations in 2011:

- the CUNA Mutual acquisition added US\$62 million in new gross written premium;
- continued excellent results from QBE LMI, reflecting the underlying strength of our underwriting controls and stable economic conditions;
- Queensland storms, cyclone Yasi and severe east coast storm activity which added over 30,000 claims, with 97% of claims already paid; and
- restructuring of our IT, targeted to provide cost savings and more robust and efficient systems.

## Asia Pacific operations

General insurance in 17 countries in the Asia Pacific region providing personal, commercial and specialist insurance covers, including professional and general liability, marine, corporate property and trade credit.

	2011	2010
Gross written premium US\$M	<b>680</b>	601
Gross earned premium US\$M	<b>653</b>	587
Net earned premium US\$M	<b>442</b>	420
Combined operating ratio %	<b>92.1</b>	86.7
Staff numbers	<b>1,346</b>	1,307

Major events impacting our Asia Pacific operations in 2011:

- premium growth achieved in challenging market conditions;
- profits achieved in all but two countries (New Zealand and Thailand);
- New Zealand earthquakes and the Thailand floods;
- the successful implementation of a new executive and management structure that more closely aligns the division with its customers, delivering increased operational efficiencies; and
- acquisition of the remaining 49% of the Malaysian operation.

## Equator Re

The Group's captive reinsurer, Equator Re, provides reinsurance protection to, and assists the management of, net exposure within the Group's appetite for risk and capital levels for the majority of the operating entities owned by the Group.

	2011	2010
Gross written premium US\$M	<b>3,807</b>	2,479
Gross earned premium US\$M	<b>3,697</b>	2,363
Net earned premium US\$M	<b>3,362</b>	2,307
Combined operating ratio %	<b>104.5</b>	90.1
Staff numbers	<b>22</b>	21

Major events impacting Equator Re in 2011:

- premium growth driven mainly by business sourced from the Group's acquisitions in the US;
- results were after prudent strengthening of risk margins in outstanding claims which added 3.2% to the COR; and
- significant catastrophe claims including two earthquakes in New Zealand, the Thailand floods, Japanese earthquake and various Australian and US weather-related events.



# North American operations review

“QBE’s North American division offers a wide range of solutions in selected market segments and comprises five main business units covering reinsurance, intermediary, program, crop and financial institutions (QBE FIRST).”

**JOHN RUMPLER** PRESIDENT AND CHIEF EXECUTIVE OFFICER, NORTH AMERICAN OPERATIONS

<b>GROSS WRITTEN PREMIUM</b>	<b>UNDERWRITING RESULT</b>	<b>INSURANCE PROFIT</b>
<b>US\$7,529M</b>	<b>US\$378M</b>	<b>US\$440M</b>
Up <b>63%</b> from last year	Up <b>35%</b> from last year	Up <b>24%</b> from last year



Despite a year of increased frequency and severity of weather-related claims, our specialised and diverse businesses produced a strong underwriting profit with a combined operating ratio of 90.6%. Underwriting profit was up 35% to US\$378 million.

Gross written premium growth benefited from acquisitions completed in the first half of the year and emerging premium rate increases in the second half, particularly in property classes and workers’ compensation. The acquisitions exceeded our expectations in relation to premium growth and overall underwriting profitability.

## MARKET CONDITIONS

In 2011, the majority of US insurers were adversely impacted by the increased frequency of catastrophe claims with 19 severe tornadoes, hail and flood claims and hurricane Irene. Combined with the subdued economic conditions and strong competition in most markets, the US property and casualty insurance industry experienced another challenging year, with many insurers reporting combined operating ratios in excess of 100%.

The higher claims cost has generally resulted in US insurers adjusting pricing and deductibles to improve profitability. Premium rates for North America were up 3% on average for renewed business and, in the last two quarters of 2011, up by around 4%. We expect further rate increases and continue to experience an improving trend in retention ratios for classes of business we have targeted to retain.

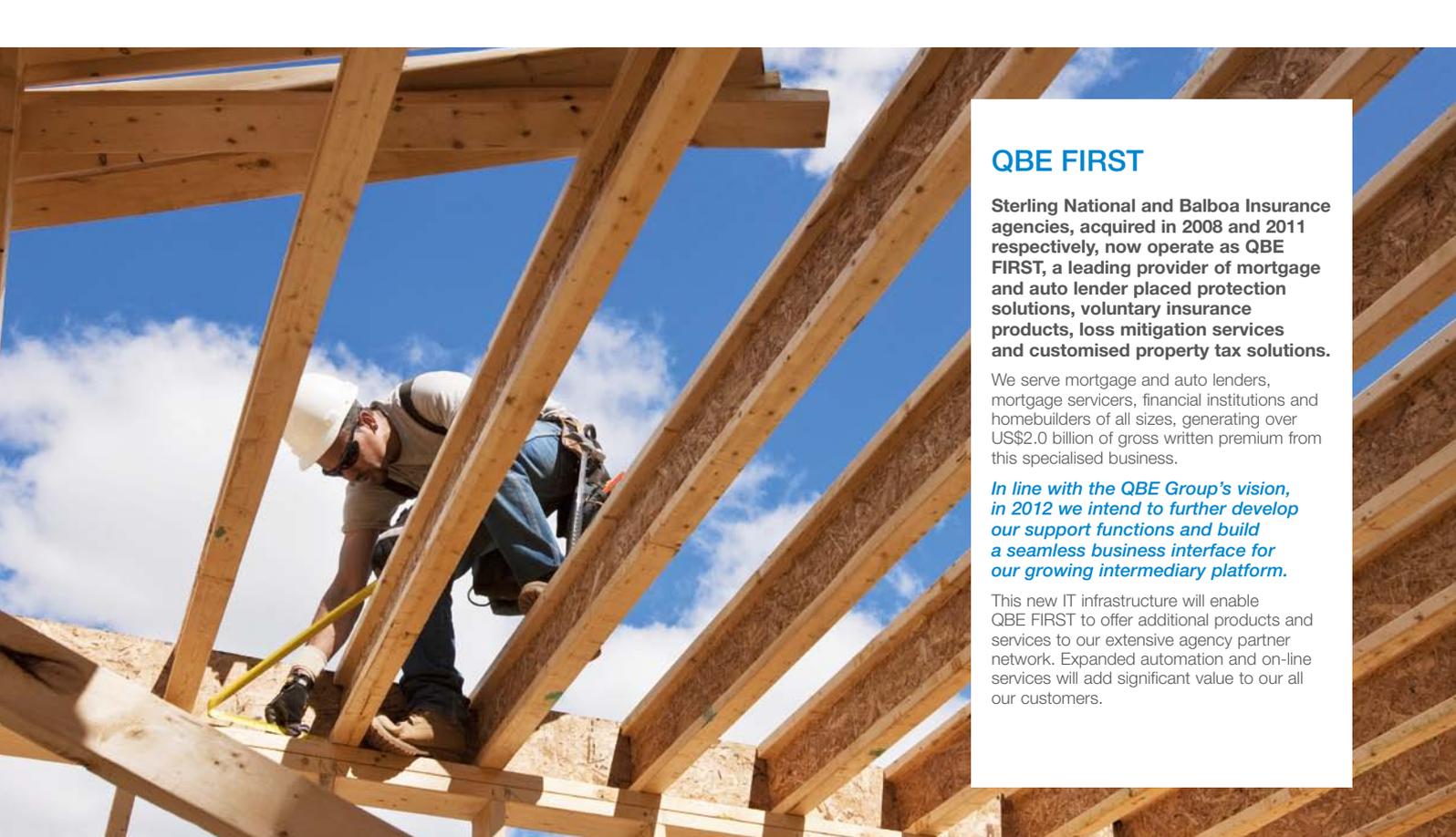
## COMBINED OPERATING RATIO AND INSURANCE PROFIT

The combined operating ratio was 90.6% which was an excellent result given the frequency of catastrophes, the competitive market and the less than average underwriting profit from crop insurance due to severe flooding and hail.

Insurance profit was US\$440 million, up 24% compared with US\$356 million in 2010, reflecting an insurance profit margin of 11.0% compared with 13.9% last year. The increased insurance profit was mainly due to the growth and profit in QBE FIRST’s lender placed homeowners business which, for 2011, represents over 27% of the total gross written premium for North America. However, the lower investment yield on policyholders’ funds and increased catastrophes adversely impacted the insurance profit margin.

## HISTORICAL OVERVIEW IN US DOLLARS

FOR THE YEAR ENDED 31 DECEMBER		2011	2010	2009	2008
Gross written premium	US\$M	<b>7,529</b>	4,606	3,648	3,417
Net earned premium	US\$M	<b>4,018</b>	2,555	2,211	2,332
Combined operating ratio	%	<b>90.6</b>	89.1	89.0	93.9
Insurance profit	US\$M	<b>440</b>	356	326	271
Insurance profit margin	%	<b>11.0</b>	13.9	14.7	11.6



## QBE FIRST

**Sterling National and Balboa Insurance agencies, acquired in 2008 and 2011 respectively, now operate as QBE FIRST, a leading provider of mortgage and auto lender placed protection solutions, voluntary insurance products, loss mitigation services and customised property tax solutions.**

We serve mortgage and auto lenders, mortgage servicers, financial institutions and homebuilders of all sizes, generating over US\$2.0 billion of gross written premium from this specialised business.

*In line with the QBE Group's vision, in 2012 we intend to further develop our support functions and build a seamless business interface for our growing intermediary platform.*

This new IT infrastructure will enable QBE FIRST to offer additional products and services to our extensive agency partner network. Expanded automation and on-line services will add significant value to our all our customers.

## PREMIUM INCOME

Gross written premium was up 63% to US\$7,529 million compared with US\$4,606 million in 2010. Premium growth benefited from US\$1,486 million of new gross written premium from the distribution agreement with Bank of America and underwriting of the Balboa Insurance lender placed homeowners portfolios from 1 April 2011. In addition, US\$1,962 million of gross written premium was generated from crop insurance with the acquisition of NAU Country in 2010 and the US Renaissance Re insurance and agency operations acquired with effect from 1 January 2011.

Net earned premium was up 57% to US\$4,018 million compared with US\$2,555 million in 2010. Net earned premium growth was also driven by acquisition activity. Reinsurance expense was up 2% to 46% of gross earned premium, with the increase mainly due to crop insurance. Excluding proportional reinsurance with our captive, Equator Re, the reinsurance expense ratio would have been 18% (2010 19%).

### PORTFOLIO MIX

#### GROSS EARNED PREMIUM FOR THE YEAR ENDED 31 DECEMBER

	2011 %	2010 %
Property	33.9	29.3
Agriculture and bloodstock	27.3	18.3
Motor and motor casualty	11.4	15.1
Casualty	9.0	13.5
Householders	6.3	4.1
Workers' compensation	4.9	5.7
Financial and credit	4.2	6.9
Accident and health	2.9	7.0
Other	0.1	0.1

## CLAIMS EXPERIENCE

The net claims ratio was 65.2% compared with 62.4% in 2010. The higher ratio was due to the frequency and increased severity of weather-related catastrophe claims from tornado activity in the first half of 2011, and windstorms, bushfires, flood and hail events in the second half which impacted our intermediary, program and crop segments. Partly offsetting this claims activity was continued strong performance in QBE FIRST due to lower than expected catastrophe claims in this portfolio.

There was a strengthening of prior accident year claims provisions within our program and intermediary segments with the overall claims provision and risk margin levels remaining stable. Our program and intermediary segments underperformed as a result of increased catastrophes and a higher frequency of attritional claims.

## COMMISSION AND EXPENSES

The total commission and expense ratio to net earned premium was 25.4%, down from 26.7% in 2010. The decrease was mainly due to the crop and QBE FIRST lender placed homeowners businesses which both operate at a lower combined commission and expense ratio.

The commission ratio was 6.6% compared with 9.6% in 2010, with the lower ratio mainly due to the significant increase in crop business and the changing mix of business in the North American portfolio.

The expense ratio was up to 18.8% from 17.1%. The increase was driven by integration costs primarily associated with the acquisition of the Balboa business and lower net agency income from third parties.

## NORTH AMERICAN OPERATIONS REVIEW CONTINUED

### UNDERWRITING RESULT

FOR THE YEAR ENDED 31 DECEMBER		2011	2010
Gross written premium	US\$M	<b>7,529</b>	4,606
Gross earned premium	US\$M	<b>7,431</b>	4,563
Net earned premium	US\$M	<b>4,018</b>	2,555
Net incurred claims	US\$M	<b>2,622</b>	1,594
Net commission	US\$M	<b>264</b>	246
Expenses	US\$M	<b>754</b>	436
Underwriting result	US\$M	<b>378</b>	279
Claims ratio	%	<b>65.2</b>	62.4
Commission ratio	%	<b>6.6</b>	9.6
Expense ratio	%	<b>18.8</b>	17.1
Combined operating ratio	%	<b>90.6</b>	89.1
Insurance profit to net earned premium	%	<b>11.0</b>	13.9

### ACQUISITIONS

Acquisitions in the first half of the year included the US insurance operations of Renaissance Re as well as the Balboa distribution agreement with Bank of America. The Renaissance Re acquisition was effective 1 January 2011, whilst Balboa was effective 1 April 2011. Total gross written premium from these acquisitions in a full year is expected to be around US\$2.5 billion.

Our immediate focus is on integrating acquisitions to date, maximising synergies and cross-selling opportunities within our existing business and improving the profitability of our intermediary and program business.

### OTHER DEVELOPMENTS

The North American division's long-term strategic plan to achieve greater efficiency in systems, distribution and claims handling progressed significantly in 2011. Benefits were delivered primarily from claims efficiencies due to improved vendor management, data governance, data centre consolidation and better information systems. Key business development accomplishments during the year included the launch of new businesses such as the major brokers unit and our specialist aviation team, the progressive alignment and integration of our agency operations within our mainstream businesses and the launch of a number of major technology projects.

## OUTLOOK FOR 2012

Gross written premium for 2012 for our US operations is forecast to be around US\$7.1 billion; however, this is subject to crop premium rates for 2012 which are dependent on commodity prices.

We have increased prices in most classes of business and adjusted deductibles where appropriate. We expect overall average premium rate increases on renewed business, excluding crop, of close to 5%. We are focusing on the profitability of specialist programs and ensuring higher levels of efficiency and improved products within our independent agency businesses. Our reinsurance business remains consistently profitable and is now benefiting from improving market conditions.

Initiatives are in place and targeted to achieve an improvement in the combined operating ratio. These include cancelling some program and intermediary business; more efficient claims handling and claims cost leakage improvements; process and product enhancements; and systems consolidation.

We will maintain our strict underwriting discipline, with our aim to consistently produce an overall combined operating ratio of less than 90% and to exceed the Group's minimum target of 15% return on allocated capital for each of our products and businesses.

### 2012 FORECAST GWP US\$7.1BN

**REINSURANCE**  
US\$500M

**INTERMEDIARY**  
US\$1,400M

**PROGRAM**  
US\$1,500M

**CROP**  
US\$1,800M

**QBE FIRST**  
US\$1,900M

The division has again produced a sound result in what has been a prolonged challenging period for the US property and casualty industry. I would like to commend the team and thank them for their hard work and contributions, and their ability to remain focused on servicing our customers. We look forward to further improved profitability in 2012.

**John Rumpler**

President and chief executive officer, North American operations



# Latin American operations review

“ Our Latin American division now operates in seven countries with a focus on specialised classes of business which can consistently exceed the Group’s 15% minimum return on allocated capital requirement. ”

JOSE SOJO CHIEF EXECUTIVE OFFICER, LATIN AMERICAN OPERATIONS

GROSS WRITTEN PREMIUM

US\$**768M**

Up **37%** from last year

UNDERWRITING RESULT

US\$**64M**

Up **113%** from last year

INSURANCE PROFIT

US\$**101M**

Up **80%** from last year

QBE is one of the largest insurers in the workers’ compensation market for agencies in Argentina, the largest non-life insurer in Ecuador, the largest underwriter of personal injury insurance in Colombia, a developer of select micro insurance products in Brazil and one of the most profitable underwriters of small to medium enterprise (SME) business in Mexico.

Premium growth during the year benefited from acquisitions in Argentina and Ecuador, with underwriting profits achieved in all the countries in which we operate.

## MARKET CONDITIONS

Unlike the rest of the world, 2011 was a relatively benign year for catastrophe claims in Latin America. As such, market conditions remained competitive, especially in non-catastrophe affected lines of business.

In 2011, we were able to obtain strong premium rate increases in our SME portfolios in Argentina and Mexico (12% and 6% respectively); however, premium rates were flat in other lines of business across the region.

We believe that QBE Latin America is very well positioned for growth and are confident that we will be able to continue to produce solid growth and consistent outperformance for our shareholders. Our focus is to further diversify our product offering and target classes of businesses where competition is less prevalent. We have maintained a selective approach to writing classes of business that maximise profitability rather than offering a broad array of products across the region.

## COMBINED OPERATING RATIO AND INSURANCE PROFIT

The combined operating ratio was an excellent 89.7%, with strong underwriting profits in each of the countries in which we operate. Insurance profit was US\$101 million, up 80% from US\$56 million in 2010, reflecting an insurance profit margin of 16.3% compared with 12.3% in 2010. The improved insurance profit was mainly due to the growth and increased profitability following the successful 2010 acquisitions of CNA in Argentina and Colonial Compania de Seguros y Reaseguros in Ecuador.

### HISTORICAL OVERVIEW IN US DOLLARS

FOR THE YEAR ENDED 31 DECEMBER		2011	2010	2009	2008
Gross written premium	US\$M	<b>768</b>	559	353	323
Net earned premium	US\$M	<b>620</b>	454	316	273
Combined operating ratio	%	<b>89.7</b>	93.4	94.6	91.6
Insurance profit	US\$M	<b>101</b>	56	41	29
Insurance profit margin	%	<b>16.3</b>	12.3	13.0	10.6

## LATIN AMERICAN OPERATIONS REVIEW CONTINUED

### PREMIUM INCOME

Gross written premium was up 37% to US\$768 million compared with US\$559 million in 2010. Premium growth was due mainly to the acquisitions of Colonial Compania de Seguros y Reaseguros in Ecuador and CNA Argentina, which completed in June and July 2010, respectively.

Net earned premium was up 37% to US\$620 million compared with US\$454 million in 2010. Net earned premium growth was also driven by acquisition activity. The cost of reinsurance decreased only slightly from 18.1% to 17.6% of gross earned premium. Approximately 40% of the current cost was reinsurance purchased from other QBE owned entities.

### PORTFOLIO MIX

#### GROSS EARNED PREMIUM FOR THE YEAR ENDED 31 DECEMBER

	2011 %	2010 %
Workers' compensation	36.4	31.6
Accident and health	23.2	32.9
Life insurance	11.5	17.4
Property	10.5	9.9
Motor and motor casualty	7.5	3.8
Casualty	6.9	2.1
Marine and energy	3.3	1.6
Other	0.7	0.7

### CLAIMS EXPERIENCE

The net claims ratio was 56.7% compared with 57.3% in 2010. The lower ratio was mainly due to a change in the mix of business and improvements in the claims ratios for Argentina and Mexico.

### COMMISSION AND EXPENSES

The ratio of total commission and expense to net earned premium was 33.0%, down from 36.1% in 2010. The decrease was mainly due to a change in the mix of business and synergies from acquisitions.

The commission ratio was 19.0% compared with 22.2% in 2010, with the lower ratio due to the CNA acquisition in Argentina which carries a lower commission cost. The expense ratio was up to 14.0% from 13.9%. The slight increase was driven by a higher expense ratio in the business acquired in Ecuador.

### UNDERWRITING RESULT

#### FOR THE YEAR ENDED 31 DECEMBER

		2011	2010
Gross written premium	US\$M	768	559
Gross earned premium	US\$M	752	554
Net earned premium	US\$M	620	454
Net incurred claims	US\$M	351	260
Net commission	US\$M	118	101
Expenses	US\$M	87	63
Underwriting result	US\$M	64	30
Claims ratio	%	56.7	57.3
Commission ratio	%	19.0	22.2
Expense ratio	%	14.0	13.9
Combined operating ratio	%	89.7	93.4
Insurance profit to net earned premium	%	16.3	12.3

### ACQUISITIONS

In January 2012, we announced the acquisition of Optima Insurance Group of Puerto Rico, a property and casualty underwriter. This acquisition is an example of a private, well run carrier that will benefit from QBE's brand, capital rating and reinsurance agreements. We believe profitability at Optima will increase as it is integrated into QBE. The acquisition completed in February 2012 and we expect it to produce US\$45 million in gross written premium during 2012.

### OTHER DEVELOPMENTS

In October 2011, we received a property and casualty insurance licence in Chile. Our start-up operation, QBE Chile, is now operational and staffed with experienced insurance executives. Our focus is on the SME and affinity market segments, as well as specialised lines such as mining and contractors' equipment, which will be written with the support of QBE's global expertise.

In Argentina, we successfully completed the integration of CNA into QBE Argentina with minimal disruption to the acquired customer base and producers group whilst maintaining a high level of employee motivation. The Argentine business is now operating under the QBE brand in the local market.



## DEVELOPMENT PROGRAMS

**Our fast growing Latin American operations have embraced the Group's vision to develop "can do" people who live our essential behaviours in everything they do.**

Our OPENUP QBE development programs are tailored to meet region specific needs, with a range of workshops now facilitated by divisional management in the local language.

In 2011, we delivered the second year of staff development workshops in Latin America, including OPENUP Underwriting in Mexico City. This workshop focused on engaging the highly entrepreneurial spirit of staff from across the region and leveraging their varied specialist expertise to generate new product development initiatives.

*Our focus is to pursue profitable growth in the property and casualty sector, both organically and through acquisitions such as CNA Argentina, Seguros Colonial Ecuador and Optima which have enabled us to provide a wide variety of products to our mainly SME customer base.*

We continue to look at opportunities to access established distribution channels. We also believe it is critical for us to look for alternate distribution models with a broad customer base and product expansion opportunities. As such, in 2011 we actively worked on developing new distribution alternatives that will produce growth and profitability in the future.

In November 2011, we held our second OPENUP Underwriting forum in Spanish in Mexico City. With the attendance of key underwriters in our region, this event reflected the keen interest of QBE Latin America in developing local talent and leveraging the Group's global training platform to promote a better understanding of QBE's business philosophy and consistency in values and behaviours.



## OUTLOOK FOR 2012

Gross written premium for 2012 for Latin America is forecast to be around US\$915 million.

We have several business development projects under way which are considering appropriate growth opportunities that may assist in mitigating the impact of competition on some of our products. We are targeting over 10% organic growth from new initiatives, and we expect our combined operating ratio to remain close to 2011 levels. We are also targeting acquisition opportunities that meet our strict criteria.

Competition is expected to remain strong and the economic environment will remain challenging in some parts of our region. We will maintain our strategy of being selective and writing business in those segments of the market where we believe we can obtain superior returns. Our continued aim is to exceed the Group's minimum target of 15% return on allocated capital for each of our products and businesses.

### 2012 FORECAST GWP US\$915M

**ARGENTINA**  
US\$300M

**COLOMBIA**  
US\$260M

**BRAZIL**  
US\$75M

**ECUADOR**  
US\$160M

**MEXICO**  
US\$65M

**CHILE**  
US\$10M

**PUERTO RICO**  
US\$45M

For several consecutive years, we have been able to outperform our competitors. This is the result of the everyday efforts of each of our staff who are dedicated to the execution and delivery of our plans. I wish to sincerely thank our 1,000 plus people in the different countries that make up our operations in Latin America for their significant contribution in 2011.

**Jose Sojo**  
Chief executive officer, Latin American operations

# European operations review

“ QBE’s European operations are in 20 countries throughout Europe with the head office in London. Over 75% of total premium income is derived from the London market. ”

STEVEN BURNS CHIEF EXECUTIVE OFFICER, EUROPEAN OPERATIONS

## GROSS WRITTEN PREMIUM

**US\$4,828M**

Up **16%** from last year

## UNDERWRITING RESULT

**US\$143M**

Down **42%** from last year

## INSURANCE PROFIT

**US\$298M**

Down **21%** from last year

## MARKET CONDITIONS

We experienced another challenging year largely due to a record level of catastrophes which more than offset the benefits achieved from initiatives to reduce acquisition costs and attritional claims. Premium growth was achieved from the Secura acquisition in 2010, modest premium rate increases across a number of products and a lower reinsurance expense ratio.

The eurozone debt crisis and weaker economic conditions in the UK and US affected investment income, with only modest investment returns on our cash and fixed income portfolios, mainly due to unrealised mark to market losses on our corporate bond portfolios at the balance date.

We maintained our focus on retaining quality clients in ongoing soft markets. Our market leading franchise has supported our capacity to retain business and assisted access to new business where pricing is adequate.

Significant rate increases were observed during 2011 on renewal of energy and catastrophe impacted classes of business, particularly Australian and Japanese reinsurance and worldwide energy clients. We also obtained increases in June and July on US catastrophe reinsurance renewals and international property business. UK commercial motor rates have been increasing by around 5% for most clients in response to poor market results and bodily injury claims inflation in the market; however, in other classes, particularly UK and European property and casualty, markets remain very competitive. Our overall average rate increase for European operations in 2011 was around 2%. Despite these difficult conditions, the diversity of our businesses and careful risk management assisted in producing an underwriting profit.

## COMBINED OPERATING RATIO AND INSURANCE PROFIT

The London market was heavily exposed to the Australian storms, Thailand floods, US storms and New Zealand and Japanese earthquakes. These catastrophes impacted reinsurance, marine and direct property lines of business. In addition, there was a frequency of large marine and energy risk claims on onshore energy portfolios. European operations benefited on a net basis from its prudent approach to purchasing reinsurance.

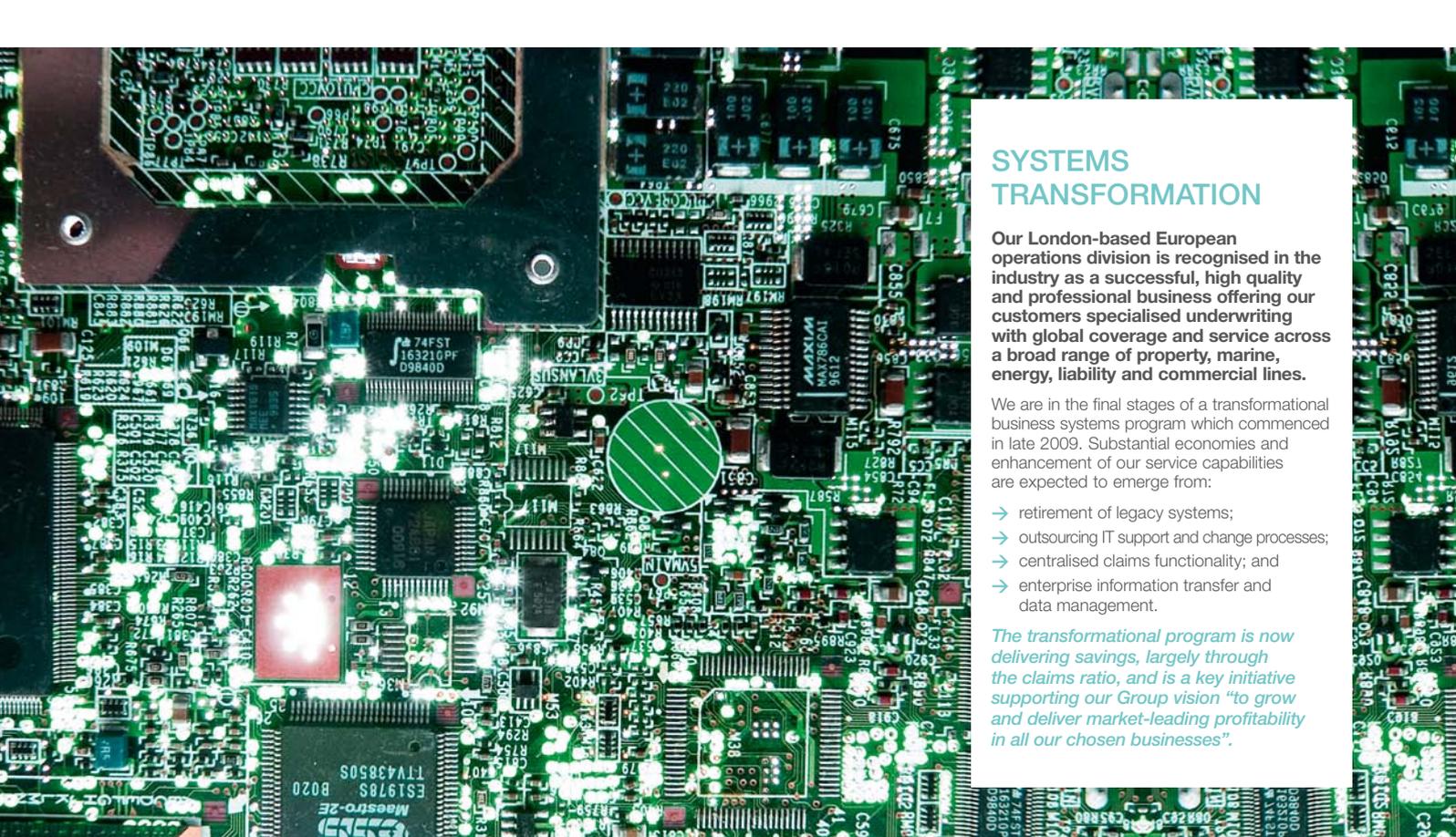
The combined operating ratio of 95.5% was a strong performance compared with most of our market peers, particularly given the increased level of catastrophe events.

Insurance profit was US\$298 million, down 21% compared with US\$376 million in 2010, and the insurance profit margin was 9.5% (2010 14.5%). The insurance profit margin was impacted by the significant large individual risk and catastrophe claims referred to above, partly offset by further releases of risk margins from the favourable run-off of prior year claims provisions. Overall attritional claims ratios were stable. The investment yield on policyholders’ funds remains low with no sign of a material increase in interest rates whilst economies remain depressed and the European sovereign debt crisis continues.

Our casualty, marine & energy, trade credit and commercial motor portfolios produced underwriting profits whereas reinsurance, aviation and property produced underwriting losses from the significant increase in large individual risk and catastrophe claims.

## HISTORICAL OVERVIEW IN POUNDS STERLING

FOR THE YEAR ENDED 31 DECEMBER		2011	2010	2009	2008
Gross written premium	£M	<b>3,009</b>	2,686	2,552	2,297
Net earned premium	£M	<b>1,963</b>	1,676	1,633	1,491
Combined operating ratio	%	<b>95.5</b>	90.5	91.3	85.6
Insurance profit	£M	<b>186</b>	243	257	377
Insurance profit margin	%	<b>9.5</b>	14.5	15.7	25.3



## SYSTEMS TRANSFORMATION

Our London-based European operations division is recognised in the industry as a successful, high quality and professional business offering our customers specialised underwriting with global coverage and service across a broad range of property, marine, energy, liability and commercial lines.

We are in the final stages of a transformational business systems program which commenced in late 2009. Substantial economies and enhancement of our service capabilities are expected to emerge from:

- retirement of legacy systems;
- outsourcing IT support and change processes;
- centralised claims functionality; and
- enterprise information transfer and data management.

*The transformational program is now delivering savings, largely through the claims ratio, and is a key initiative supporting our Group vision "to grow and deliver market-leading profitability in all our chosen businesses".*

## PREMIUM INCOME

Gross written premium for the year was up 16% to US\$4,828 million (2010 US\$4,156 million). In local currency, it was up 12% to £3,009 million. The growth in premium income was partly due to the acquisition of the Belgian reinsurer, Secura, in late 2010. Growth was also assisted by premium rate increases, a number of successful new business and product initiatives and inward reinstatements on reinsurance portfolios. Overall average premium rate increases were 2% on renewed business. Retention ratios on renewed business were maintained at over 80%, a very pleasing result considering the competitive market conditions.

Net earned premium was up 21% to US\$3,150 million or 17% to £1,963 million in local currency. The higher relative growth rate in net earned premium compared with gross written premium was due to lower proportional reinsurance with our captive Equator Re, the benefit of the Group's comprehensive reinsurance protections and lower reinsurance cost on business written by Secura. Reinsurance costs reduced from 35% to 32% of gross earned premium. Excluding proportional reinsurance with our captive Equator Re, the reinsurance expense ratio would have been 19.4% (2010 21.0%).

## PORTFOLIO MIX

GROSS EARNED PREMIUM FOR THE YEAR ENDED 31 DECEMBER		2011	2010
		%	%
Marine, energy and aviation		21.3	23.9
Public/product liability		18.4	16.8
Property facultative and direct		12.2	11.6
Professional indemnity		12.1	13.0
Motor and motor casualty		11.7	11.0
Property treaty		10.7	10.1
Workers' compensation		5.0	6.2
Financial and credit		3.4	3.1
Other		2.6	2.5
Accident and health		2.6	1.8

## CLAIMS EXPENSE

As mentioned previously, there was an increased level of catastrophe claims in the year including the Thailand floods and New Zealand and Japanese earthquakes, as well as a modest level of exposure to other catastrophes such as the Australian storms, hurricane Irene, US tornadoes and European riots and floods. European operations was well protected by reinsurance for these events. Catastrophe claims were partially offset by releases of prior accident year risk margins on some portfolios. The net claims ratio was 65.3% compared with 57.7% in 2010.

Claims provisions remain strong overall, particularly in our Lloyd's and reinsurance portfolios.

## COMMISSION AND EXPENSES

The combined commission and expense ratio was 30.2% compared with 32.8% in 2010. The commission ratio was 17.0% compared with 16.9% last year, with the slight increase due to a change in business mix following the Secura acquisition and increased broker pressure on commissions. Whilst the level of expenses was stable, the expense ratio was lower at 13.2% compared with 15.9% in 2010. An increase in the underlying cost of the IT transformational project launched in 2009 and preparation for Solvency II regulatory compliance were offset by lower staff incentive provisions due to reduced profits and increased external profit commission income on syndicate 386.

## EUROPEAN OPERATIONS REVIEW CONTINUED

### UNDERWRITING RESULT

FOR THE YEAR ENDED 31 DECEMBER		2011	2010
Gross written premium	US\$M	<b>4,828</b>	4,156
Gross earned premium	US\$M	<b>4,635</b>	4,008
Net earned premium	US\$M	<b>3,150</b>	2,593
Net incurred claims	US\$M	<b>2,054</b>	1,498
Net commission	US\$M	<b>536</b>	437
Expenses	US\$M	<b>417</b>	412
Underwriting result	US\$M	<b>143</b>	246
Claims ratio	%	<b>65.3</b>	57.7
Commission ratio	%	<b>17.0</b>	16.9
Expense ratio	%	<b>13.2</b>	15.9
Combined operating ratio	%	<b>95.5</b>	90.5
Insurance profit to net earned premium	%	<b>9.5</b>	14.5

### ACQUISITIONS AND OTHER DEVELOPMENTS

Our Belgian reinsurer, Secura, which was acquired in November 2010, is performing well ahead of expectations. Full year premium income from Secura was US\$326 million. Secura had no exposure to the 2011 catastrophes, which demonstrates the benefits of the diversification that this acquisition brings to European operations and QBE as a whole.

The broader European insurance market is preparing for the introduction of Solvency II and is dealing with generally increased regulatory oversight and compliance costs. QBE is well prepared for these changes and has recently increased capital levels and resources and improved systems in anticipation.

We continue to monitor market consolidation which may provide acquisition opportunities in the Lloyd's and mainland European markets; however, the potential opportunities reviewed in the year have not met our strict acquisition criteria. We continue to expect an increase in opportunities in the London market, the UK and mainland Europe as a consequence of the fallout from the European debt crisis and as the full impact of regulatory changes, particularly Solvency II, are better understood and adopted across the market.

### OUTLOOK FOR 2012

Gross written premium for 2012 is expected to be up 3% to £3.1 billion. Growth is weighted to the first half of the year due to the timing of business written in our reinsurance and major clients portfolios. Our organic growth and new business will always be limited whilst soft markets prevail. Our focus will therefore continue to be on maintaining high retention ratios for our quality customer base and seeking acquisitions that meet our strict criteria. We expect overall average premium rate increases on renewed business to be around 3% in 2012.

The effects of a significant level of catastrophe activity and prolonged soft market conditions have begun to emerge in the results of our peers. Market reaction should begin to move rates upwards in most classes; however, this will probably not occur until the second half of 2012. Premium rate movements will be accelerated if the high level of catastrophe activity continues.

We will maintain our focus on ensuring that all portfolios target the achievement of the Group's minimum 15% return on allocated capital. Property continues to be our main concern; however, actions taken on some segments of the portfolio have helped to reduce the attritional claims ratio for the 2011 year and improve the underwriting results.

Our transformational systems project is on track to be materially complete by the middle of 2012.

### 2012 FORECAST GWP £3.1BN

PROPERTY, CASUALTY  
AND MOTOR  
£1.7BN

MARINE, ENERGY  
AND AVIATION  
£0.7BN

REINSURANCE  
AND CREDIT  
£0.7BN

Our professional team in Europe has again produced a strong result in difficult market conditions and after a record year of catastrophes for the industry. I appreciate the support and commitment of our hard working staff over the past year.

**Steven Burns**

Chief executive officer, European operations



# Australian operations review

“The exceptional level of claims activity was matched by our dedicated claims staff who worked tirelessly to provide support to the thousands of our customers in need.”

COLIN FAGEN CHIEF EXECUTIVE OFFICER, AUSTRALIAN OPERATIONS

GROSS WRITTEN PREMIUM

US\$4,486M

Up **21%** from last year

UNDERWRITING RESULT

US\$25M

Down **92%** from last year

INSURANCE PROFIT

US\$243M

Down **53%** from last year

The results for Australian operations were affected by a series of catastrophes and increased claims from weather-related events, particularly in the first half of the year. Our reinsurance arrangements responded well; however, the cost of reinstatement and back-up covers offset some of the benefits. Attritional claims were slightly up on last year, consistent with the higher frequency and severity of claims. Underwriting action to limit exposure to weather-related events impacted premium growth; nonetheless, premium rate increases were achieved across most portfolios. Lower interest rates used for discounting claims also impacted the claims ratio and underwriting profit.

## MARKET CONDITIONS

Economic conditions in Australia remained relatively buoyant; however, global events continued to generate caution in the community with generally lower retail sales. GDP growth was positive, although heavily dependent on the mining sector. Due to another year of higher than normal claims activity, the Australian insurance market, whilst competitive, saw premium rates increase in property, homeowners, commercial packages, farm and motor products, particularly in the second half of 2011. Competition in long tail classes of business remains strong. QBE continues to focus on retaining profitable and high quality business. Inadequate pricing for exposures in some segments has seen us cancel business or elect not to write new business. QBE continues to focus its business distribution through a diverse range of intermediaries with the very clear aim of attracting and retaining quality customers.

## COMBINED OPERATING RATIO AND INSURANCE PROFIT

Despite the difficult conditions arising from the frequency and severity of catastrophes in 2011, we produced a small underwriting profit with a combined operating ratio of 99.3%, compared with 89.2% last year. The insurance profit margin of 6.5% was significantly lower than 17.0% in 2010 mainly due to increased catastrophe activity, in particular claims and the cost of reinsurance from the various Queensland and Victorian storms; cyclones Yasi, Anthony and Bianca;

the Western Australian bushfires; and the claims from some of our policyholders exposed to the Christchurch earthquake in New Zealand. Our longer tail liability classes, lenders' mortgage insurance and credit and surety portfolios all performed well. These factors, combined with a slightly lower investment yield on investment assets backing our policyholders' funds, resulted in an insurance profit for the year of US\$243 million, down from US\$516 million last year.

## HISTORICAL OVERVIEW IN AUSTRALIAN DOLLARS

FOR THE YEAR ENDED 31 DECEMBER		2011	2010	2009	2008
Gross written premium	A\$M	<b>4,311</b>	4,051	3,509	2,914
Net earned premium	A\$M	<b>3,620</b>	3,314	2,749	2,363
Combined operating ratio	%	<b>99.3</b>	89.2	89.0	90.6
Insurance profit	A\$M	<b>234</b>	564	594	494
Insurance profit margin	%	<b>6.5</b>	17.0	21.6	20.9

## PREMIUM INCOME

Gross written premium was up 21% to US\$4,486 million, or up 6% in local currency to A\$4,311 million, with the stronger Australian dollar positively impacting premium growth when translated to US dollars. Retention remains strong, with most portfolios achieving retention ratios of around 80%.

Overall average premium rate increases were over 5%. The CUNA Mutual acquisition and increased premium income, in particular from our lenders' mortgage and our intermediary business, contributed to the higher gross written premium. Our New South Wales CTP and long tail liability classes, where competition was most evident, did not achieve gross written premium expectations.

Net earned premium increased 24% to US\$3,767 million, assisted by reduced proportional reinsurance on the Elders and property portfolios.

## AUSTRALIAN OPERATIONS REVIEW CONTINUED

### PORTFOLIO MIX

GROSS EARNED PREMIUM FOR THE YEAR ENDED 31 DECEMBER		2011 %	2010 %
Householders		17.8	16.1
Property		17.2	21.0
Motor and motor casualty		14.7	11.3
General liability		10.4	13.6
Financial and credit		9.4	10.3
Compulsory third party (CTP)		8.4	7.8
Workers' compensation		7.8	8.0
Agriculture		4.5	1.5
Marine, energy and aviation		3.5	3.5
Professional indemnity		2.7	3.0
Accident and health		2.5	3.1
Travel		0.9	0.8
Other		0.2	–

### REINSURANCE COSTS

The reinsurance expense ratio was down to 13.5% of gross earned premium compared with 18.5% for 2010. This reflected the benefit of the Group's worldwide reinsurance program, partly offset by additional reinstatements and back-up covers purchased from Equator Re at a cost of US\$87 million as a result of the exceptional catastrophe frequency. We were also able to benefit from reduced proportional reinsurance on the Elders and property portfolios.

Our reinsurance program has been beneficial in 2011, delivering a high level of protection to our underwriting results and providing significant capital support to our balance sheet.

### CLAIMS EXPERIENCE

The net claims ratio was 69.4% of net earned premium compared with 60.9% in 2010. The notable catastrophe events which occurred were the Queensland, Victorian and Northern New South Wales storms; cyclones Bianca, Yasi and Anthony; the Western Australian bushfires; and the claims from some of our policyholders exposed to the Christchurch earthquake in New Zealand. Collectively, these natural catastrophes resulted in net claims of approximately US\$200 million for Australian operations. The impact of the catastrophes was partly mitigated by recoveries under the Group aggregate cover and from Equator Re. Attritional claims were slightly higher due to the increase in weather-related claims.

### UNDERWRITING RESULT

FOR THE YEAR ENDED 31 DECEMBER		2011	2010
Gross written premium	US\$M	4,486	3,707
Gross earned premium	US\$M	4,355	3,720
Net earned premium	US\$M	3,767	3,033
Net incurred claims	US\$M	2,617	1,846
Net commission	US\$M	488	316
Expenses	US\$M	637	542
Underwriting result	US\$M	25	329
Claims ratio	%	69.4	60.9
Commission ratio	%	13.0	10.4
Expense ratio	%	16.9	17.9
Combined operating ratio	%	99.3	89.2
Insurance profit to net earned premium	%	6.5	17.0

Claims ratios improved in aviation, CTP Queensland, trade credit, surety, public liability and QBE LMI. Our claims teams worked long hours and provided extraordinary service throughout the year, ensuring claims from the various catastrophe events were quickly assessed and settled as soon as possible.

The significantly lower yields on government bonds used to discount outstanding claims increased the net claims ratio by approximately 5%. The impact of lower yields was more pronounced in the second half of the year. Overall, there was a net release in the prior year undiscounted central estimate.

### COMMISSION AND EXPENSES

The combined commission and expense ratio was 29.9%, up compared with 28.3% in 2010. The higher ratio was due to the loss of exchange commission following the changes to our proportional treaty reinsurance, which was the main reason for the increased commission ratio of 13.0% (2010 10.4%). The expense ratio was 16.9%, down from 17.9% last year mainly due to reduced staff costs, partly offset by increased IT expenses and reduced net fee income on workers' compensation funds.

### ACQUISITIONS

We completed the acquisition of the Australian operations of US-owned CUNA Mutual Group in April 2011, increasing our share of the Australian credit union and community-based financial institutions insurance market to more than 30%. This acquisition generated US\$62 million of gross written premium in 2011.

The acquisition is a key component in QBE's strategy of building its presence in the Australian financial institutions sector. CUNA adds a new and expanding customer base for QBE's current range of products and also provides the opportunity for QBE to expand its product suite.

### OTHER DEVELOPMENTS

Following the restructure to separate the management of our Australian and Asia Pacific operations, Colin Fagen was appointed to the role of chief executive officer, Australian operations. Subsequent changes were made to the Australian operations executive team, which saw a renewed focus on the profitability of distribution channels and the alignment of support services with our vision and strategy.

In July 2011, we announced the restructure of our Australian IT function to provide more effective and robust services for our internal and external users. The project was completed in the fourth quarter and will provide significant annualised savings going forward.





## CLAIMS

**Our Australian operations experienced an unprecedented level of catastrophe claims in 2011.**

These catastrophes impacted communities, customers and our intermediary partners across the country. Many businesses were affected including mining services, commercial property, farm and engineering. QBE Australia's claims operations received over 30,000 claims.

Displaying great resilience and teamwork, particularly with numerous QBE offices experiencing emergency closures throughout the catastrophes, our claims staff worked together tirelessly to ensure that they delivered the best claims experience possible to the thousands of customers in need. The majority of claims were accepted within 30 days and accommodation and emergency payments were made where necessary.

*These results demonstrate the commitment of our Australian operations to the Group's vision of developing "can do" people who live our essential behaviours in everything they do.*

Changes were also made across our human resources and finance support services following reviews that highlighted the need to improve operational and servicing capability. These changes were also completed in the fourth quarter. Although our claims teams were stretched during 2011, investment in substantial numbers of new roles in claims helped us to continue to deliver outstanding claims service as a point of differentiation. This also assisted in improving our results through increased recovery rates.

Driven by increased catastrophe claims, claims inflation and reinsurance costs, we took significant action to improve profitability in the second half of 2011. This included pricing adjustments and increased excesses and deductibles across a range of portfolios. While premium rate increases have been achieved across most portfolios, proportionally greater increases will be required in areas with higher exposure to weather-related claims, particularly in Northern Queensland. We will continue to target premium rate increases in products where rates have not been matching underlying inflation. Our approach also involves a strong focus on retaining quality customers.



## OUTLOOK FOR 2012

Previously announced operational cost reduction initiatives are proceeding to target, with systems integration and consolidation underway. Further savings are expected in 2012 as a result of ongoing efforts across claims and processing functions. These changes will focus on the creation of claims hubs in New South Wales and Victoria, the centralisation of credit control functions and the establishment of an additional national service centre for processing activity.

We will continue to focus on the achievement of a minimum 15% return on allocated capital. We expect insurance profitability to improve in 2012 as a result of expected premium rate increases of around 6% on average and other underwriting action. Gross written premium is expected to be A\$4.6 billion.

### 2012 FORECAST GWP A\$4.6BN

**INTERMEDIARY  
DISTRIBUTION  
A\$2,330M**

**CORPORATE PARTNERS  
AND DIRECT  
A\$1,845M**

**LMI  
A\$300M**

**CREDIT  
AND SURETY  
A\$150M**

While 2011 has been a difficult year, the commitment and dedication of our teams has been unwavering. Our continued focus on strong partnerships with our intermediaries was recognised when QBE was awarded the NIBA General Insurer of the Year for a record 10th consecutive year. We thank our intermediary partners for their continued support and look forward to working with them in 2012 and beyond. I would like to acknowledge and thank the Australian team of over 4,300 staff for their dedication, commitment and hard work in a difficult year.

#### **Colin Fagen**

**Chief executive officer, Australian operations**

# Asia Pacific operations review

“ QBE’s Asia Pacific operations experienced a challenging year with staff handling a significant increase in claims activity across the region, particularly as a result of the catastrophic events in Christchurch and Thailand. ”

MICHAEL GOODWIN CHIEF EXECUTIVE OFFICER, ASIA PACIFIC OPERATIONS

GROSS WRITTEN PREMIUM

US\$680M

Up **13%** from last year

UNDERWRITING RESULT

US\$35M

Down **38%** from last year

INSURANCE PROFIT MARGIN

US\$59M

Down **23%** from last year

In a year of significant catastrophe claims activity in the Asia Pacific region, our reinsurance arrangements responded well; however, the frequency of events and additional costs of reinstatement premiums affected the bottom line. Overall, we were able to generate a pleasing underwriting profit in the circumstances, although down on average when compared with previous years. Premium growth was encouraging despite the competitive market conditions.

## MARKET CONDITIONS

Premium rates were generally flat in the Asia Pacific region throughout the year with greater competition on larger accounts. New Zealand saw significant increases in premium rates for property business following the earthquakes in Christchurch. During the year, we experienced a large number of catastrophes with two major events in Christchurch, the massive flooding in Thailand and smaller events impacting New Caledonia and Malaysia. Following the flood events that occurred in Thailand, we have started to see significant rate increases in this market and substantially reduced coverage for flood. With the scale of the natural catastrophe losses within the wider Asia Pacific region in 2011, it is expected that premium rates will start to harden in many countries as insurers and reinsurers review their exposures and increase prices for possible catastrophic events, particularly floods in developing countries.

QBE’s renewal retention remains high due to our close working relationship with agents and brokers. QBE’s overall average premium rate increases on renewed business for the year across the Asia Pacific region were around 4%, largely driven by increased rates in property classes in New Zealand.

Generally, economic growth remains positive throughout the region with a number of countries adjusting monetary policy to manage growth and possible inflationary pressures. Investment yields on fixed interest and cash portfolios in most countries remain at low levels, primarily due to the influence of low US interest rates.

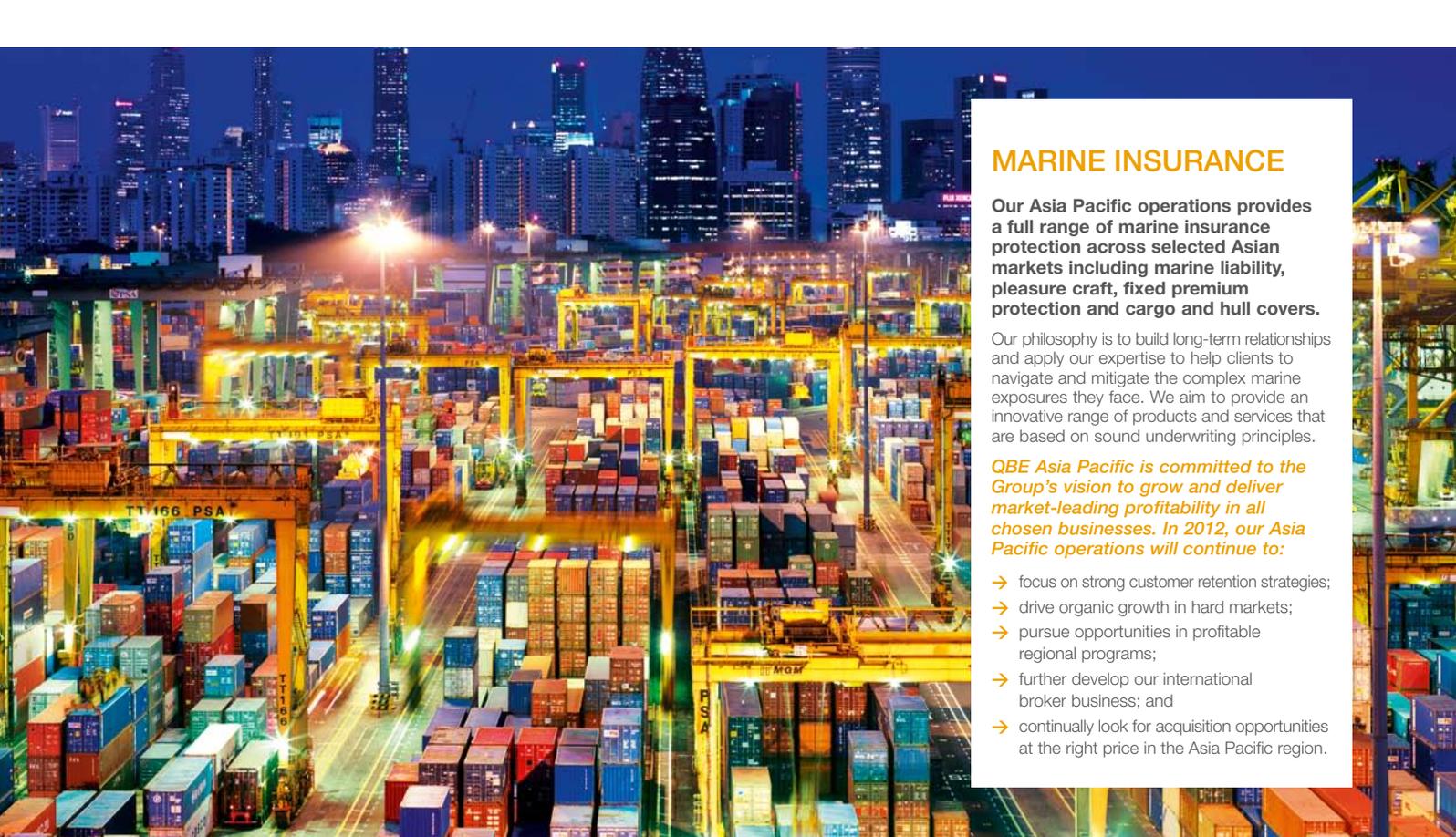
## COMBINED OPERATING RATIO AND INSURANCE PROFIT

The combined operating ratio of 92.1% was the highest for many years driven by the record catastrophes and the reinstatement premiums paid to Equator Re to renew reinsurance protections.

Insurance profit was US\$59 million compared with US\$77 million in 2010. Investment income on policyholders’ funds was slightly higher than 2010. All countries produced underwriting profits except New Zealand and Thailand which were impacted by the catastrophes.

### HISTORICAL OVERVIEW IN US DOLLARS

FOR THE YEAR ENDED 31 DECEMBER		2011	2010	2009	2008
Gross written premium	US\$M	<b>680</b>	601	549	554
Net earned premium	US\$M	<b>442</b>	420	372	378
Combined operating ratio	%	<b>92.1</b>	86.7	88.1	82.9
Insurance profit	US\$M	<b>59</b>	77	55	94
Insurance profit margin	%	<b>13.3</b>	18.3	14.8	24.8



## MARINE INSURANCE

Our Asia Pacific operations provides a full range of marine insurance protection across selected Asian markets including marine liability, pleasure craft, fixed premium protection and cargo and hull covers.

Our philosophy is to build long-term relationships and apply our expertise to help clients to navigate and mitigate the complex marine exposures they face. We aim to provide an innovative range of products and services that are based on sound underwriting principles.

*QBE Asia Pacific is committed to the Group's vision to grow and deliver market-leading profitability in all chosen businesses. In 2012, our Asia Pacific operations will continue to:*

- focus on strong customer retention strategies;
- drive organic growth in hard markets;
- pursue opportunities in profitable regional programs;
- further develop our international broker business; and
- continually look for acquisition opportunities at the right price in the Asia Pacific region.

## PREMIUM INCOME

Gross written premium was up 13% to US\$680 million. There was growth in local currency in most countries as well as positive foreign exchange rate impacts on translation to US dollars when compared with 2010.

Net earned premium was up 5% to US\$442 million compared with US\$420 million in 2010. Net earned premium was adversely impacted by the payment of reinstatement premiums to the Group's captive, Equator Re, in relation to the Christchurch earthquakes and Thailand floods, which had a consequent impact on our commission and expense ratios. Reinsurance expense was 32% of gross earned premium, up from 28% in 2010. Excluding proportional reinsurance with Equator Re, the reinsurance expense ratio would have been 27.3% (2010 22.7%).

### PORTFOLIO MIX

#### GROSS EARNED PREMIUM FOR THE YEAR ENDED 31 DECEMBER

	2011 %	2010 %
Property	23.4	21.9
Marine	16.1	15.0
Motor and motor casualty	12.1	13.1
Professional indemnity	11.0	12.5
Liability	9.3	9.4
Workers' compensation	8.6	8.5
Accident and health	5.2	5.3
Engineering	4.5	4.4
Financial and credit	3.0	3.9
Travel	2.6	2.2
Other	2.2	1.8
Householders	2.0	2.0

## CLAIMS EXPERIENCE

The claims ratio was 46.6% of net earned premium compared with 45.7% in 2010. Improved claims experience in Hong Kong, Malaysia and Singapore was more than offset by the impact of the New Zealand earthquakes and Thailand floods. The Asia Pacific portfolios, particularly New Zealand, benefited from recoveries under the Group's worldwide reinsurance program and support from Equator Re. Risk margins in outstanding claims reduced slightly and overall there was a small release in the net central estimate claims provision from prior years.

## COMMISSION AND EXPENSES

The combined commission and expense ratio was 45.5% compared with 41.0% in 2010. The increase was partly as a result of the lower net earned premium due to the increased cost of reinstatement premiums. Commissions were higher, up from 20.0% to 22.9% of net earned premium, mainly reflecting the effect of reinstatement premiums. The higher expense ratio, up from 21.0% to 22.6%, was mainly due to foreign currency fluctuations. Total expenses, using constant exchange rates, were slightly up from 2010.

### UNDERWRITING RESULT

FOR THE YEAR ENDED 31 DECEMBER		2011	2010
Gross written premium	US\$M	<b>680</b>	601
Gross earned premium	US\$M	<b>653</b>	587
Net earned premium	US\$M	<b>442</b>	420
Net incurred claims	US\$M	<b>206</b>	192
Net commission	US\$M	<b>101</b>	84
Expenses	US\$M	<b>100</b>	88
Underwriting result	US\$M	<b>35</b>	56
Claims ratio	%	<b>46.6</b>	45.7
Commission ratio	%	<b>22.9</b>	20.0
Expense ratio	%	<b>22.6</b>	21.0
Combined operating ratio	%	<b>92.1</b>	86.7
Insurance profit to net earned premium	%	<b>13.3</b>	18.3

## OTHER DEVELOPMENTS

During the year, we acquired the remaining 49% of the Malaysian shareholding from our joint venture partner. Our plan is to continue to seek growth opportunities at the right price across the region. We will also continue to focus on further increasing our collaboration with international brokers and other intermediaries to secure new business that meets our strict underwriting criteria.

The year has been marked by the unfortunate catastrophes that saw the tragic loss of lives in many countries as well as significant economic and insurance losses. I am pleased to say that our staff, supplemented by staff from our other global operations, responded extremely well to assist our customers in their time of need.

We continue to grow our relationships with intermediaries within the region and will look to further strengthen these in the future. We have commenced the gradual roll out of Q-Tools, our online intermediary interface, within the Asian market with a view to providing a better technology platform to assist our intermediaries. This roll out will also provide ongoing processing efficiencies to our intermediaries and our own businesses.

Our Manila based IT application development centre has continued to provide support to the Asian and Australian businesses as we look to improve our systems capability within the region.

The year has also seen regulatory developments in a number of countries including the implementation or review of risk-based capital requirements, the establishment of policyholder protection funds and increasing corporate governance and risk management requirements.

## OUTLOOK FOR 2012

We will continue to maintain a strong focus on underwriting fundamentals and target increased market penetration through our intermediary networks to further build on our successful businesses. We will also focus on our specialist product lines and collaborate with other QBE divisions to distribute their specialist products throughout the Asia Pacific region. We have continued our research into the Chinese market with a view to developing a strategy that meets our longer term strategic objectives. We expect our Indian joint venture to continue to write business on a very selective basis given the ultra-competitive conditions in that market. We are also reviewing our approach to underwriting industrial parks in a number of Asian countries following our experience in Thailand.

There continues to be significant regulatory change across the region which is expected to increase our compliance costs and also involve greater management time. These changes, consistent with the general increase in supervisory focus on risk, are likely to have capital implications for many of our competitors and may provide opportunities for QBE in the future. QBE is well placed to meet these regulatory changes.

We expect markets to remain competitive. We are aiming for an overall average rate increase of 4.0% on renewed business in 2012, underpinned by the rate increases in property classes in New Zealand and property insurance in Asia. Premium growth in local currencies is expected to be modest and, for the full year, we project gross written premium to be up 9% to US\$740 million. We have an excellent range of businesses throughout Asia Pacific and New Zealand with a dedicated team of professionals and a strong track record of profitability. We remain focused on the achievement of a minimum 15% return on allocated capital and are confident that the underlying underwriting profit will improve to previous levels, subject to the usual caveats.

### 2012 FORECAST GWP US\$740M

**ASIA**  
US\$400M

**PACIFIC**  
US\$110M

**NEW ZEALAND**  
US\$230M

The performance of our management and staff has been outstanding during a very difficult year and I thank them for their dedication and hard work. I also wish to thank our many customers, intermediaries and partners for their ongoing support during the year.

**Mike Goodwin**

Chief executive officer, Asia Pacific operations



# Equator Re review

“ Equator Re is QBE’s wholly-owned captive reinsurer which has the sole purpose of providing excess of loss and proportional reinsurance protections to QBE entities globally within QBE’s appetite for risk. ”

DES FOGARTY PRESIDENT, EQUATOR RE

**GROSS WRITTEN PREMIUM**  
**US\$3,807M**  
Up **54%** from last year

**UNDERWRITING LOSS**  
**US\$151M**  
Compared with profit of US\$228M last year

**INSURANCE LOSS**  
**US\$56M**  
Compared with profit of US\$322M last year

Business written by Equator Re is maintained within the risk appetite and maximum event retention of the Group and is designed to support the management of aggregate exposures to any one large individual risk or catastrophe claim and to optimise the levels of capital held within the Group. A large part of Equator Re’s risk profile reflects the Group’s exposure to catastrophe and large individual risk claims and, therefore, it has not been immune to the record level of catastrophe claims that occurred in 2011.

## MARKET CONDITIONS

Overall premium rate increases achieved by the operating divisions in the direct insurance markets and acquisitions in the US crop and lender placed homeowners businesses assisted premium growth through proportional reinsurance ceded to Equator Re. The increase in catastrophe claims also generated additional premiums from reinstating excess of loss catastrophe covers for the various QBE subsidiaries.

The Group’s new worldwide reinsurance program and associated aggregate covers gave Equator Re an opportunity to assist in consolidating the Group’s exposures, continuing to provide reinsurance protection to the various divisions below the worldwide covers and within QBE’s appetite for risk.

Investment income was affected by lower yields and unrealised losses from the widening of credit spreads in the second half of the year. The overall return was assisted by increased policyholders’ funds. A large proportion of funds are US dollar denominated which continue to be affected by low prevailing interest rates.

## COMBINED OPERATING RATIO AND INSURANCE PROFIT

In line with the results of most global reinsurers, the combined operating ratio increased to 104.5%, up from 90.1% last year, due to the record level of catastrophes, lower risk-free rates used for discounting claims which impacted claims by US\$82 million and a prudent strengthening of risk margins in outstanding claims by US\$109 million. Reinsurers’ results should be considered over a period of time and over the past seven years Equator Re’s combined operating ratio has averaged 91.9%.

Due to the unprecedented frequency of catastrophe claims in Australia and the Asia Pacific region in 2011 and lower investment yields on policyholders’ funds, the company reported an insurance loss of US\$56 million compared with an insurance profit of US\$322 million in 2010. The insurance margin fell to a loss of 1.7% compared with a profit of 14.0% in 2010.

Investment income on policyholders’ funds was up slightly on last year, assisted by foreign exchange gains on operational exposures.

## PREMIUM INCOME

### GROSS WRITTEN PREMIUM BY SOURCE – HISTORICAL OVERVIEW IN LOCAL CURRENCY

FOR THE YEAR ENDED 31 DECEMBER		2011	2010	2009	2008
North American operations	US\$M	2,218	1,335	979	792
Latin American operations	US\$M	39	36	–	–
European operations	£\$M	607	540	517	417
Australian operations	A\$M	400	155	146	268
Asia Pacific operations	US\$M	160	131	99	90
Total	US\$M	3,807	2,479	1,994	1,870

## EQUATOR RE REVIEW CONTINUED

Gross written premium was up 54% to US\$3,807 million compared with US\$2,479 million in 2010. Premium income growth benefited from proportional reinsurance on the 2011 acquisitions. The premium income from excess of loss business also increased compared with last year. Part of the overall increase was due to the frequency and severity of catastrophe losses which generated additional premium income from the divisions for reinstatement of covers.

Net earned premium was up 46% to US\$3,362 million compared with US\$2,307 million in 2010. External reinsurance expense increased to US\$335 million compared with US\$56 million in 2010. The increase was due to Equator's share of the Group's new worldwide reinsurance programs, a higher level of retrocession cover, a new proportional reinsurance treaty and additional catastrophe cover purchased during the course of the year.

### PORTFOLIO MIX

GROSS EARNED PREMIUM FOR THE YEAR ENDED 31 DECEMBER		2011 %	2010 %
Property		<b>37.1</b>	26.5
Agricultural and bloodstock		<b>16.6</b>	11.1
Public/product liability		<b>15.5</b>	17.8
Marine, energy and aviation		<b>8.4</b>	14.0
Motor and motor casualty		<b>6.7</b>	7.4
Financial and credit		<b>4.1</b>	6.0
Workers' compensation		<b>3.3</b>	4.8
Professional indemnity		<b>3.0</b>	4.3
Householders		<b>2.9</b>	1.5
Accident and health		<b>2.1</b>	4.5
Other		<b>0.3</b>	2.1

### CLAIMS EXPERIENCE

The net claims ratio was 77.8%, up from 61.4% in 2010, due to the increased frequency of catastrophe claims including exposure to the Queensland, Victorian and Northern New South Wales storms; cyclones Yasi and Anthony; the Thailand floods; the two earthquakes in New Zealand; the Japanese earthquake and tsunami; and the increase in risk margins in outstanding claims. The result benefited from a small release from prior year central estimates.

### COMMISSIONS AND EXPENSES

The combined commission and expense ratio was 26.7% compared with 28.7% in 2010. The decrease in the commission ratio mainly reflected the change in mix of business.

### UNDERWRITING RESULT

FOR THE YEAR ENDED 31 DECEMBER		2011	2010
Gross written premium	US\$M	<b>3,807</b>	2,479
Gross earned premium	US\$M	<b>3,697</b>	2,363
Net earned premium	US\$M	<b>3,362</b>	2,307
Net incurred claims	US\$M	<b>2,616</b>	1,417
Net commission	US\$M	<b>784</b>	575
Expenses	US\$M	<b>113</b>	87
Underwriting result	US\$M	<b>(151)</b>	228
Claims ratio	%	<b>77.8</b>	61.4
Commission ratio	%	<b>23.3</b>	24.9
Expense ratio	%	<b>3.4</b>	3.8
Combined operating ratio	%	<b>104.5</b>	90.1
Insurance profit to net earned premium	%	<b>(1.7)</b>	14.0



## REINSURANCE PROGRAMS

Equator Re assists in the management of QBE's worldwide reinsurance program by providing internal excess of loss reinsurance to the divisions, below the Group's desired net retentions.

Net retentions are determined using market-leading catastrophe modelling solutions such as Risk Management Solutions and AIR Worldwide. The models are continually updated to reflect changing market conditions and include scenarios of highly localised variations in natural and other hazards and the distribution of property and human exposures.

QBE's wide-ranging reinsurance protections, combined with Equator Re's captive role, provide us with a significant competitive advantage in an environment of escalating reinsurance rates.

*Our reinsurance programs are a key driver in maintaining our targeted reinsurance expense ratio at around 12.5% of gross earned premium, thereby contributing to profitability and the Group vision "to increase the long-term wealth of our shareholders".*



## OUTLOOK FOR 2012

Gross written premium for the full year 2012 is targeted to be around US\$4.0 billion and net earned premium around US\$3.6 billion. Whilst the overall volume of business is not expected to materially change, we remain focused on delivering on the Group's minimum target of a 15% return on equity and hopefully exceeding that target given a more normal claims environment. Equator Re's net assets are around US\$1.3 billion and its A+ stable insurer financial strength rating was recently confirmed.

Equator Re will continue to provide protection to the Group operating divisions below the Group's appetite for risk on a carefully selected basis. In view of the level of catastrophe activity in recent years and in line with the market, the retentions and premium rates on divisional catastrophe programs have been increased for 2012. Premium rates for non-catastrophe business have been maintained, with any changes to overall pricing primarily driven by changes to exposures, loss experience and market pricing.

Looking ahead to 2012, we are confident that the underwriting changes which we have implemented will deliver a positive underwriting result, subject to large individual risk and catastrophe losses not exceeding the record level of catastrophes in 2011.

I would very much like to take the opportunity to thank each and every member of the Equator Re team for their continued commitment and support, and I look forward to working with them in the future to deliver a number of key projects that will further improve the efficiency and profitability of the business.

**Des Fogarty**  
President, Equator Re



# Board of directors

Directors are selected to achieve a broad range of skills, experience and knowledge complementary to the Group's activities. The board currently comprises eight directors, being an independent chairman, the chief executive officer and six independent non-executive directors.

## BELINDA HUTCHINSON AM

BEC, FCA, MAICD, AGE 58  
CHAIRMAN

Ms Hutchinson was appointed as an independent non-executive director of QBE in September 1997 and became chairman in July 2010. She is chairman of the funding committee and a member of the audit and risk, investment and remuneration committees. She is a director of AGL Energy Limited and St Vincent's Health Australia. She is also a member of the Salvation Army Sydney and Territorial advisory board and the external advisory panel of the Australian Securities & Investments Commission.

## LEN BLEASEL AM

FAIM, FAICD, AGE 69

Mr Bleasel was appointed as an independent non-executive director of QBE in January 2001. He is chairman of the remuneration committee and a member of the audit and risk committee. Mr Bleasel is chairman of APA Group and the RBS Group (Australia) Pty Limited advisory council. He is also chairman of the Zoological Parks Board of New South Wales. Since July 2010, following the previous chairman's retirement, Mr Bleasel acts as the lead independent director.

## DUNCAN BOYLE

BA, FCII, FAICD, AGE 60

Mr Boyle was appointed as an independent non-executive director of QBE in September 2006. He is chairman of the audit and risk committee and a member of the remuneration committee. Mr Boyle is a director of Clayton Utz and Stockland Trust Group and has 39 years experience in the insurance industry in Australia, New Zealand and the UK.

## ISABEL HUDSON

MA, FCII, AGE 52

Ms Hudson is based in the UK and was appointed as an independent non-executive director of QBE in November 2005. She is a member of the audit and risk and remuneration committees. Ms Hudson is chairman of a committee of Scope, a UK charity, and chair of the National House Building Council. She is also a director of MGM Advantage, Phoenix Group Holdings and the Pensions Regulator in the UK. She is a member of the Standard Life With Profits Committee. She has 31 years experience in the insurance industry in the UK and mainland Europe.

## CHARLES IRBY

FCA (ENGLAND & WALES), AGE 66

Mr Irby is based in the UK and was appointed as an independent non-executive director of QBE in June 2001. He is a member of the investment committee and the European operations' audit committee. He is a director of Great Portland Estates plc and North Atlantic Smaller Companies Investment Trust plc and is a member of the advisory board of Nardello & Co. Mr Irby is also a trustee and governor of King Edward VII's Hospital Sister Agnes.

## IRENE LEE

BA, BARRISTER-AT-LAW, AGE 58

Ms Lee is based in Hong Kong and was appointed as an independent non-executive director of QBE in May 2002. She is chairman of the investment committee and is a member of the audit and risk and funding committees. Ms Lee is the non-executive chairman of Keybridge Capital Limited and Hysan Development Company Limited, and is a director of Cathay Pacific Airways Limited and Sydney Symphony Limited. She is also a member of the advisory council of JP Morgan Australia.

## JOHN GREEN

B JURIS/LLB, FAICD, SF FIN, AGE 59

Mr Green was appointed as an independent non-executive director of QBE in March 2010. He is a member of the funding, investment and remuneration committees. He is a non-executive director of WorleyParsons Limited and a number of not-for-profit organisations, a member of the Takeovers Panel in Australia, a book publisher at Pantera Press, a novelist and a business writer. He was previously an executive director at Macquarie Bank and, prior to that, a partner in two commercial law firms.

## FRANK O'HALLORAN

FCA, AGE 65  
CHIEF EXECUTIVE OFFICER

Mr O'Halloran has been the chief executive officer and managing director of QBE Group since 1998. He has 49 years experience in financial services including 35 years at QBE in various Group head office and board roles such as financial controller, chief financial officer, director of finance and director of operations. With an unparalleled depth of understanding of the QBE business and the insurance industry generally, Mr O'Halloran's leadership is widely recognised and in 2010 he was inducted into the International Insurance Society Hall of Fame.



1	5
2	6
3	7
4	8

- 1 Belinda Hutchinson AM
- 2 Len Bleasel AM
- 3 Duncan Boyle
- 4 Isabel Hudson
- 5 Charles Irby
- 6 Irene Lee
- 7 John Green
- 8 Frank O'Halloran





## GROUP EXECUTIVE BIOGRAPHIES

### GEORGE THWAITES

CHIEF RISK OFFICER  
B ENG (HONS), ACA, AGE 46

Mr Thwaites has worked at QBE for 12 years and was appointed Group chief risk officer in 2005. He joined QBE in 1999 as financial controller for the Asia Pacific division. Prior to joining QBE, Mr Thwaites worked in finance and accounting roles in insurance and the accounting profession in Australia, the UK and Canada. He has been involved with the insurance industry for more than 16 years.

### BLAIR NICHOLLS

CHIEF ACTUARIAL OFFICER  
BA ECON, FIAA, FIA (UK), AMP INSEAD, AGE 44

Mr Nicholls has worked at QBE for 17 years and was appointed Group chief actuarial officer in 2006. He has been with QBE since 1994 and has undertaken a variety of roles including having spent three years in QBE's London office as the chief actuary for QBE's European operations and, prior to that, a number of positions in QBE's Australian operations.

### JOHN RUMPLER

PRESIDENT AND CHIEF EXECUTIVE OFFICER,  
NORTH AMERICAN OPERATIONS  
F FIN, FAIEX, AGE 51

Mr Rumpler has worked at QBE for 14 years and was appointed president and chief executive officer, the Americas in 2009. He joined QBE in 1997 and led the development of QBE's international credit and surety businesses. Mr Rumpler was formerly a member of the Australian operations' executive team and held board positions on several QBE subsidiaries. Mr Rumpler has more than 30 years experience in international banking, government and insurance.

### JOSE SOJO

CHIEF EXECUTIVE OFFICER, LATIN AMERICAN OPERATIONS  
B BUS, M ECON/POL. SCIENCE, AGE 40

Mr Sojo has worked at QBE for 11 years and was initially appointed general manager, QBE Latin America in 2002. He joined QBE following the Group's acquisition of QBE Argentina in 2001. Reflecting the significant growth and development of the region, he was appointed chief executive officer, Latin American operations in early 2011.

### STEVEN BURNS

CHIEF EXECUTIVE OFFICER, EUROPEAN OPERATIONS  
FCA, AGE 53

Mr Burns has worked at QBE for 11 years and was appointed chief executive officer of QBE's European operations in 2004. He is a chartered accountant and was finance director of the Janson Green managing agency at Lloyd's from 1987, prior to it being acquired by Limit in 1998. Mr Burns became chief executive officer of the Limit Group in August 2000.

### MICHAEL GOODWIN

CHIEF EXECUTIVE OFFICER, ASIA PACIFIC OPERATIONS  
BVSc, FIAA, FAICD, AGE 53

Mr Goodwin has worked at QBE for seven years and was appointed chief executive officer of QBE's Asia Pacific operations in 2007. He is an actuary and has been in the insurance industry for 20 years, having started his career with Mercantile Mutual. Mr Goodwin was deputy general manager of the QBE Mercantile Mutual joint venture when ING's half share was purchased by QBE in 2004 and became chief operating officer of Asia Pacific operations in 2006.

### DES FOGARTY

PRESIDENT, EQUATOR RE  
B COMM, ACII, AGE 50

Mr Fogarty has worked at QBE for 23 years and was appointed president of Equator Re in 2005. He previously worked for Universal Insurance Company of Ireland Limited from 1983. He has held a number of senior management positions within the Group in Ireland and the UK. He has extensive experience in the reinsurance arena, having worked in both claims and underwriting.

### COLIN FAGEN

CHIEF EXECUTIVE OFFICER, AUSTRALIAN OPERATIONS  
BCOM, MBA, AGE 45

Mr Fagen has worked at QBE for over 13 years. He was appointed chief executive officer of QBE's Australian operations in July 2011. Mr Fagen has been involved in the insurance industry for over 21 years in operational, marketing, relationship management and senior executive roles across all classes of general insurance. During his time at QBE, Mr Fagen has served in a number of senior executive roles in Australian operations. He most recently held the position of executive general manager-intermediary distribution.

# CORPORATE GOVERNANCE STATEMENT

The 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, the quality of its reinsurers and the depth of its culture of honesty, integrity and business acumen.

This statement incorporates the disclosures required by the revised recommendations of the ASX Corporate Governance Council (ASX CGC) issued in June 2010.

## Board of directors

Directors are selected to achieve a broad range of skills, experience and expertise complementary to the Group's activities. Details of individual directors are included on pages 48 and 49 and can also be found on the QBE website at [www.qbe.com](http://www.qbe.com). The board currently comprises eight directors including an independent chairman, the 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 chief executive officer are not exercised by the same individual.

The relationships identified by the ASX CGC as affecting a director's independent status no longer refer to the period for which a director has served on a board. 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 2009 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 Messrs Bleasel AM and Irby who joined the board in January and June 2001 respectively. Mr Bleasel AM was re-elected as a director at the 2010 AGM and Mr Irby at the 2011 AGM.

In 2010, Mr Bleasel AM was appointed lead independent director, which role includes leading the board's evaluation of the chairman.

The chairman oversees the performance of the board, its committees and each director. The board regularly reviews its performance. The board's formal review procedure involves an annual assessment of the entire board and each director, comprising a combination of written questions and answers completed confidentially by each director together with the chairman conducting an interview with each director, which includes a consideration of the director's performance and contribution to the board and relevant committees. Each director provides comments on the chairman's performance and contribution to the lead independent director, who in turn provides these comments to the chairman. 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. 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 conducted in accordance with the process above in December 2011 ahead of nominating Ms Hudson, Ms Lee and the chairman for re-election at the 2012 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 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.

In accordance with its charter, the board:

- oversees corporate governance;
- selects and supervises the chief executive officer;
- provides direction to management;
- approves the strategies and major policies of the Group;
- monitors the achievement of strategies and policies;
- 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. Each meeting normally considers reports from the chief executive officer, the chief financial officer and the chief executive officer of global underwriting operations, together with other relevant reports. The board regularly meets in the absence of management. The chairman and chief executive officer in particular, and board members in general, have substantial contact outside board and committee meetings.

The board delegates responsibility to the chief executive officer for management of the business on a day to day basis.

## Board selection process

The board believes that its composition, including selection, appointment, renewal and retirement of members, to be 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

# CORPORATE GOVERNANCE STATEMENT

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 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.

## 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 are the audit and risk committee, the investment committee and the remuneration committee. The first of these committees became the audit and risk committee during the year to better reflect its role. These committees operate under a written charter approved by the board. Any non-executive director may attend a committee meeting. The committees have direct and unlimited access to QBE's senior managers during their meetings and may consult external advisers when necessary at QBE's cost, including requiring their attendance at committee meetings. Committee membership is reviewed regularly. The chairman of each of the audit and risk and investment committees changed in September 2010 based on experience and following the appointment of Ms BJ Hutchinson AM as Group chairman in July 2010.

In addition, the board has established a funding committee comprising the chairman, Mr JM Green, Ms IYL Lee and the chief executive officer. This committee meets as required.

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 59.

## Audit and risk committee

The membership of the audit and risk 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 LF Bleasel AM, Ms IF Hudson, Ms BJ Hutchinson AM and Ms IYL Lee.

The role of the audit and risk committee is to oversee the integrity of QBE's financial reporting process. This includes review of:

- the quality of financial reporting to the Australian Securities and Investments Commission (ASIC), ASX and shareholders;
- the Group's accounting policies, practices and disclosures; and
- the scope and outcome of external and internal audits.

This committee's responsibilities include reviewing the financial statements (including items such as the outstanding claims provision, reinsurance recoveries and income tax), risk management, internal controls, compliance other than regulatory compliance and significant changes in accounting policies.

The chairman of the board and other non-executive directors normally attend audit and risk committee meetings which consider the 30 June and 31 December financial reports. Meetings of this committee usually include, by invitation, the chief executive officer, the chief financial officer, the chief executive officer of global underwriting operations, the chief actuarial officer, the chief risk officer, the Group head of internal audit and the external auditor. As appropriate, other relevant senior managers also attend.

The audit and risk committee has direct and unlimited access to the external auditor. The external auditor, the Group head of internal audit, the chief risk officer and the chief actuarial officer have direct and unlimited access to this committee.

The chief executive officer and 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*.

## 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 and risk committee confirms this by separate enquiry. The audit and risk 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 and risk 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.

## Investment committee

The membership of the investment committee comprises four non-executive directors and one executive director. The investment committee normally meets five 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 JM Green, Mr CLA Irby, Ms BJ Hutchinson AM and Mr FM O'Halloran. Meetings of the investment committee usually include, by invitation, the chief investment officer, the chief financial officer and the chief executive officer of global underwriting operations. 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 responsibilities include 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.

## 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 Mr LF Bleasel AM (chairman), Mr DM Boyle, Mr JM Green, Ms IF Hudson and Ms BJ Hutchinson AM. Meetings of the remuneration committee

# CORPORATE GOVERNANCE STATEMENT

usually include, by invitation, the chief executive officer, the chief executive officer of global underwriting operations and the Group general manager, human resources.

QBE's governance of remuneration focuses on ensuring that the remuneration and reward strategy and frameworks are aligned with robust risk management practices and strong governance principles and that shareholders receive value for remuneration expenditure.

The role of the remuneration committee is to oversee QBE's general remuneration practices. The remuneration committee, in particular, assesses the appropriateness of remuneration frameworks and practices in order to fairly and responsibly reward the 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 responsibilities include:

- recommendation of the total remuneration (fixed and at-risk) of the chief executive officer to the board and approval of the total remuneration of other members of the Group executive;
- review and approval 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 personal development plans (PDP) 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.

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 PDP involves a meeting between the relevant member of the Group executive, the chief executive officer and the Group general manager, human resources 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 2011. In addition, the board continually monitors the performance of the Group executive through regular contact and reporting.

QBE has operations and staff in 52 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 61 to 86 and in notes 30 and 31 to the financial statements.

## Global workforce diversity policy

On 3 December 2010, the remuneration committee approved a global workforce diversity policy in early adoption of the amendments to the ASX CGC recommendations. The policy provides a platform for an integrated diversity management policy across the Group, improving governance and monitoring of diversity at all levels. A workforce diversity committee will annually set and monitor specific objectives in line with the policy.

Since its introduction, the policy has been communicated to all employees to create Group-wide awareness of the intent and objectives. The Group defines diversity as differences in ethnic background, gender, age, sexual orientation, religion and disability. Measurable objectives for fostering inclusive, diverse work groups have also been added to the performance objectives for senior leaders. The workforce diversity committee has convened once in accordance with its charter to monitor progress towards agreed objectives.

The Group has undertaken an employee survey to establish a baseline measure of effectiveness in building diverse workgroups based on meritocracy and the QBE essential behaviours. Divisional diversity plans aligned to the objectives in the policy and the results of the survey have been established to achieve performance improvements in each division. These plans leverage initiatives already in place, such as paid parental leave and a formal program to support parents in returning to work from parental leave.

The Group has been assessed as compliant with the Equal Opportunities for Women in the Workplace Act (for Australian-based employees). Particular focus in 2011 has been given to developing pipelines of talented female employees for management roles. Currently, women comprise 57% of employees throughout the Group. Across all areas, 16% of senior executive positions are occupied by female employees and 37.5% of Group board members are female. In 2011, 40% of employees on our graduate program were women.

Subject to local legal requirements and other commitments within each market within which QBE operates, QBE's aspirational goals for women in senior positions remain at 25% in Group head office and 20% in its divisions by 31 December 2012.

QBE's specific objectives are:

- 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;
- 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; and
- improved access to resources that assist women in achieving their career goals.

QBE believes that it is making reasonable progress against these objectives.

## 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.



# CORPORATE GOVERNANCE STATEMENT

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 52 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 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 tolerances. The REMS covers topics such as the Group's risk tolerance and 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 24 to 27 of the annual report and in note 5 to the financial statements.

Management has reported to either the audit and risk 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's chief actuarial officer and chief risk officer are 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 are provided to the QBE Group board twice a year on environmental initiatives with a climate change related focus.

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 (CO<sub>2</sub>e) for 2011 were 52,957 tonnes (2010 52,730 tonnes), an increase of 0.4%. This can be summarised as:

- 1,306 tonnes of scope 1 direct greenhouse emissions due to natural gas and oil consumption used for heating (2010 1,170 tonnes);
- 36,541 tonnes of scope 2 indirect greenhouse emissions from electricity consumption (2010 35,990 tonnes); and
- 15,110 tonnes of scope 3 other indirect greenhouse emissions, defined as emissions relating to travel (2010 15,570 tonnes).

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, CDP2011, was published in September 2011 and is available on our website in the investor information section.

## 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 and risk 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 and risk 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.

## 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 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 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.

# CORPORATE GOVERNANCE STATEMENT

## Actuarial review

It is a long-standing 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. The chief actuarial officer is based in head office and there are over 220 actuarial staff in the Group. 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 90% of QBE's central estimate is also reviewed by external actuaries annually. External actuaries are generally from organisations which are not associated with the external auditor.

## 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.

## Communication and guidelines

### 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 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 2011 is included on page 168.

### 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. In 2012, it will be held on 4 April. 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 chief executive officer, chief financial officer, chief executive officer of global underwriting operations, chief actuarial officer, chief risk officer, general counsel and company secretary, global 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.

## Share trading policy

QBE revised its policy in 2010 for directors and senior Group executives relating to the purchase and sale of QBE securities. These are 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; and
- notify any intended transaction to nominated people within the Group, including notification of any hedging of vested entitlements.

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.

## Other 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 essential 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. One of the core values of the Group is integrity.

QBE in Australia follows the general insurance code of practice, a self-regulated code developed by the Insurance Council of Australia relating to the provision of products and services to customers of the general insurance industry of Australia. A revised code of practice commenced in July 2010.

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

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 58.

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

- board charter;
- role of non-executive directors;
- audit and risk, investment and remuneration 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;
- global workforce diversity policy;
- continuous disclosure guidelines; and
- shareholder communication guidelines.

# DIRECTORS' REPORT

FOR THE YEAR ENDED 31 DECEMBER 2011

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 2011.

## Directors

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

LF Bleasel AM  
DM Boyle  
JM Green  
IF Hudson  
BJ Hutchinson AM (chairman)  
CLA Irby  
IYL Lee  
FM O'Halloran

At the 2012 annual general meeting (AGM), Ms Hudson, Ms Hutchinson AM and Ms Lee will retire by rotation and offer themselves for re-election.

Details of the directors and their qualifications are provided on pages 48 and 49.

## Consolidated results

	2011 US\$M	2010 US\$M
Gross written premium	18,291	13,629
Unearned premium movement	(451)	(197)
Gross earned premium revenue	17,840	13,432
Outward reinsurance premium	(2,592)	(2,106)
Deferred reinsurance premium movement	111	36
Outward reinsurance premium expense	(2,481)	(2,070)
Net earned premium	15,359	11,362
Net claims incurred	(10,466)	(6,807)
Net commission	(2,291)	(1,759)
Underwriting and other expenses	(2,108)	(1,628)
Underwriting profit	494	1,168
Net investment income on policyholders' funds	591	535
Insurance profit	1,085	1,703
Net investment income on shareholders' funds	185	124
Financing and other costs	(275)	(222)
Share of net profits of associates	6	5
Amortisation of intangibles and impairment of goodwill/intangibles	(133)	(59)
Profit before income tax	868	1,551
Income tax expense	(149)	(257)
Profit after income tax	719	1,294
Net profit attributable to non-controlling interests	(15)	(16)
Net profit after income tax	704	1,278

## Profit

Net profit after income tax for the year ended 31 December 2011 was US\$704 million, down 45% from US\$1,278 million last year. 2011 was the worst year on record for catastrophe events, with insured losses from major catastrophes currently estimated at around US\$105 billion for the global insurance and reinsurance industry. The cost of large individual risk and catastrophe claims to QBE increased by US\$1,275 million compared with 2010. In addition, QBE's profits were affected by reduced risk-free interest rates used to discount outstanding claims and widening credit spreads on quality corporate bonds. The combined impact of these factors amounted to US\$493 million, reducing profit before tax by 44% to US\$868 million.



# DIRECTORS' REPORT

FOR THE YEAR ENDED 31 DECEMBER 2011

## Dividends

Due to the lower net profit after tax, the directors announced a reduced final dividend of 25.0 Australian cents per share, down from 66.0 Australian cents per share last year. The franking of the final dividend will increase to 25%. The total dividend payout is A\$956 million compared with A\$1,336 million in 2010. The bonus share and dividend reinvestment plans continue at a 2.5% discount.

## Activities

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

## Shareholders' funds

Shareholders' funds were US\$10,386 million compared with US\$10,311 million at 31 December 2010. The movement includes the profit for the year, the impact of exchange rate movements on the translation of our foreign operations to US dollars and the payment of the 2010 final and 2011 interim dividends net of reinvestment. Our 2010 final dividend was fully reinvested through a combination of the dividend reinvestment plans and underwriting of the dividend.

The number of shares advised to the Australian Securities Exchange increased slightly from 1,052 million to 1,116 million.

## Presentation currency

The Group has presented this financial report in US dollars, consistent with our reporting in 2010. 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.

## Review of operations

Gross earned premium was US\$17,840 million, up 33% from last year. Premium growth was achieved largely as a result of the acquisitions completed in late 2010 and during 2011, the weaker US dollar and higher premium rates for US crop business due to rising commodity prices. Net earned premium increased 35% to US\$15,359 million, slightly better than the growth in gross earned premium due to a lower reinsurance expense ratio, principally as a result of the new worldwide reinsurance covers and reduced proportional reinsurance.

The ratio of claims, commissions and expenses to net earned premium (combined operating ratio) was 96.8% compared with 89.7% last year. The net claims ratio was 68.2% compared with 59.9% last year, with the increase mainly reflecting the record level of catastrophe claims in the year and the impact of lower risk-free rates used to discount outstanding claims. The strength of our provision for outstanding claims reduced slightly reflecting lower average discount rates, with a probability of adequacy of 86.3% compared with 89.8% at 31 December 2010. The combined commission and expense ratio was 28.6% of net earned premium, down from 29.8% last year. The ratio was down due to the change in business mix following the US crop insurance and Balboa acquisitions, the rationalisation of our systems in Europe and North America and the accrual of lower incentives as a result of reduced profitability.

## North American operations

This operating segment reported net earned premium growth of 57% to US\$4,018 million. Growth was due mainly to the 2010 and 2011 acquisitions. The cost of reinsurance increased from 44% to 46% of gross earned premium mainly due to the impact of crop business which generates higher reinsurance premiums when business is profitable. The combined operating ratio was 90.6% compared with 89.1% last year. The net claims ratio increased slightly from 62.4% to 65.2% reflecting the increased frequency and severity of weather-related catastrophe claims in the year, which impacted our intermediary, program and crop segments. This was partly offset by the continued strong performance of our QBE FIRST segment. The combined commission and expense ratio reduced from 26.7% to 25.4%. The commission ratio was 6.6% compared with 9.6% last year, mainly due to the significant increase in crop business and the changing mix of the North American portfolio. The expense ratio was up to 18.8% from 17.1% due to costs associated with the integration of Balboa and lower net agency income from third parties.

## Latin American operations

Our Latin American operations reported net earned premium growth of 37% to US\$620 million. Growth was due mainly to the 2010 acquisitions of Colonial Compania de Seguros y Reaseguros in Ecuador and CNA in Argentina. The combined operating ratio was 89.7% compared with 93.4% last year. The net claims ratio was 56.7% compared with 57.3% in 2010, mainly due to a change in the mix of business and improvements in the claims ratios for Argentina and Mexico. The combined commission and expense ratio was 33.0%, down from 36.1% last year, mainly due to a change in the mix of business and synergies from acquisitions.

## European operations

European operations' combined operating ratio was 95.5% compared with 90.5% last year, impacted by the record level of catastrophe claims. Net earned premium increased by 21% to US\$3,150 million mainly due to the Secura acquisition in late 2010, premium rate increases, a number of successful new business and product initiatives and inward reinstatement premiums on our reinsurance portfolios. The claims ratio increased from 57.7% to 65.3% due to the claims activity referred to above. The impact of catastrophe claims was partially offset by the release of prior accident year risk margins on some portfolios. The combined commission and expense ratio reduced from 32.8% to 30.2%. The commission ratio was materially unchanged at 17.0% of net earned premium compared with 16.9% last year, with the slight increase due to a change in business mix following the Secura acquisition and increased broker pressure on commissions. Whilst the quantum of expenses was stable, the expense ratio was lower at 13.2% compared with 15.9% last year.

## Australian operations

Australian operations' combined operating ratio was 99.3% compared with 89.2% last year. The result was significantly impacted by increased claims activity, in particular the Queensland, Victorian and Northern New South Wales storms; cyclones Yasi, Anthony and Bianca; the Western Australian bushfires; and the claims from some of our policyholders exposed to the Christchurch earthquake in New Zealand. Net earned premium of US\$3,767 million was up 24% from last year. Premium growth was aided by the acquisition of CUNA Mutual's Australian operations and rate increases. The claims ratio increased from 60.9% last year to 69.4% due to the weather-related claims events. The combined commission and expense ratio was 29.9%, up from 28.3% in 2010. The higher ratio was due to the loss of exchange commission following changes to our proportional treaty reinsurance, which increased the commission ratio from 10.4% to 13.0%. The expense ratio was 16.9%, down from 17.9% last year, partly due to reduced staff costs and reduced net fee income on workers' compensation funds.



# DIRECTORS' REPORT

FOR THE YEAR ENDED 31 DECEMBER 2011

## Asia Pacific operations

Asia Pacific operations' combined operating ratio was 92.1%, up from 86.7% last year. The result was impacted by the devastating Christchurch earthquakes and Thailand floods. Net earned premium was up 5% to US\$442 million. Net earned premium was impacted by the payment of reinstatement premiums to the Group's captive, Equator Re, in relation to the catastrophes which had a consequent impact on the commission and expense ratios. The claims ratio increased from 45.7% to 46.6%. Improved claims experience in Hong Kong, Malaysia and Singapore was more than offset by the impact of the New Zealand earthquakes and the Thailand floods. The combined commission and expense ratio increased from 41.0% to 45.5%. The increase was partly due to the impact of reinstatement costs on net earned premium. Commissions were higher, up from 20.0% to 22.9%, mainly reflecting the effect of reinstatement premiums. The slightly higher expense ratio, up from 21.0% to 22.6%, was largely due to foreign currency fluctuations. Total expenses, using constant exchange rates, were slightly up from last year.

## Equator Re

Equator Re is QBE's wholly-owned captive reinsurer based in Bermuda. The operating segment reported net earned premium growth of 46% to US\$3,362 million. Premium growth was mainly due to proportional reinsurance from the 2011 acquisitions and additional premium income from reinstatement of covers as a result of the higher frequency of catastrophe claims. The combined operating ratio was 104.5% compared with 90.1% last year. The net claims ratio increased from 61.4% to 77.8%. Catastrophe claims from exposure to the Queensland, Victorian and Northern New South Wales storms; cyclones Yasi and Anthony; the New Zealand and Japanese earthquakes; and the floods in Thailand were some of the larger claims during the year. The combined commission and expense ratio was 26.7% compared with 28.7% in 2010. The decrease in the commission ratio from 24.9% last year to 23.3% mainly reflected the change in mix of business and increased excess of loss writings.

## Investment income

Investment income, including foreign exchange gains and investment expenses, was US\$776 million compared with US\$659 million last year. Investment income was lower than anticipated mainly due to generally lower interest rates and widening credit spreads on corporate bonds in the latter half of the year following negative market sentiment due to global economic uncertainty and concerns surrounding European sovereign debt.

The gross investment yield before foreign exchange gains and investment expenses was 2.4% compared with 2.3% last year.

## Income tax

Income tax expense for the year increased from 16.6% of net profit before tax to 17.2% due to losses this year in lower tax paying countries.

## Outstanding claims provision

The provision for outstanding claims for the majority of Group entities is determined after consultation with internal and external actuaries. The outstanding claims assessment takes into account the statistical analysis of past claims, allowance for claims incurred but not reported, recoveries and future interest and inflation factors. As in previous years, the directors consider that substantial risk margins are required in addition to actuarial central estimates to cover uncertainties such as latency claims, changes in interest rates and superimposed inflation. The probability of adequacy of the outstanding claims provision at 31 December 2011 was 86.3% compared with 89.8% 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 (ASIC), 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 each director.

## 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 page 48, the secretary, DA Ramsay, and deputy secretary, P Smiles.

In accordance with normal commercial practice, disclosure of the total 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.

# DIRECTORS' REPORT

FOR THE YEAR ENDED 31 DECEMBER 2011

## Likely developments

Information on likely developments in the Group's operations in future financial years and the expected results of those operations has not been included in this report because disclosure of the information 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 or State legislation.

## Meetings of directors

	FULL MEETINGS OF DIRECTORS <sup>(1)</sup>	MEETINGS OF NON-EXECUTIVE DIRECTORS	MEETINGS OF COMMITTEES			
			AUDIT AND RISK	FUNDING	INVESTMENT	REMUNERATION
Number of meetings held	11	9	4	1	5	6
<b>Number attended</b>						
LF Bleasel AM	11	9	4	–	–	6
DM Boyle	11	9	4	–	–	6
JM Green	11	9	–	1	5	6
IF Hudson	11	9	4	–	–	6
BJ Hutchinson AM	11	9	4	1	5	6
CLA Irby	10	8	–	–	3	–
IYL Lee	11	9	4	1	5	–
FM O'Halloran <sup>(2)</sup>	11	–	–	1	5	–

(1) Included a three day review meeting in Buenos Aires and a five day review meeting in the UK and the US. In addition, directors attended meetings for each of the Australian regulated insurance companies until November 2011.

(2) Mr O'Halloran attends audit and risk and remuneration committee meetings by invitation, not being a member of these committees.

During the February 2011 board meeting, the board also met as the nomination committee. Further meetings occurred during the year, including meetings of the chairman and 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 2009 to 28 February 2012, the directors also served as directors of the following listed entities:

	POSITION	DATE APPOINTED	DATE CEASED
<b>LF Bleasel AM</b>			
APA Group	Chairman	30 October 2007	–
<b>DM Boyle</b>			
Stockland Trust Group	Director	7 August 2007	–
<b>JM Green</b>			
WorleyParsons Limited	Director	11 October 2002	–
<b>IF Hudson</b>			
Phoenix Group Holdings plc	Director	18 February 2010	–
<b>BJ Hutchinson AM</b>			
AGL Energy Limited	Director	22 December 2010	–
<b>CLA Irby</b>			
Aberdeen Asset Management plc	Chairman	1 August 1999	22 January 2009
Great Portland Estates plc	Director	1 April 2004	–
North Atlantic Smaller Companies Investment Trust plc	Director	10 December 2002	–
<b>IYL Lee</b>			
Cathay Pacific Airways Limited	Director	13 January 2010	–
Hysan Development Company	Chairman <sup>(1)</sup>	9 March 2011	–
Keybridge Capital Limited	Chairman <sup>(2)</sup>	26 October 2006	–

(1) Ms Lee became chairman on 9 May 2011.

(2) Ms Lee stepped down from her position as executive chairman on 9 October 2009 and assumed the role of non-executive chairman.

# DIRECTORS' REPORT

FOR THE YEAR ENDED 31 DECEMBER 2011

## Qualifications and experience of company secretaries

### DA Ramsay B Comm, LLB, LLM, FANZIIF, FCIS

Mr Ramsay is the 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 and a trustee respectively of QBE sponsored superannuation plans in Australia and New Zealand.

### P Smiles LLB, MBA, ACIS

Mr Smiles is the deputy company secretary of QBE Insurance Group Limited and company secretary of various QBE subsidiaries in Australia. He has 20 years insurance experience, which includes 11 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 also 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	2011 NUMBER	2010 NUMBER
LF Bleasel AM	98,638	67,604
DM Boyle	17,617	13,437
JM Green	35,856	35,856
IF Hudson	11,737	11,359
BJ Hutchinson AM	94,646	78,646
CLA Irby	22,889	22,889
IYL Lee	26,749	26,749
FM O'Halloran	1,498,196	1,343,769

### (B) Options and conditional rights

At the date of this report, Mr O'Halloran had 347,957 (2010 347,957) options over ordinary shares of the company and 300,887 (2010 218,629) conditional rights to ordinary shares of the company under the QBE Incentive Scheme (QIS). Details of the QIS 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

Dear Shareholder,

The 2011 remuneration report describes QBE's executive remuneration strategy, framework and outcomes.

The remuneration committee is committed to aligning remuneration and reward outcomes with an increase in long-term shareholder value as is shown in the report.

The Group operates in a competitive global environment where the key to achieving sustained performance is to create a 'can-do' approach to work by motivating and retaining quality employees in each location.

Over the past 12 months, QBE has not been immune from the worst catastrophe year on record for the insurance and reinsurance industry and the difficult investment market conditions impacting results. Despite the cyclical, and sometimes volatile, nature of the insurance industry, the remuneration committee considers the remuneration framework has remained robust and focused on ensuring that at-risk reward structures reflect the current operating environment, are consistent with strong governance principles and promote integrated risk management practices.

Our remuneration framework is designed to drive the achievement and outperformance of financial and non-financial targets, ensuring that at-risk incentives are in place for most employees worldwide. Executive reward structures ensure that at-risk incentives are only earned when financial targets are met or exceeded.

Using the seven year spread basis of accounting, return on equity (ROE) was down from 15.9% to 7.4%. As a result, no short-term incentives will be payable to Group head office, Australian and Asia Pacific executives which clearly demonstrates the alignment of shareholders' and management interests.

The 2011 remuneration report articulates the remuneration approach adopted by QBE and its commercial rationale, and provides ongoing transparency of our reward structures.

The remuneration committee endeavours to have at-risk reward structures in place that are aligned to the drivers of shareholder value in terms of growth in share price.



**Belinda J Hutchinson AM**  
Chairman



**Len Bleasel AM**  
Chairman, Remuneration committee

# REMUNERATION REPORT

QBE's approach to remuneration is designed to ensure that shareholders receive value for fixed remuneration and at-risk reward expenditure. The remuneration policy and framework is underpinned by guiding principles linking it to QBE's business strategy which promote robust risk management practices.

Remuneration policy is reviewed annually to ensure that the structure remains market competitive and aligned with business strategy.

The 2011 remuneration report is structured as follows:

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# REMUNERATION REPORT

## 1. Executive remuneration at a glance

### 1.1 What is QBE's executive remuneration strategy?

QBE's executive remuneration strategy aims to provide a market competitive remuneration structure that motivates, retains and aligns our people to deliver sustained shareholder value.

#### REMUNERATION STRATEGY

- Promote sustainable long-term value for shareholders
- Retain, attract and motivate high quality talent



#### GUIDING PRINCIPLES

##### Market competitive

Fixed remuneration considers the diversity of individual roles, expertise required and complexity of each operating environment

##### Transparent

Simple and easy to understand performance and reward methodology

##### Performance-based

Linking individual outcomes to the achievement of financial targets, objectives and business strategies

##### Shareholder aligned

Achievement of short-term and long-term financial targets through risk adjusted ROE and investment performance



#### HOW WE APPLY THE REMUNERATION PRINCIPLES

- Use of market data and published recognised survey tools and/or undertaking external market reviews to inform the setting of competitive fixed remuneration levels
- Business plans and financial targets approved annually by the board
- Incentive approach and targets for executives approved annually by the remuneration committee
- Documentation explaining operation of incentives
- At-risk rewards paid only when minimum ROE and investment income targets are achieved
- LTI plan requires performance in the top 10% of the top 50 global insurers and reinsurers as measured by net earned premium
- Vesting of LTI equity is measured against achievement of earnings per share (EPS), ROE and combined operating ratio (COR) targets
- Equity awards are subject to a clawback for material deterioration of the relevant entity's ROE
- Equity awards are vested as deferred shares that have to be retained until minimum shareholding requirements are met
- Minimum shareholding policy applies to each executive

# REMUNERATION REPORT

## 1. Executive remuneration at a glance continued

### 1.2 What was the executive remuneration framework in 2011?

QBE continues to ensure that remuneration arrangements reflect current economic and market conditions, and performance based at-risk rewards are linked to the achievement of challenging financial performance targets.

TOTAL REMUNERATION	COMPONENTS	2011 STRUCTURE
Fixed remuneration	All guaranteed pay – base salary, superannuation and other guaranteed benefits	<ul style="list-style-type: none"> <li>• CEO fixed remuneration increased by 4.3% from 1 January 2011. The increase was supported by an independent review of external remuneration market data</li> <li>• Fixed remuneration increases limited to an average of 4.2% for executives with exceptions made only where a promotion or a significant market movement has taken place</li> </ul>
At-risk reward	<p>Cash and deferred equity awards delivered under the QBE Incentive Scheme (QIS)</p> <hr/> <p>Equity award delivered under the Long-Term Incentive (LTI) scheme</p>	<ul style="list-style-type: none"> <li>• Short-term cash awards significantly less than 2010 reflecting 2011 financial results</li> <li>• No cash award payout for the CEO reflecting 2011 financial results</li> <li>• Cash award payout limited to two executives reflecting 2011 financial results</li> <li>• Deferred equity grants also significantly less than 2010 reflecting 2011 financial results</li> <li>• At the discretion of the remuneration committee, deferred equity vesting continues to be subject to a clawback for subsequent material deterioration of the relevant ROE that was used to determine the grant</li> <li>• The remuneration committee continues to exercise discretion to pay cash in lieu of shares in certain circumstances such as death, disability, redundancy or retirement</li> </ul> <hr/> <ul style="list-style-type: none"> <li>• The LTI scheme was introduced in 2010, and is subject to future performance hurdles as follows: <ul style="list-style-type: none"> <li>– 50% of the award is contingent on the Group's diluted EPS increasing by a compound average 7.5% per annum over a five year vesting period; and</li> <li>– 50% of the award allocation is contingent on the Group's average ROE and combined operating ratio for the five year vesting period being in the top 10% of the top 50 largest global insurers and reinsurers as measured by net earned premium</li> </ul> </li> <li>• The achievement of performance hurdles is reviewed annually. For awards granted in March 2011 (for the 2010 year), the EPS hurdle was not met in 2011</li> <li>• Equity vesting continues to be subject to a clawback for subsequent material deterioration of the Group's ROE</li> <li>• Equity vesting continues to be subject to a five year tenure hurdle</li> <li>• The remuneration committee continues to exercise discretion to pay cash in lieu of shares in certain circumstances such as death, disability, redundancy or retirement</li> </ul>

# REMUNERATION REPORT

## 1.3 Actual remuneration outcomes in 2011

Details of the remuneration received by the executive director and other executives in 2011 are provided below. Remuneration details provided in accordance with accounting standards are included in section 3.1 of this remuneration report. Remuneration of non-executive directors is shown on page 82.

	FIXED REMUNERATION			AT-RISK REWARD			TOTAL US\$000
	CASH SALARY <sup>(1)</sup> US\$000	OTHER FIXED <sup>(2)</sup> US\$000	TOTAL US\$000	CASH INCENTIVE US\$000	SHARE BASED <sup>(3)</sup> INCENTIVE US\$000	OTHER <sup>(4)</sup> US\$000	
<b>Executive director</b>							
FM O'Halloran	2,326	15	2,341	–	819	724	3,884
<b>Executives</b>							
G Brader	687	15	702	–	54	47	803
SP Burns	1,083	352	1,435	1,004	1,841	28	4,308
NG Drabsch	1,038	29	1,067	–	400	229	1,696
C Fagen <sup>(5)</sup>	386	11	397	–	86	96	579
D Fogarty	506	–	506	–	188	169	863
MJ Goodwin	608	–	608	–	90	508	1,206
J Neal	1,249	–	1,249	–	1,074	471	2,794
BM Nicholls	692	16	708	–	177	21	906
DA Ramsay	791	16	807	–	226	157	1,190
J Rumpler	985	15	1,000	878	119	121	2,118
JM Smith	656	15	671	–	184	53	908
GB Thwaites	653	18	671	–	165	47	883
<b>Former key management personnel</b>							
TW Ibbotson <sup>(6)</sup>	544	21	565	–	1,592	30	2,187
V McLenaghan <sup>(7)</sup>	622	24	646	–	487	118	1,251

(1) Cash salary reflects the amount of fixed cash remuneration earned during the year.

(2) Other fixed remuneration comprises guaranteed benefits such as superannuation.

(3) The share based incentive value reflects the value realised by the executive in the financial year. The value has been determined based on the options and conditional rights that vested during 2011 by reference to the closing share price on the vesting date. Details are provided in section 1.4 of this report.

(4) Other remuneration includes deemed interest on employee loans and long service leave accruals where appropriate.

(5) Mr Fagen's remuneration is for the period from 21 July to 31 December 2011.

(6) The table does not include Mr Ibbotson's termination benefit of US\$3,214,000, details of which are shown in the footnote to the table on page 77.

(7) The table does not include Mr McLenaghan's termination benefit of US\$4,072,000, details of which are shown in the footnote to the table on page 77.

# REMUNERATION REPORT

## 1. Executive remuneration at a glance continued

### 1.4 Which equity awards vested in 2011?

The table below details the value of deferred equity awards granted in previous financial years that vested in 2011. Options vested were in accordance with the legacy 2005 Senior Executive Equity Scheme (SEES) terms and conditional rights vested were in accordance with the legacy 2007 Deferred Compensation Plan (DCP). Award vesting was subject to a tenure hurdle being met which was achieved by each executive.

	CONDITIONAL RIGHTS VESTED IN 2011		OPTIONS VESTED IN 2011	
	NUMBER	VALUE AT VESTING DATE <sup>(1)</sup> US\$000	NUMBER	VALUE AT VESTING DATE <sup>(2)</sup> US\$000
<b>Executive director</b>				
FM O'Halloran	43,660	819	94,771	–
<b>Executives</b>				
G Brader	2,879	54	4,750	–
SP Burns	98,111	1,841	110,515	–
NG Drabsch	21,310	400	50,460	–
C Fagen	4,591	86	7,727	–
D Fogarty	10,062	189	25,924	–
MJ Goodwin	4,808	90	2,076	–
J Neal	57,200	1,074	50,559	–
BM Nicholls	9,407	177	41,366	–
DA Ramsay	12,040	226	26,981	–
J Rumpler	6,356	119	13,711	–
JM Smith	9,784	184	22,566	–
GB Thwaites	8,796	165	7,485	–
<b>Former key management personnel</b>				
TW Ibbotson <sup>(3)</sup>	84,837	1,592	96,902	–
V McLenaghan	25,954	487	39,141	–

(1) The share price on the vesting dates of conditional rights was A\$18.01 for Mr O'Halloran whose conditional rights vested on 4 April 2011 and A\$18.03 for all other key management personnel whose conditional rights vested on 3 March 2011.

(2) The share price on the vesting dates of options was A\$18.97 for Mr O'Halloran whose options vested on 6 April 2011 and A\$17.98 for all other key management personnel whose options vested on 1 March 2011. The exercise price per option on the vesting dates was greater than the actual share price and has remained so for the remainder of the financial year. As a result, all vested options remain unexercised at the balance date.

(3) Mr Ibbotson's position was made redundant on 31 August 2011. As part of his redundancy arrangements, the vesting of 73,211 conditional rights and 71,971 options was accelerated into the current financial year.

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 service period ending at the vesting date, regardless of the value which is ultimately received by the executive.

### 1.5 Looking forward – 2012

<b>Remuneration and at-risk reward</b>	<ul style="list-style-type: none"> <li>A fixed remuneration increase of 4% has been approved for the CEO effective from 1 January 2012.</li> <li>Fixed remuneration increases for executives has been limited to an average of 3.58% effective from 1 January 2012.</li> <li>Structural changes have been approved by the remuneration committee to the at-risk cash award schemes operating within Australia and the Americas.</li> <li>The at-risk reward schemes are under review to ensure that they remain market competitive.</li> </ul>
<b>Workplace diversity</b>	<ul style="list-style-type: none"> <li>In line with amendments to the ASX Corporate Governance Council Principles and Recommendations, from 2011, the remuneration committee will annually review and report to the board on workplace diversity within QBE. This will include disclosure to the market on policy, gender objectives and achievements in our annual report.</li> </ul>
<b>Governance</b>	<ul style="list-style-type: none"> <li>Compliance with the APRA prudential standards covering remuneration governance (effective from 1 April 2010) will continue to be actively monitored by the remuneration committee and management to ensure appropriateness of the Group's remuneration policy and its link to risk management practices.</li> <li>As the Australian executive remuneration legislative landscape continues to evolve, the federal government has indicated its intention to implement many of the Productivity Commission's recommendations into the regulation of director and executive remuneration. The remuneration committee therefore continues to review and implement aspects of the recommendations to ensure compliance with any legislative changes.</li> </ul>

# REMUNERATION REPORT

## 2. Remuneration explained

### 2.1 Introduction

The information presented in the 2011 remuneration report forms part of the directors' report and has been prepared in accordance with section 300A of the *Corporations Act 2001*. The information has been audited as required by section 308(3C) of the *Corporations Act 2001*.

The report sets out remuneration details of the Group chief executive officer, executives and non-executive directors, who are the key people accountable for managing QBE and its controlled entities.

QBE's key management personnel at the date of this report are listed in the tables below.

NAME	POSITION	COUNTRY OF RESIDENCE
<b>Executive director</b>		
FM O'Halloran	Chief executive officer	Australia
<b>Executives</b>		
G Brader <sup>(1)</sup>	Group chief investment officer	Australia
SP Burns	Chief executive officer, European operations	United Kingdom
NG Drabsch	Chief financial officer	Australia
C Fagen <sup>(2)</sup>	Chief executive officer, Australian operations	Australia
D Fogarty	President, Equator Re	Ireland
MJ Goodwin	Chief executive officer, Asia Pacific operations	Singapore
AR Jackson <sup>(3)</sup>	Global head of investor relations and communications	Australia
J Neal <sup>(4)</sup>	Chief executive officer of global underwriting operations	Australia
BM Nicholls	Group chief actuarial officer	Australia
DA Ramsay	Group general counsel and company secretary	Australia
J Rumppler	President and chief executive officer, North American operations	United States
JM Smith	Group general manager, human resources	Australia
J Sojo <sup>(5)</sup>	Chief executive officer, Latin American operations	Argentina
GB Thwaites	Group chief risk officer	Australia
<b>Former key management personnel</b>		
TW Ibbotson <sup>(6)</sup>	Global head of distribution	Australia
V McLenaghan <sup>(7)</sup>	Chief executive officer, Australia Asia Pacific	Australia

(1) Mr Brader assumed the role of Group chief investment officer on 1 January 2011.

(2) Mr Fagen assumed the role of chief executive officer, Australian operations on 21 July 2011.

(3) Mr Jackson assumed the role of global head of investor relations and communications on 1 January 2012.

(4) Mr Neal assumed the role of chief executive officer of global underwriting operations on 1 January 2011.

(5) Mr Sojo was appointed to the Group executive committee in 2012.

(6) Mr Ibbotson's position was made redundant on 31 August 2011.

(7) Mr McLenaghan ceased being part of key management personnel on 21 July 2011. His position was made redundant on 21 January 2012.

NAME	POSITION	COUNTRY OF RESIDENCE
<b>Non-executive directors</b>		
LF Bleasel AM	Non-executive director	Australia
DM Boyle	Non-executive director	Australia
JM Green	Non-executive director	Australia
IF Hudson	Non-executive director	United Kingdom
BJ Hutchinson AM	Chairman, non-executive director	Australia
CLA Irby	Non-executive director	United Kingdom
IYL Lee	Non-executive director	Hong Kong



# REMUNERATION REPORT

## 2.3 Use of remuneration consultants

The remuneration committee seeks and considers advice from independent remuneration consultants where appropriate. Remuneration consultants are engaged by, and report directly to, the remuneration committee. Potential conflicts of interest are considered when remuneration consultants are selected and their terms of engagement regulate their level of access to, and require independence from, QBE's management. Any advice and recommendations of external consultants are used as a guide, and are not a substitute for thorough consideration of all the issues by each non-executive director.

Guerdon Associates, who were appointed by the remuneration committee to act as independent remuneration advisers, provide specialist remuneration advice and do not provide other services to the Group. During 2011, Guerdon Associates provided advice and assistance to the remuneration committee on the following matters:

- review of and commentary on management proposals on capital allocation for incentive scheme proposals;
- analysis and support in the review of Group head office executives' short-term incentive scheme arrangements; and
- ad hoc support and advice as requested by the remuneration committee.

The cost of advice and assistance provided by Guerdon Associates during 2011 was A\$74,600.

## 2.4 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. A significant component of executive remuneration is at-risk, ensuring alignment between QBE's performance and executive reward.

The achievement of ROE targets is the primary performance measure of QBE's strength. ROE is a relative 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. It represents shareholders' "bottom line" and is understood and accepted by institutional investors.

Overall levels of at-risk reward delivered through the QIS take into account the ROE performance of QBE over a number of years, with greater emphasis given to the current financial year. The use of ROE targets ensures that executives focus on delivering superior returns to shareholders.

For incentive purposes, ROE is determined as net profit after tax (NPAT) on a management basis as a percentage of opening allocated capital. For the determination of Group incentives, NPAT on a management basis is prepared on a seven year spread basis of accounting. For further clarification, see page 84. If ROE becomes too low, shareholders and the Group may prefer to invest funds elsewhere where they could earn a higher return. As such, it is vitally important that QBE maintains a healthy and stable ROE to ensure shareholder satisfaction. This is why QBE insists on the achievement of a minimum ROE hurdle of 15% of opening allocated capital for each insurance division. This hurdle is well above the majority of QBE's peers around the world.

Other key financial profit drivers that are linked to executive reward include investment income performance, EPS and COR.

As the ROE for 2011 was below the minimum benchmark for Group head office and some divisions due to the record level of catastrophes, there will be no cash or deferred equity award under the QIS except for European operations and the Americas.

QBE's philosophy is that long-term success is a result of sound operating performance measured by financial metrics such as ROE and investment performance, prudent risk taking, solid strategic decision making and the focus of key executives on the underlying business performance indicators and profit drivers.

# REMUNERATION REPORT

## 2. Remuneration explained continued

Creating shareholder value is a fundamental goal for QBE. The value of QBE's share price is an indication of shareholder wealth. The share price can be influenced positively by the following measures which are aligned with our executive reward framework:

- growth and increased profitability, particularly insurance profit and investment income performance;
- consistency of earnings, particularly EPS;
- achievement of ROE targets;
- dividend yield and franking credits; and
- quality of the management team.

Over the period from 2007 to 2011:

- QBE's underwriting profit decreased by a compound annual average 11.4% per annum;
- QBE's NPAT decreased by a compound annual average 8.9% per annum;
- diluted EPS decreased by a compound annual 14.1% per annum; and
- dividends per share decreased by a compound annual average of 1.7% per annum.

Our 2011 net profit after tax was impacted by a higher incidence of large individual risk and catastrophe claims and volatile investment markets.

During the same period, average executive remuneration (fixed remuneration and at-risk) reduced by a compound average 8.9% per annum reflecting lower at-risk remuneration.

We have a highly experienced executive team with a strong retention record. The average tenure of the executive team (including the Group CEO) is 17 years. All executives have position descriptions in place which set out their roles, accountabilities and duties. They also have employment contracts which confirm their remuneration and reward arrangements, including entitlements on termination.

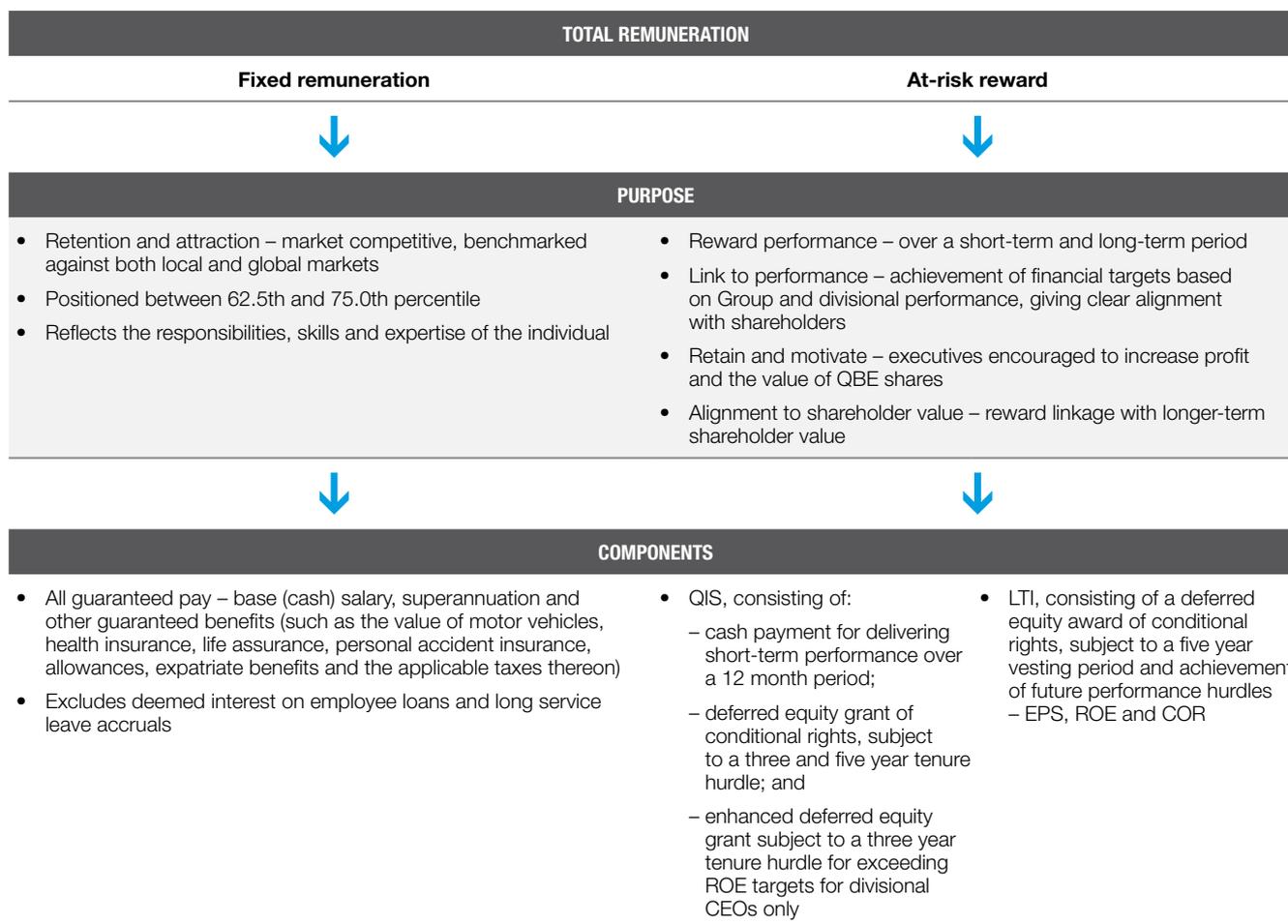
Executives are required to adhere to a range of Group-wide policies to ensure risk taking is managed, strong governance structures are in place and high ethical standards are maintained. These policies are communicated to employees across various intranets in operation throughout the Group.

Executive performance is evaluated annually by 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 position description, demonstrated behaviours and an assessment of current capability and future potential.

# REMUNERATION REPORT

## 2.5 How is executive remuneration structured?

Our fixed remuneration and at-risk reward structure recognises the significant influence executives have on achieving QBE's financial results. The structure encourages sustained high performance based on meeting or exceeding financial results which deliver performance in the top 10% of the top 50 largest global insurers and reinsurers (as measured by net earned premium).



### 2.5.1 Total reward mix

Consistent with market practice, the mix of total remuneration and reward is reflective of the executive's ability to influence QBE's financial results. The table below shows the 2011 potential total reward mix assuming maximum at-risk incentives.

POSITION	FIXED REMUNERATION %	AT-RISK REWARD		
		QIS – CASH %	QIS – DEFERRED EQUITY %	LTI %
Group CEO	26	35	26	13
Other executives	23 – 35	29 – 38	26 – 43	3 – 13

# REMUNERATION REPORT

## 2. Remuneration explained continued

### Assessing what is 'competitive'

To assess competitiveness of fixed remuneration, the remuneration committee considers a defined comparator group of companies as set out in the table below.

EXECUTIVES	COMPARATOR GROUP
<b>Australian-based</b>	Generally 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 is expanded to 25% to 400% of market capitalisation.
<b>Overseas-based</b>	Market data on the US and the UK is gathered from relevant external surveys. A similar benchmarking approach, with the emphasis on a comparative group of a similar size to the relevant US or UK operations, is used to filter survey data for both the US and UK executives.

Remuneration practices vary in each of the markets within which we operate, therefore the diversity of individual roles and the complexity of each operating environment is considered.

### Balancing short-term and long-term rewards

Based on our view of current market practice and the principles of our remuneration policy, we have developed an at-risk reward structure that balances short-term and long-term incentives.

It consists of the following components:

- cash awards paid under the QIS scheme;
- deferred equity awards granted under the QIS;
- enhanced deferred equity awards under the QIS for exceeding ROE targets (divisional CEOs only); and
- equity awards granted under the LTI.

The short and long-term at-risk rewards aim to reward, retain and motivate executives for making QBE successful.

The 2011 at-risk reward delivery structure is shown below.

AT RISK REWARD	MARCH 2012	2013	2014	2015	2016	2017
QIS – cash award	Cash payment for 2011 financial target achievements					
QIS – deferred equity	Grant of conditional rights with a three and five year vesting tenure hurdle			50% vests		50% vests
	Grant of conditional rights with a three year vesting tenure hurdle <sup>(1)</sup>			100% vests		
LTI – equity	Grant of conditional rights with a five year vesting, subject to future performance hurdles					50% vests = EPS hurdle 50% vests = ROE + COR hurdle

The success of our at-risk reward schemes is demonstrated by the low turnover of senior employees.

(1) Refers to enhanced QIS deferred equity award, applicable to divisional CEOs only.

## 2.6 How did QBE's performance affect executive rewards in 2011?

### 2.6.1 QIS – cash award

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 award is designed to motivate and reward executives when annual ROE targets and investment income targets relating to the financial year's performance are achieved or exceeded. Non-executive directors are not eligible to receive a QIS cash reward.

The table on page 73 shows the 2011 financial performance targets, incentive opportunity and achieved award for each executive. The different cash award percentage levels reflect an executive's relative influence on organisational performance.

Cash awards are aligned with shareholders' interests to ensure that short-term incentives are more beneficial to the executive when minimum ROE targets are exceeded.

# REMUNERATION REPORT

		FINANCIAL TARGET				ACTUAL ACHIEVEMENT	
		ROE		CASH AWARD <sup>(1)</sup>		ROE	CASH AWARD <sup>(1)</sup>
		MINIMUM %	MAXIMUM %	MINIMUM %	MAXIMUM %	%	%
<b>Executive director</b>							
FM O'Halloran	QBE Group ROE	14	<b>21</b>	15	<b>134</b>	7.4	–
<b>Executive</b>							
G Brader	QBE Group ROE	14	<b>21</b>	3.13	<b>25</b>	7.4	–
	Investment targets	–	–	–	<b>100</b>	–	–
SP Burns	European operations ROE	10	<b>22</b>	–	<b>133.34</b>	16.3	<b>70.0</b>
NG Drabsch	QBE Group ROE	14	<b>21</b>	15	<b>117</b>	7.4	–
C Fagen <sup>(2)</sup>	Australian operations ROE	15	<b>24</b>	20	<b>125</b>	10.2	–
D Fogarty <sup>(3)</sup>	QBE Group ROE	14	<b>21</b>	15	<b>94</b>	7.4	–
MJ Goodwin <sup>(4)</sup>	Asia Pacific operations ROE	15	<b>24</b>	25	<b>125</b>	3.2	–
J Neal	QBE Group ROE	14	<b>21</b>	15	<b>133</b>	7.4	–
BM Nicholls	QBE Group ROE	14	<b>21</b>	15	<b>94</b>	7.4	–
DA Ramsay	QBE Group ROE	14	<b>21</b>	15	<b>94</b>	7.4	–
J Rumppler	the Americas ROE	15	<b>22</b>	39.9	<b>133</b>	17.6	<b>87.8</b>
JM Smith	QBE Group ROE	14	<b>21</b>	15	<b>94</b>	7.4	–
GB Thwaites	QBE Group ROE	14	<b>21</b>	15	<b>94</b>	7.4	–
<b>Former key management personnel</b>							
TW Ibbotson	QBE Group ROE	14	<b>21</b>	6.25	<b>50</b>	7.4	–
	Global distribution targets	–	–	10	<b>75</b>	–	–
V McLenaghan	Australian Asia Pacific operations ROE	15	<b>24</b>	15	<b>133</b>	9.5	–

(1) The cash award is generally calculated as a percentage of fixed remuneration as at 31 December 2011.

(2) Mr Fagen's targets are effective from 21 July 2011.

(3) Mr Fogarty is based in Dublin. His cash award is calculated using his base salary.

(4) Mr Goodwin is based in Singapore. His cash award is calculated as a percentage of his overseas (assignment) net salary (excluding any positive cost of living adjustment).

## 2.6.2 QIS – deferred equity award

The QIS deferred equity award provides executives with the opportunity to acquire equity in the form of conditional rights to fully paid shares without payment. Executives are granted deferred equity only if a cash award is earned for the financial year. Non-executive directors are not eligible to receive a QIS deferred equity award.

A tenure hurdle is attached to deferred equity awards. Shares will normally only 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 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.

The maximum deferred equity award is based on an amount which is the lesser of 80% of the cash award earned in the financial 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 cash award is paid.

The maximum deferred equity award is used as the basis of calculating the number of conditional rights 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 allocation of conditional rights is calculated is the weighted average sale price of QBE shares over the five trading days on the ASX from 28 February 2012, being the date on which QBE's annual result is announced to the ASX.

Other key senior employees of the QBE Group are also eligible to participate in the QIS deferred equity award.

The tenure hurdle places significant focus on sustained share price growth over the longer-term and provides a significant retention element for the executive.

The ultimate vesting of conditional rights is contingent on there being no material deterioration of the original ROE for 2011 during the vesting period.

Equity is subject to clawback at the discretion of the remuneration committee.

# REMUNERATION REPORT

## 2. Remuneration explained continued

The table below shows the deferred equity award that will be granted in March 2012, based on 2011 performance. Only two key management personnel will be granted QIS deferred equity awards based on 2011 performance.

	QIS CASH AWARD			DEFERRED EQUITY AWARD – CONDITIONAL RIGHTS				
	FIXED REMUNERATION US\$000	% OF FIXED REMUNERATION	CASH US\$000	MAXIMUM US\$000 <sup>(1)</sup>	THREE YEARS <sup>(3)</sup>		FIVE YEARS <sup>(3)</sup>	
					AWARD US\$000	NO. OF SHARES <sup>(2)</sup>	AWARD US\$000	NO. OF SHARES <sup>(2)</sup>
<b>Executive</b>								
SP Burns <sup>(3)</sup>	1,435	70.0	1,004	669	402	33,566	402	33,566
J Rumpler <sup>(4)</sup>	1,000	87.8	878	702	351	29,340	351	29,340

(1) Lesser of 66.67% of cash award or 100% of fixed remuneration for Mr Burns and lesser of 80% of cash award or 100% of fixed remuneration for Mr Rumpler.

(2) For indicative purposes, a share price of A\$11.50 has been used.

(3) Mr Burns' deferred equity is determined as 60% of the maximum for each of the three and five year awards.

(4) Mr Rumpler's deferred equity is determined as 50% of the maximum for each of the three and five year awards.

### 2.6.3 Enhanced QIS deferred equity awards (divisional CEOs)

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

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

The ultimate vesting of the conditional rights is also contingent on no material deterioration of the division's 2011 ROE during the vesting period.

The value of the conditional rights allocated varies for each executive, ranging from 3% up to 15% of fixed remuneration or base (cash) salary as appropriate, except for Mr Burns whose award ranges from 0% to 50% of the QIS cash award. To calculate the number of conditional rights granted, the award value is divided by the weighted average sale price of QBE shares over the five trading days on the ASX prior to the grant date (generally the first week of March).

The divisional ROE hurdles, the minimum and maximum awards and the actual award for the 2011 financial year are shown in the table below.

EXECUTIVE	DIVISION	DIVISIONAL ROE HURDLES	ENHANCED DEFERRED EQUITY AWARD AS A % OF FIXED REMUNERATION		
		MINIMUM AND MAXIMUM %	MINIMUM AND MAXIMUM %	ACTUAL AWARD %	AWARD VALUE US\$000
SP Burns <sup>(1)</sup>	European operations	22 – 32	0 – 50	–	–
C Fagen <sup>(2)</sup>	Australian operations	23 – 27	3 – 15	–	–
MJ Goodwin	Asia Pacific operations	23 – 27	3 – 15	–	–
J Rumpler	the Americas	23 – 27	3 – 15	–	–

(1) Mr Burns' award is determined as a percentage of the QIS cash award.

(2) Mr Fagen participated in this scheme from 21 July 2011.

The enhanced deferred equity award aims to encourage superior performance from our divisional CEOs and to increase shareholder value by motivating them to exceed ROE targets.

# REMUNERATION REPORT

## 2.6.4 Long-Term Incentive (LTI) plan

LTI plan was introduced from 1 January 2010.

Specific risk-related performance measurements and an EPS measure ensure alignment with APRA's guidelines on prudent risk taking for long-term financial soundness of the business and with shareholders' interests. The LTI 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:

- 50% of the award allocation will be contingent on QBE's diluted EPS 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 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 2011 will be granted in March 2012 and, subject to achievement of the above performance hurdles, will vest in March 2017. The vesting of the conditional rights is also contingent on there being no material deterioration in QBE's 2011 ROE during the vesting period.

These combined performance hurdles will determine the number of conditional rights to vest in March 2017, up to a maximum of between 15% and 50% of fixed remuneration as shown in the table below.

	LTI AWARD AS A % OF FIXED REMUNERATION			LTI AWARD – CONDITIONAL RIGHTS	
	DILUTED EPS HURDLE %	ROE AND COR HURDLE %	MAXIMUM AWARD %	MAXIMUM AWARD US\$000	INDICATIVE NO. OF SHARES <sup>(1)</sup>
<b>Executive director</b>					
FM O'Halloran	25	25	50	1,171	97,827
<b>Executives</b>					
G Brader	7.5	7.5	15	105	8,805
SP Burns	7.5	7.5	15	215	17,980
NG Drabsch	12.5	12.5	25	267	22,283
C Fagen <sup>(2)</sup>	7.5	7.5	15	60	4,982
D Fogarty	7.5	7.5	15	76	6,340
MJ Goodwin	7.5	7.5	15	96	8,033
J Neal	25	25	50	624	52,174
BM Nicholls	7.5	7.5	15	106	8,874
DA Ramsay	7.5	7.5	15	121	10,109
J Rumpfer	7.5	7.5	15	150	12,534
JM Smith	7.5	7.5	15	101	8,414
GB Thwaites	7.5	7.5	15	101	8,414
<b>Former key management personnel</b>					
TW Ibbotson <sup>(3)</sup>	7.5	7.5	15	–	–
V McLenaghan <sup>(3)</sup>	7.5	7.5	15	–	–

(1) For indicative purposes, a share price of A\$11.50 has been used above.

(2) Mr Fagen participated in this scheme from 21 July 2011. His award is calculated on a pro-rata basis.

(3) Neither Mr Ibbotson nor Mr McLenaghan will be granted awards under the LTI plan in March 2012.

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 if the individual is not subject to disciplinary proceedings or notice on that date.

## 2.7 Keeping executives' and shareholders' interests aligned

### 2.7.1 Minimum shareholding

In keeping with our remuneration philosophy to align executive at-risk reward with the achievement of returns for shareholders in terms of both dividends and growth in share price, an executive minimum shareholding requirement was introduced from 31 March 2008.

Under the requirement, the Group CEO and executives (excluding non-executive directors) were required to accumulate a minimum vested shareholding in QBE equivalent to one year's fixed remuneration by 31 March 2011. 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 shareholdings over a three year period after the first equity grant vests.

Compliance with the requirement is assessed as at 31 March each year.

If an executive does not meet the minimum shareholding at the annual review date, QBE may impose a restriction on the sale of any further equity grants.

Challenging performance hurdles applicable over the five year vesting period have been included in the LTI in response to shareholders' requests to ensure sustainable business development whilst providing appropriate returns to shareholders.

The minimum shareholding requirement encourages executives to actively build their shareholdings and ensures they have significant exposure to QBE's share price and, by so doing, confirms their long-term interests are aligned with shareholders.

# REMUNERATION REPORT

## 2. Remuneration explained continued

As at 31 March 2011, the Group CEO and executives met the necessary minimum shareholding requirement with the exceptions of Mr Goodwin, Ms Smith and Mr Nicholls. Mr Goodwin has been granted an exemption until 31 March 2012 due to his appointment on 8 October 2007. Mr Nicholls and Ms Smith did not meet the requirement of retaining a minimum shareholding. In line with the executive minimum shareholding requirement, QBE has imposed a sales restriction on the sale of any further equity grants. Individual executive requirements are recalculated annually to consider fixed remuneration increases and changes in the share price or exchange rates.

### 2.7.2 Current exposure

Executives have further exposure to QBE's share price through their unvested conditional rights and options. The total shareholding investment of executives (excluding non-executive directors) is shown in the table on page 78.

Options issued to executives in 2007, 2008 and 2009 continue to remain below the share price at the grant date (details are provided on page 86) and 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 executive remuneration.

### 2.7.3 Trading policy

A policy exists stating that non-executive directors, key management personnel and key senior employees should notify any intended share transaction to nominated people within the Group, including hedging of vested entitlements. Trading in QBE ordinary shares is generally only permitted during designated trading windows.

The policy also prohibits the hedging of unvested entitlements. 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 key management personnel and shareholders, with the effect that market share value movements (either positive or negative) will economically impact the executive.

The policy is enforced by requiring key management personnel to sign an annual declaration that indicates 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](http://www.qbe.com/investor/information/corporate_governance/background_documents).

# REMUNERATION REPORT

## 3. Remuneration in detail

### 3.1 Statutory executive remuneration disclosures

The following table provides details of the remuneration of QBE's key management personnel (excluding non-executive directors) as determined by reference to applicable Australian accounting standards for the financial year ended 31 December 2011. Overseas remuneration has been converted to US dollars using the cumulative average rates of exchange as set out on page 98 of the annual report.

	YEAR	CURRENCY	SHORT-TERM EMPLOYEE BENEFITS			POST EMPLOYMENT BENEFITS	OTHER LONG-TERM EMPLOYMENT BENEFITS	SHARE BASED PAYMENTS <sup>(1)</sup>		TERMINATION BENEFITS	TOTAL
			BASE SALARY	OTHER <sup>(2)</sup>	CASH INCENTIVE AWARD <sup>(3)</sup>	SUPER-ANNUATION	LONG SERVICE LEAVE	CONDITIONAL RIGHTS	OPTIONS		
<b>Executive director<sup>(4)</sup></b>											
FM O'Halloran	2011	US\$	2,326	637	–	15	87	1,241	213	–	4,519
	2010	US\$	1,956	464	934	19	30	1,128	312	–	4,843
FM O'Halloran	2011	A\$	2,235	612	–	15	83	1,193	205	–	4,343
	2010	A\$	2,137	507	1,021	21	33	1,232	341	–	5,292
<b>Executives</b>											
G Brader <sup>(5)</sup>	2011	US\$	687	3	–	15	44	95	4	–	848
	2010	US\$	–	–	–	–	–	–	–	–	–
SP Burns	2011	US\$	1,083	380	1,004	–	–	1,588	284	–	4,339
	2010	US\$	996	352	3,080	–	–	1,728	451	–	6,607
NG Drabsch	2011	US\$	1,038	194	–	37	27	656	89	–	2,041
	2010	US\$	888	157	386	17	14	476	134	–	2,072
C Fagen <sup>(6)</sup>	2011	US\$	386	27	–	11	69	48	8	–	549
	2010	US\$	–	–	–	–	–	–	–	–	–
D Fogarty	2011	US\$	506	66	–	103	–	217	45	–	937
	2010	US\$	468	61	171	87	–	230	66	–	1,083
MJ Goodwin	2011	US\$	608	467	–	26	15	409	27	–	1,552
	2010	US\$	484	423	474	58	9	270	30	–	1,748
J Neal <sup>(7)</sup>	2011	US\$	1,249	154	–	–	317	973	108	–	2,801
	2010	US\$	–	–	–	–	–	–	–	–	–
BM Nicholls	2011	US\$	692	5	–	16	16	239	55	–	1,023
	2010	US\$	589	14	312	15	16	238	88	–	1,272
DA Ramsay	2011	US\$	791	138	–	16	19	276	50	–	1,290
	2010	US\$	666	111	250	23	10	273	75	–	1,408
J Rumpfer	2011	US\$	985	113	878	15	8	285	26	–	2,310
	2010	US\$	889	92	802	13	7	153	38	–	1,994
JM Smith	2011	US\$	656	18	–	15	35	223	41	–	988
	2010	US\$	528	24	198	14	10	222	61	–	1,057
GB Thwaites	2011	US\$	653	27	–	20	18	216	34	–	968
	2010	US\$	533	20	200	17	8	208	41	–	1,027
<b>Former key management personnel</b>											
TW Ibbotson <sup>(8)</sup>	2011	US\$	544	19	–	25	7	260	36	3,214	4,105
	2010	US\$	723	27	530	28	11	329	75	–	1,723
V McLenaghan <sup>(9)</sup>	2011	US\$	622	86	–	33	23	473	56	4,072	5,365
	2010	US\$	979	113	592	32	15	810	137	–	2,678
Total	2011	US\$	12,826	2,334	1,882	347	685	7,199	1,076	7,286	33,635
	2010	US\$	9,699	1,858	7,929	323	130	6,065	1,508	–	27,512

(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 the deemed value of the employee loans, provision of motor vehicles, health insurance, staff insurance discount benefits received during the year, life assurance and personal accident insurance and the applicable taxes thereon. It includes notional interest on 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 2012.

(4) Mr O'Halloran's remuneration is shown in both local currency and in the Group's presentation currency to assist readers of the remuneration report.

(5) Mr Brader was appointed as group chief investment officer on 1 January 2011. His remuneration for 2010 in his previous role is not included in this report.

(6) Mr Fagen was appointed as chief executive officer, Australian operations on 21 July 2011. Before this appointment, he was executive general manager – intermediary distribution in Australian operations. His remuneration for the period from 1 January to 20 July 2011 and for 2010 in his previous role is not included in this report.

(7) Mr Neal was appointed as chief executive officer of global underwriting operations on 1 January 2011. His remuneration for 2010 in his previous role is not included in this report.

(8) Mr Ibbotson's position was made redundant on 31 August 2011. His termination benefit was calculated using his 2011 fixed remuneration of A\$815,000 and includes a statutory payment in lieu of notice (five weeks), a redundancy payment in accordance with QBE's policy, a pro-rata QIS cash payment approved by the remuneration committee and the accounting value of his accelerated conditional rights and options. Mr Ibbotson will provide consulting services to QBE from 1 November 2011 to 30 June 2012 for a gross fee of A\$600,000.

(9) Mr McLenaghan ceased being part of key management personnel on 21 July 2011. This position was made redundant on 21 January 2012. His termination benefit has been calculated using his 2011 fixed remuneration of A\$1,122,000 and includes a redundancy payment in accordance with QBE's policy, a pro-rata QIS cash payment approved by the remuneration committee, the accounting value of his accelerated conditional rights and options and notional interest on share loans for the period from 21 July 2011 to 21 January 2012.

# REMUNERATION REPORT

## 3. Remuneration in detail continued

### 3.2 Equity based remuneration

#### 3.2.1 Executive investment in QBE

	ORDINARY SHARES NUMBER	CONDITIONAL RIGHTS NUMBER	TOTAL POTENTIAL SHARES IN QBE AT 31 JAN 2012 NUMBER	VALUE OF POTENTIAL SHARES AT 31 JAN 2012 <sup>(1)</sup> US\$000	COST TO REPAY SHARE LOANS US\$000	NET INVESTMENT IN QBE AT 31 JAN 2012 US\$000
<b>Executive director</b>						
FM O'Halloran	1,498,196	300,887	1,799,083	21,886	(7,706)	14,180
<b>Executives</b>						
G Brader	2,879	20,122	23,001	280	-	280
SP Burns	93,948	379,107	473,055	5,755	-	5,755
NG Drabsch	179,395	194,297	373,692	4,546	(2,077)	2,469
C Fagen	69,862	26,274	96,136	1,170	(426)	744
D Fogarty	67,374	53,057	120,431	1,465	(92)	1,373
MJ Goodwin	22,413	102,942	125,355	1,525	(38)	1,487
J Neal	52,227	217,895	270,122	3,286	-	3,286
BM Nicholls	9,407	59,411	68,818	837	-	837
DA Ramsay	257,460	68,179	325,639	3,962	(1,728)	2,234
J Rumppler	78,190	74,603	152,793	1,859	(568)	1,291
JM Smith	32,379	55,146	87,525	1,065	-	1,065
GB Thwaites	40,356	53,671	94,027	1,144	(275)	869

(1) The closing share price at 31 January 2012 was A\$11.46 (US\$12.17 using the 31 January rate of exchange).

Amounts in the above table include relevant interests but do not include interests attributable to personally related parties.

#### 3.2.2 Conditional rights

Details of conditional rights to ordinary shares in QBE provided as remuneration to executives are set out below. When exercisable, each conditional right is convertible into one ordinary share of the company.

	NUMBER OF RIGHTS GRANTED IN THE YEAR		NUMBER OF RIGHTS VESTED IN THE YEAR	
	2011	2010	2011	2010
<b>Executive director</b>				
FM O'Halloran	<b>105,695</b>	98,014	<b>43,660</b>	30,348
<b>Executives</b>				
G Brader	<b>8,519</b>	n/a	<b>2,879</b>	n/a
SP Burns	<b>104,012</b>	86,827	<b>98,111</b>	35,734
NG Drabsch <sup>(1)</sup>	<b>108,435</b>	39,224	<b>21,310</b>	14,506
C Fagen	<b>9,484</b>	n/a	<b>4,591</b>	n/a
D Fogarty	<b>11,976</b>	16,970	<b>10,062</b>	7,200
MJ Goodwin	<b>39,259</b>	30,040	<b>4,808</b>	1,737
J Neal <sup>(2)</sup>	<b>71,985</b>	n/a	<b>57,200</b>	n/a
BM Nicholls	<b>16,266</b>	20,324	<b>9,407</b>	12,607
DA Ramsay	<b>18,470</b>	23,212	<b>12,040</b>	8,085
J Rumppler	<b>42,690</b>	16,788	<b>6,356</b>	4,378
JM Smith	<b>14,587</b>	18,876	<b>9,784</b>	6,446
GB Thwaites	<b>14,778</b>	18,336	<b>8,796</b>	5,004
<b>Former key management personnel</b>				
TW Ibbotson	<b>32,638</b>	26,194	<b>84,837</b>	7,079
V McLenaghan	<b>59,527</b>	48,978	<b>25,954</b>	15,255

(1) In addition to conditional rights issued under the QIS deferred equity award, this includes 75,814 conditional rights granted on 18 October 2011. These conditional rights vest on 31 December 2012 if Mr Drabsch remains in the employment of QBE beyond that date.

(2) In addition to conditional rights issued under the QIS deferred equity award, this includes 25,000 conditional rights granted on 1 January 2011. These conditional rights vest on 1 January 2014.

# REMUNERATION REPORT

## 3.2.3 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.

	NUMBER OF OPTIONS GRANTED IN THE YEAR		NUMBER OF OPTIONS VESTED IN THE YEAR		NUMBER OF OPTIONS EXERCISED IN THE YEAR <sup>(1)</sup>	
	2011	2010	2011	2010	2011	2010
<b>Executive director</b>						
FM O'Halloran	-	-	94,771	118,587	-	118,587
<b>Executives</b>						
G Brader	-	-	4,750	n/a	-	n/a
SP Burns	-	-	110,515	163,522	-	163,522
NG Drabsch	-	-	50,460	67,350	-	67,350
C Fagen	-	-	7,727	n/a	-	n/a
D Fogarty	-	-	25,924	12,014	-	12,014
MJ Goodwin	-	-	2,076	10,033	-	10,033
J Neal	-	-	50,559	n/a	-	n/a
BM Nicholls	-	-	41,366	19,158	-	19,158
DA Ramsay	-	-	26,981	33,423	-	33,423
J Rumppler	-	-	13,711	15,217	-	15,217
JM Smith	-	-	22,566	27,009	-	27,009
GB Thwaites	-	-	7,485	8,825	-	8,825
<b>Former key management personnel</b>						
TW Ibbotson	-	-	24,931	27,767	27,767	-
V McLenaghan	-	-	39,141	48,487	-	48,487

(1) No options that vested in 2011 were exercised during the year.

## 3.2.4 Future performance options

Future performance options that affect remuneration of executives in the previous, current or future reporting periods are as follows:

NAME	GRANT DATE	NUMBER OF OPTIONS GRANTED <sup>(2)</sup>	EXERCISE PRICE	VALUE PER RIGHT AT GRANT DATE <sup>(1)</sup>
SP Burns	2 March 2007	20,000	A\$20.44	A\$12.55
SP Burns	4 March 2008	20,000	A\$20.44	A\$3.36
SP Burns	6 March 2009	20,000	A\$20.44	A\$2.77
SP Burns	5 March 2010	20,000	A\$20.44	A\$1.88
SP Burns	7 March 2011	20,000	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 earned evenly over the period between grant and vesting.

(2) 100,000 future performance options were granted to Mr Burns at an exercise price of A\$20.44 in tranches of 20,000 over a five year period from March 2007. The options were approved by the remuneration committee in October 2005 as a five year retention incentive. The vesting of these options was subject to European operations achieving an average insurance profit of at least 8% for underwriting years 2006 to 2010. All options vested on 28 February 2011 and were due to expire on 1 April 2011. On 31 March 2011, an extension to exercise these options was granted until 31 March 2012.

# REMUNERATION REPORT

## 3. Remuneration in detail continued

### 3.3 Total reward mix

The total reward mix for executives includes actual fixed remuneration and at-risk reward components based on the contractual entitlements and structure outlined on page 71.

The table below shows the maximum potential and actual proportions of fixed remuneration and at-risk reward applicable to each executive during 2011 and 2010.

	MAXIMUM POTENTIAL REWARD MIX					ACTUAL REWARD MIX				
	FIXED REMUNERATION		AT-RISK REWARD			FIXED REMUNERATION		AT-RISK REWARD		
	YEAR	%	QIS CASH %	DEFERRED EQUITY %	LTI %	%	QIS CASH %	DEFERRED EQUITY %	LTI %	
<b>Executive director</b>										
FM O'Halloran	<b>2011</b>	<b>26</b>	<b>35</b>	<b>26</b>	<b>13</b>	<b>67</b>	–	–	<b>33</b>	
	2010	26	35	26	13	43	20	16	21	
<b>Executives</b>										
G Brader	<b>2011</b>	<b>30</b>	<b>37</b>	<b>29</b>	<b>4</b>	<b>87</b>	–	–	<b>13</b>	
	2010	–	–	–	–	–	–	–	–	
SP Burns	<b>2011</b>	<b>23</b>	<b>31</b>	<b>43</b>	<b>3</b>	<b>42</b>	<b>29</b>	<b>23</b>	<b>6</b>	
	2010	23	31	43	3	27	36	33	4	
NG Drabsch	<b>2011</b>	<b>30</b>	<b>35</b>	<b>28</b>	<b>7</b>	<b>80</b>	–	–	<b>20</b>	
	2010	30	35	28	7	50	21	17	12	
C Fagen	<b>2011</b>	<b>28</b>	<b>35</b>	<b>33</b>	<b>4</b>	<b>87</b>	–	–	<b>13</b>	
	2010	–	–	–	–	–	–	–	–	
D Fogarty	<b>2011</b>	<b>35</b>	<b>33</b>	<b>27</b>	<b>5</b>	<b>87</b>	–	–	<b>13</b>	
	2010	35	33	27	5	56	20	16	8	
MJ Goodwin	<b>2011</b>	<b>31</b>	<b>29</b>	<b>35</b>	<b>5</b>	<b>87</b>	–	–	<b>13</b>	
	2010	28	35	33	4	31	29	35	5	
J Neal	<b>2011</b>	<b>26</b>	<b>35</b>	<b>26</b>	<b>13</b>	<b>67</b>	–	–	<b>33</b>	
	2010	–	–	–	–	–	–	–	–	
BM Nicholls	<b>2011</b>	<b>35</b>	<b>33</b>	<b>27</b>	<b>5</b>	<b>87</b>	–	–	<b>13</b>	
	2010	35	33	27	5	56	20	16	8	
DA Ramsay	<b>2011</b>	<b>35</b>	<b>33</b>	<b>27</b>	<b>5</b>	<b>87</b>	–	–	<b>13</b>	
	2010	35	33	27	5	56	20	16	8	
J Rumpler	<b>2011</b>	<b>27</b>	<b>37</b>	<b>32</b>	<b>4</b>	<b>37</b>	<b>32</b>	<b>26</b>	<b>5</b>	
	2010	27	37	32	4	36	32	26	6	
JM Smith	<b>2011</b>	<b>35</b>	<b>33</b>	<b>27</b>	<b>5</b>	<b>87</b>	–	–	<b>13</b>	
	2010	35	33	27	5	56	20	16	8	
GB Thwaites	<b>2011</b>	<b>35</b>	<b>33</b>	<b>27</b>	<b>5</b>	<b>87</b>	–	–	<b>13</b>	
	2010	35	33	27	5	56	20	16	8	
<b>Former key management personnel</b>										
TW Ibbotson	<b>2011</b>	<b>30</b>	<b>37</b>	<b>29</b>	<b>4</b>	<b>100</b>	–	–	–	
	2010	29	35	32	4	41	29	24	6	
V McLenaghan	<b>2011</b>	<b>29</b>	<b>38</b>	<b>29</b>	<b>4</b>	<b>100</b>	–	–	–	
	2010	26	35	26	13	39	23	18	20	

# REMUNERATION REPORT

## 3.4 Employment agreements

The terms and conditions of employment of each executive reflect market conditions at the time of their contract negotiation and appointment. The material terms of the employment agreements for the Group chief executive officer and executives are summarised in the table below.

CONTRACTUAL TERM	PERSONS AFFECTED	CONDITIONS
Duration of contract	CEO and other executives	Permanent full-time contract until notice given by either party.
Notice to be provided by executive or QBE	CEO and other executives	Notice periods are six months except for Mr Drabsch (four weeks), Mr Burns (12 months) and Mr Neal (12 months).
Involuntary termination	CEO and other executives	QBE may pay an executive 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 is pending, the executive is entitled to the value of outstanding QIS cash awards, QIS DEA, legacy DCP awards and GERSP 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	CEO and other executives	In the case of voluntary termination, executives forfeit all conditional rights to ordinary shares not yet vested under the QIS DEA, legacy DCP, GERSP and LTI, and all unexercised options under the legacy DCP. QBE may pay an executive 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.
Retirement benefit	CEO Other executives	One year's fixed remuneration at retirement and statutory entitlements. No specific arrangements in place.
Post-employment restraints	CEO Mr Drabsch Mr Ibbotson Mr McLenahan Other executives	Three year non-compete agreement post-retirement. Two year non-compete agreement post-retirement. From 31 August 2011, a two year post-employment restraint of trade operating globally is in place. It includes non-compete provisions and non-solicitation of clients, customers, suppliers, employees and contractors provisions. From 21 January 2012, a six month post-employment restraint of trade operating globally is in place. It includes non-compete provisions and non-solicitation of clients, customers, suppliers, employees and contractors provisions. No specific arrangements in place.

# REMUNERATION REPORT

## 4. Non-executive directors' remuneration

### Remuneration philosophy

Non-executive director remuneration reflects QBE's desire to attract, motivate and retain high quality 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 Group's chief executive officer and other 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\$2,700,000 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) may receive further fees for membership or chairmanship of a board committee. Future fees may be sacrificed into the QBE non-executive directors' share plan. Directors' fees increased by 4.05% effective 1 January 2011.

Details of the relevant annual fees are included in the table below:

	2011 US\$000 <sup>(1)</sup>	2010 US\$000 <sup>(1)</sup>
<b>Base fees</b>		
Chairman	647	551
Non-executive director	203	177
<b>Committee chairman fees</b>		
Audit and risk committee	49	41
Investment committee	49	28
Remuneration committee	49	28
<b>Committee membership fees</b>		
Audit and risk committee	27	22
Investment committee	27	20
Remuneration committee	27	20

(1) Remuneration has been converted to US dollars using the cumulative average rate of exchange for the relevant year.

# REMUNERATION REPORT

## 4. Non-executive directors' remuneration continued

### 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.

### Superannuation

QBE pays superannuation of 9% to Australian-based non-executive directors. Non-executive directors based overseas receive the cash equivalent amount as fees.

### Remuneration

Details of the nature and amount of each component of the remuneration of our non-executive directors for the year ended 31 December 2011 are set out in the table below.

	YEAR	SHORT-TERM EMPLOYEE BENEFITS		POST EMPLOYMENT BENEFITS		TOTAL
		DIRECTORS' FEES US\$000	OTHER <sup>(3)</sup> US\$000	SUPERANNUATION US\$000	RETIREMENT BENEFITS US\$000	US\$000 <sup>(4)</sup>
LF Bleasel AM	<b>2011</b>	<b>287</b>	<b>-</b>	<b>17</b>	<b>6</b>	<b>310</b>
	2010	227	-	21	6	254
DM Boyle	<b>2011</b>	<b>287</b>	<b>1</b>	<b>17</b>	<b>-</b>	<b>305</b>
	2010	225	1	20	-	246
JM Green	<b>2011</b>	<b>264</b>	<b>-</b>	<b>15</b>	<b>-</b>	<b>279</b>
	2010	182	-	16	-	198
IF Hudson <sup>(1)</sup>	<b>2011</b>	<b>324</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>324</b>
	2010	278	-	-	-	278
BJ Hutchinson AM	<b>2011</b>	<b>691</b>	<b>-</b>	<b>14</b>	<b>15</b>	<b>720</b>
	2010	395	-	27	14	436
CLA Irby <sup>(1)</sup>	<b>2011</b>	<b>324</b>	<b>-</b>	<b>-</b>	<b>6</b>	<b>330</b>
	2010	278	-	-	5	283
IYL Leel <sup>(2)</sup>	<b>2011</b>	<b>287</b>	<b>1</b>	<b>17</b>	<b>4</b>	<b>309</b>
	2010	235	-	21	4	260
Total	<b>2011</b>	<b>2,464</b>	<b>2</b>	<b>80</b>	<b>31</b>	<b>2,577</b>
	2010	1,820	1	105	29	1,955

(1) Mr Irby and Ms Hudson are UK residents. They each receive an annual travel allowance of A\$40,000 and additional fees of 9% in lieu of superannuation. Both are included in directors' fees.

(2) Ms Lee relocated to Hong Kong on 1 January 2012. In 2012, she will receive additional fees of 9% in lieu of superannuation.

(3) Staff insurance discount benefits received during the year.

(4) Remuneration has been converted to US dollars using the cumulative average rate of exchange for the relevant year.

### 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 at the balance date.

	RETIREMENT ALLOWANCE	
	2011 US\$000	2010 US\$000
LF Bleasel AM	<b>148</b>	141
BJ Hutchinson AM	<b>331</b>	317
CLA Irby	<b>130</b>	128
IYL Lee	<b>94</b>	90

# REMUNERATION REPORT

## 5. Appendices

### 5.1 Glossary of key terms

The key remuneration terms and abbreviations used in the remuneration report are set out in the table below.

TERM	DEFINITION
<b>Combined operating ratio (COR)</b>	Refer to the definition on page 170 of the annual report.
<b>Deferred Compensation Plan (DCP)</b>	<p>A legacy remuneration arrangement granting equity benefits which ceased from 1 January 2010. From 1 January 2009, equity granted under the DCP was in the form of conditional rights. Prior to 31 December 2008, equity granted under the DCP was in the form of conditional rights and options. Vesting is subject to a three or five year tenure hurdle.</p> <p>Refer to page 85 for further details.</p>
<b>Diluted earnings per share (EPS)</b>	Refer to note 1 to the consolidated financial statements.
<b>Executives</b>	For the purpose of the remuneration report, executives comprise the executive director and the other key management personnel who are members of the Group executive. Details are provided on page 67 of this report.
<b>Fixed remuneration</b>	All guaranteed pay i.e. base salary, superannuation and other guaranteed benefits.
<b>Group Executive Restricted Share Plan (GERSP)</b>	<p>A remuneration arrangement which came into existence on 1 January 2008, granting conditional rights to QBE shares to participants if QBE's ROE target of 22% was exceeded. During 2008, the equity under GERSP was referred to as "restricted shares"; however these instruments have the same terms as conditional rights under the DCP. Vesting is subject to a three year tenure hurdle and is contingent on no material subsequent deterioration of QBE's ROE during the vesting period.</p> <p>Only key management personnel (excluding executive and non-executive directors) were invited to participate in the GERSP. The GERSP ceased on 31 December 2009. Refer to page 85 for further details.</p>
<b>Key management personnel (KMP)</b>	<p>Accounting standards require QBE to make disclosures about 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".</p> <p>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 executives included on page 67 are considered to be key management personnel because they are members of the Group executive, being the management body responsible for the Group's strategy and operation.</p>
<b>Long-Term Incentive Plan (LTI)</b>	<p>The long-term incentive plan replaced the GERSP effective from 1 January 2010. Vesting is subject to a five year tenure hurdle and is contingent on no subsequent material deterioration of the Group's ROE during the vesting period. The LTI includes two performance hurdles:</p> <ul style="list-style-type: none"> <li>• 50% of the award allocation is contingent on QBE's average diluted EPS increasing by a compound 7.5% per annum over a five year vesting period; and</li> <li>• 50% of the award allocation is contingent on QBE's average ROE and COR 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.</li> </ul> <p>Participation in the LTI is limited to key management personnel excluding non-executive directors. Refer to page 75 for further details.</p>
<b>QBE Incentive Scheme (QIS)</b>	<p>The at-risk reward structure that comprises cash awards and deferred equity awards effective from 1 January 2010. The QIS consists of:</p> <ul style="list-style-type: none"> <li>• a cash award delivered annually for meeting ROE or investment income performance targets, linked to annual budget metrics;</li> <li>• a deferred equity award (DEA) of conditional rights, subject to a three and five year tenure hurdle; and</li> <li>• an enhanced deferred equity grant subject to a three year tenure hurdle for exceeding ROE targets (divisional CEOs only).</li> </ul>
<b>Return on equity (ROE)</b>	Net profit after tax (NPAT) on a management basis as a percentage of opening allocated capital. For the determination of Group incentives, NPAT on a management basis is prepared on a seven year spread basis of accounting which spreads realised and unrealised gains on equities and properties evenly over a period of seven years. Opening allocated capital is adjusted for dividend and capital movements in the year.

# REMUNERATION REPORT

## 5. Appendices continued

### 5.2 Legacy equity schemes

#### 5.2.1 Deferred Compensation Plan (DCP)

##### Until 31 December 2008 and applicable to awards 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, executives were provided with the opportunity to acquire equity in the form of conditional rights to fully paid shares without payment by the executive 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 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 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; and
- options over ordinary shares to the value of 40% of the DCP award, with the resulting number multiplied by three.

Conditional rights and options relating to the achievement of profit targets in the financial year were granted in March of the following year. 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.

Conditional rights and options issued in 2004 and prior financial years were exercisable after three years. Options issued in 2005 and later financial years are exercisable after five years, with the exception of options for senior employees in the Group investment division which continue to be exercisable after three years. The issue of options and interest-free personal recourse loans under the DCP will cease after the final vesting of all incentives granted in March 2009.

##### From 1 January 2009 and applicable to awards 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 share price upon which the allocation of conditional rights was calculated was the weighted average sale price of QBE shares over the five trading days on the ASX prior to the grant date.

The ultimate vesting of the conditional rights is also contingent on there being no material subsequent deterioration of the consolidated entity's ROE during the vesting period. Notional dividends earned are added to the value of the conditional rights granted during the vesting period.

#### 5.2.2 Group Executive Restricted Share Plan (GERSP)

##### From 1 January 2008 to 31 December 2009 and applicable to awards in March 2010

Key management personnel (excluding non-executive directors, the Group chief executive officer and Mr Burns) were eligible to participate in the GERSP with effect from its inception on 1 January 2008. The GERSP was replaced in 2010 by the Long-Term Incentive (LTI) Plan. Refer to page 75 for further details of the LTI.

The GERSP aimed to retain and reward key executives and to increase shareholder value by motivating executives to exceed Group ROE targets. It provided executives with the opportunity to acquire additional equity in the form of conditional rights (referred to as restricted shares in 2008) without payment by the executive if the Group's ROE target was exceeded.

Each participant received an award of conditional rights if the Group achieved a ROE on a seven year spread basis of accounting in excess of 21%. The benefit to each participant was maximised when the Group achieved a ROE of 26%.

Deferred equity delivered under the terms of the GERSP is subject to a three year tenure hurdle. Conditional rights 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 ultimate vesting of the conditional rights is contingent on no material subsequent deterioration of the consolidated entity's ROE during the vesting period.

The value of the conditional rights allocated varied for each executive ranging from 3% up to 25% of fixed remuneration or base (cash) salary as appropriate. To calculate the number of conditional rights granted, the award value was divided by the weighted average sale price of QBE shares over the five trading days on the ASX prior to the grant date.

# REMUNERATION REPORT

## 5.3 Valuation of options and conditional rights

### 5.3.1 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 <sup>(1)</sup>
2 March 2007	1 March 2010	A\$32.68
4 April 2007	2 April 2010	A\$32.68
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	31 December 2012	A\$14.05

(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.

### 5.3.2 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 OPTION AT GRANT DATE <sup>(1)</sup>
3 March 2005	3 March 2010	3 March 2011	A\$8.04	A\$6.90
3 March 2005	3 March 2010	3 March 2011	A\$11.08	A\$5.17
3 March 2005	3 March 2010	3 March 2011	A\$14.85	A\$3.60
8 April 2005	8 April 2010	8 April 2011	A\$14.85	A\$3.60
2 March 2006	2 March 2009	2 March 2010	A\$20.44	A\$3.85
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 2010	2 March 2011	A\$32.68	A\$5.05
2 March 2007	1 March 2012	2 March 2013	A\$32.68	A\$6.28
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 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

(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.

Details of future performance options are shown in section 3.2.4 of this report.



# DIRECTORS' REPORT

FOR THE YEAR ENDED 31 DECEMBER 2011

## 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 and risk 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 and risk 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 88.

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 28th day of February 2012 in accordance with a resolution of the directors.



**BJ Hutchinson AM**  
Director



**FM O'Halloran**  
Director



# DIRECTORS' REPORT

FOR THE YEAR ENDED 31 DECEMBER 2011

## AUDITOR'S INDEPENDENCE DECLARATION FOR THE YEAR ENDED 31 DECEMBER 2011

As lead auditor for the audit of QBE Insurance Group Limited for the year ended 31 December 2011, 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.

**KG Smith**  
**Partner**  
**PricewaterhouseCoopers**

Sydney  
28 February 2012

# ANNUAL FINANCIAL REPORT

31 DECEMBER 2011

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This financial report includes the consolidated financial statements for QBE Insurance Group Limited (the 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 in the operations overview on pages 28 to 47 and in the directors' report, neither of which is part of this financial report.

The financial report was authorised for issue by the directors on 28 February 2012.

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](http://www.qbe.com).

# CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

FOR THE YEAR ENDED 31 DECEMBER 2011

	NOTE	2011 US\$M	2010 US\$M
Gross written premium		<b>18,291</b>	13,629
Unearned premium movement		<b>(451)</b>	(197)
Gross earned premium revenue	6(A)	<b>17,840</b>	13,432
Outward reinsurance premium		<b>(2,592)</b>	(2,106)
Deferred reinsurance premium movement		<b>111</b>	36
Outward reinsurance premium expense	6(B)	<b>(2,481)</b>	(2,070)
Net earned premium (a)		<b>15,359</b>	11,362
Gross claims incurred	6(B)	<b>(12,540)</b>	(7,875)
Reinsurance and other recoveries revenue	6(A)	<b>2,074</b>	1,068
Net claims incurred (b)		<b>(10,466)</b>	(6,807)
Gross commission expense	6(B)	<b>(2,567)</b>	(1,978)
Reinsurance commission revenue	6(A)	<b>276</b>	219
Net commission (c)		<b>(2,291)</b>	(1,759)
Other acquisition costs (d)	6(B)	<b>(720)</b>	(630)
Underwriting and other expenses (e)	6(B)	<b>(1,388)</b>	(998)
<b>Underwriting profit (a)+(b)+(c)+(d)+(e)</b>		<b>494</b>	1,168
Investment and other income – policyholders' funds	7	<b>612</b>	555
Investment expenses – policyholders' funds	7	<b>(21)</b>	(20)
<b>Insurance profit</b>		<b>1,085</b>	1,703
Investment and other income – shareholders' funds	7	<b>207</b>	145
Investment expenses – shareholders' funds	7	<b>(22)</b>	(21)
Financing and other costs		<b>(275)</b>	(222)
Share of net profits of associates	18	<b>6</b>	5
Amortisation of intangibles and impairment of goodwill/intangibles		<b>(133)</b>	(59)
Profit before income tax		<b>868</b>	1,551
Income tax expense	9	<b>(149)</b>	(257)
Profit after income tax		<b>719</b>	1,294
<b>OTHER COMPREHENSIVE INCOME</b>			
Net movement in foreign currency translation reserve	26(D)	<b>(195)</b>	(408)
Actuarial losses on defined benefit superannuation plans	24(C)	<b>(17)</b>	–
Cash flow hedges	26(D)	<b>–</b>	5
Gains on revaluation of owner occupied properties	26(D)	<b>5</b>	10
Associates' share other comprehensive income		<b>(2)</b>	7
Income tax relating to components of other comprehensive income		<b>(41)</b>	12
Other comprehensive income (expense) after income tax		<b>(250)</b>	(374)
Total comprehensive income after income tax		<b>469</b>	920
Profit after income tax attributable to:			
Ordinary equity holders of the company		<b>704</b>	1,278
Non-controlling interests		<b>15</b>	16
		<b>719</b>	1,294
Total comprehensive income after tax attributable to:			
Ordinary equity holders of the company		<b>454</b>	904
Non-controlling interests		<b>15</b>	16
		<b>469</b>	920
Earnings per share for net profit after income tax attributable to ordinary equity holders of the company	NOTE	2011 US CENTS	2010 US CENTS
Basic earnings per share	28	<b>64.9</b>	123.7
Diluted earnings per share	28	<b>61.3</b>	119.6

The consolidated statement of comprehensive income should be read in conjunction with the accompanying notes.

# CONSOLIDATED BALANCE SHEET

AS AT 31 DECEMBER 2011

	NOTE	2011 US\$M	2010 US\$M
<b>ASSETS</b>			
Cash and cash equivalents	10	1,457	1,686
Investments	11	26,466	23,576
Derivative financial instruments	12	42	31
Trade and other receivables	13	5,514	4,704
Reinsurance and other recoveries on outstanding claims	22	3,693	3,219
Current tax assets		347	94
Other assets		30	40
Deferred insurance costs	14	2,432	2,003
Assets held for sale	15(B), 17	73	–
Defined benefit plan surpluses	24	1	2
Property, plant and equipment	15	448	432
Deferred tax assets	16	86	93
Investment properties	17	28	66
Investment in associates	18	55	53
Intangible assets	19	6,065	5,387
<b>Total assets</b>		<b>46,737</b>	<b>41,386</b>
<b>LIABILITIES</b>			
Derivative financial instruments	12	45	92
Trade and other payables	20	1,817	1,506
Current tax liabilities		162	106
Unearned premium	21	8,069	6,788
Outstanding claims	22	20,677	18,236
Provisions	23	95	525
Defined benefit plan deficits	24	102	95
Deferred tax liabilities	16	575	402
Borrowings	25	4,757	3,243
<b>Total liabilities</b>		<b>36,299</b>	<b>30,993</b>
<b>Net assets</b>		<b>10,438</b>	<b>10,393</b>
<b>EQUITY</b>			
Share capital	26(A)	8,939	7,972
Treasury shares held in trust	26(B)	(2)	(1)
Equity component of hybrid securities	26(C)	132	132
Reserves	26(D)	(1,776)	(1,527)
Retained profits		3,093	3,735
Shareholders' funds		10,386	10,311
Non-controlling interests		52	82
<b>Total equity</b>		<b>10,438</b>	<b>10,393</b>

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 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	SHAREHOLDERS' FUNDS US\$M	NON- CONTROLLING INTERESTS US\$M	TOTAL EQUITY US\$M
<b>2011</b>								
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
<b>Transactions with owners in their capacity as owners</b>								
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 movement	(15)	-	-	-	-	(15)	(2)	(17)
As at 31 December	8,939	(2)	132	(1,776)	3,093	10,386	52	10,438

	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	SHAREHOLDERS' FUNDS US\$M	NON- CONTROLLING INTERESTS US\$M	TOTAL EQUITY US\$M
<b>2010</b>								
As at 1 January	6,604	(1)	102	(1,182)	3,641	9,164	68	9,232
Profit after income tax	-	-	-	-	1,278	1,278	16	1,294
Other comprehensive income	-	-	-	(375)	1	(374)	-	(374)
Total comprehensive income	-	-	-	(375)	1,279	904	16	920
<b>Transactions with owners in their capacity as owners</b>								
Shares acquired and held in trust	-	(23)	-	-	-	(23)	-	(23)
Share based payment expense	-	-	-	36	-	36	-	36
Shares vested and/or released to participants	-	23	-	(23)	-	-	-	-
Taxation on options	-	-	-	(4)	-	(4)	-	(4)
Contributions of equity, net of transaction costs and tax	397	-	14	-	-	411	-	411
Purchase of non-controlling interests	-	-	-	(4)	-	(4)	(2)	(6)
Dividends paid on ordinary shares	-	-	-	-	(1,236)	(1,236)	-	(1,236)
Dividend reinvestment under Bonus Share Plan	-	-	-	-	51	51	-	51
Foreign exchange movement	971	-	16	25	-	1,012	-	1,012
As at 31 December	7,972	(1)	132	(1,527)	3,735	10,311	82	10,393

# CONSOLIDATED STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED 31 DECEMBER 2011

	NOTE	2011 US\$M	2010 US\$M
<b>OPERATING ACTIVITIES</b>			
Premium received		16,994	13,047
Reinsurance and other recoveries received		1,582	1,334
Outward reinsurance paid		(2,580)	(2,183)
Claims paid		(9,967)	(7,515)
Insurance costs paid		(3,301)	(2,430)
Other underwriting costs		(876)	(960)
Interest received		846	598
Dividends received		17	43
Other operating income		58	76
Other operating payments		(360)	(300)
Interest paid		(171)	(145)
Income taxes paid		(103)	(203)
Net cash flows from operating activities <sup>(1)</sup>	10	2,139	1,362
<b>INVESTING ACTIVITIES</b>			
Proceeds on sale of equity investments		1,179	2,248
Purchase of equity investments		(1,173)	(1,265)
Payments for forward foreign exchange contracts		(54)	(95)
Purchases of other investments		(2,884)	(577)
Purchase of controlled entities and businesses acquired <sup>(2)</sup>		(498)	(1,098)
Proceeds on disposal of controlled entities		41	2
Purchase of investment property		(5)	(1)
Proceeds on sale of investment property		1	–
Proceeds on sale of property, plant and equipment		2	3
Purchase of property, plant and equipment		(140)	(129)
Net cash flows from investing activities		(3,531)	(912)
<b>FINANCING ACTIVITIES</b>			
Proceeds from issue of shares		396	–
Purchase of treasury shares	26(B)	(29)	(23)
Proceeds from settlement of staff share loans		11	31
Proceeds from borrowings		1,767	1,513
Repayment of borrowings		(219)	(871)
Dividends paid		(776)	(830)
Net cash flows from financing activities		1,150	(180)
Net movement in cash and cash equivalents		(242)	270
Cash and cash equivalents at the beginning of the financial year		1,686	1,435
Effect of exchange rate changes		13	(19)
Cash and cash equivalents at the end of the financial year	10	1,457	1,686

(1) Included within net cash flows from operating activities are premiums received of US\$811 million, reinsurance recoveries received of US\$52 million, outward reinsurance paid of US\$234 million and claims paid of US\$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.

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# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## 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.

The presentation of the statement of comprehensive income was first amended in the interim reporting period to 30 June 2011 to provide a more detailed analysis of the results of the Group's insurance business. This is considered more relevant information to users of the financial statements. Prior year comparatives have been adjusted for consistency with the new presentation.

#### (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 for the Group 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. 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 now 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 2011 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 entities in the Group 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 which closely approximates the pattern of risks underwritten using either the daily pro-rata method or the 24ths method.

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES continued

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 that are broadly similar and 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 claim 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 by 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 liabilities and assets 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) Policyholders' and shareholders' funds

Cash and fixed income securities are held to back policyholders' funds, being the net insurance liabilities of the Group. The remaining financial assets and investment properties are held to back shareholders' funds. 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.

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## (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 as 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 are 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 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 by the Group using fair value hedge accounting, cash flow hedge accounting or hedging of a net investment in a foreign operation 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 recognised initially 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.

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES continued

### (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. 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 estimated useful life to the Group 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 the 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 using the straight line method over the estimated useful life. 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.

### (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 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 rates of exchange at the dates of the transactions. At the balance sheet date, monetary assets and liabilities denominated in foreign currencies are translated 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. When a foreign operation is sold in whole or part, these exchange differences are 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:

	2011		2010	
	PROFIT OR LOSS	BALANCE SHEET	PROFIT OR LOSS	BALANCE SHEET
A\$/US\$	1.041	1.022	0.915	1.023
£/US\$	1.605	1.554	1.547	1.561
€/US\$	1.392	1.294	1.328	1.338

### (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).

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## (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.

### (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 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.

## (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 and will have 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. 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

The assets, liabilities and results of share based remuneration trusts are included in the balance sheet and results of the Group. These trusts may hold shares in the company to satisfy the company's obligations under the Employee Share and Option Plan (the Plan). 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) Parent entity financial information

Shares in controlled entities are recorded at cost less a provision for impairment in the parent entity balance sheet.

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## 2 NEW ACCOUNTING STANDARDS AND AMENDMENTS

TITLE	OPERATIVE DATE	
AASB 9	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
AASB 1054	Australian Additional Disclosures	1 January 2012
2009-11	Amendments to Australian Accounting Standards arising from AASB 9	1 January 2015
2010-6	Amendments to Australian Accounting Standards – Disclosures on Transfers of Financial Assets	1 January 2012
2010-7	Amendments to Australian Accounting Standards arising from AASB 9 (December 2010)	1 January 2015
2010-8	Amendments to Australian Accounting Standards – Deferred Tax: Recovery of Underlying Assets	1 January 2012
2011-1	Amendments to Australian Accounting Standards arising from the Trans-Tasman Convergence Project	1 January 2012
2011-2	Amendments to Australian Accounting Standards arising from the Trans-Tasman Convergence Project – Reduced Disclosure Requirements	1 January 2014
2011-4	Amendments to Australian Accounting Standards to Remove Individual Key Management Personnel Disclosure Requirements	1 January 2014
2011-5	Amendments to Australian Accounting Standards – Extending Relief from Consolidation, the Equity Method and Proportionate Consolidation	1 January 2012
2011-6	Amendments to Australian Accounting Standards – Extending Relief from Consolidation, the Equity Method and Proportionate Consolidation – Reduced Disclosure Requirements	1 January 2014
2011-7	Amendments to Australian Accounting Standards arising from the Consolidation and Joint Arrangements Standards	1 January 2013
2011-8	Amendments to Australian Accounting Standards arising from AASB 13	1 January 2013
2011-9	Amendments to Australian Accounting Standards – Presentation of Items of Other Comprehensive Income	1 January 2013
2011-10	Amendments to Australian Accounting Standards arising from AASB 119 (September 2011)	1 January 2013
2011-11	Amendments to AASB 119 (September 2011) arising from Reduced Disclosure Requirements	1 January 2014

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.

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## 3 SEGMENT INFORMATION

### (A) Operating segments

The Group is an international general insurance and reinsurance group underwriting most major commercial and personal lines classes of business through operations in 52 countries. The business is managed on an operating segment basis as follows:

- North American operations writes general insurance and reinsurance business in the US and Bermuda.
- Latin American operations writes general insurance business in Central and South America.
- European operations comprises QBE Insurance Europe and QBE Underwriting Limited (Lloyd's division). QBE Insurance Europe writes insurance business in the UK, Ireland and mainland Europe, and reinsurance business in Ireland and mainland Europe. QBE Underwriting Limited underwrites reinsurance and commercial insurance in the Lloyd's market.
- Australian operations primarily underwrites general insurance risks throughout Australia providing all major lines of insurance cover 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 providing reinsurance protection to related entities and participating on reinsurances placed with external reinsurers. All inward premium received by Equator Re is derived from within the QBE Group and is eliminated on consolidation.

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.

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).

	NORTH AMERICAN OPERATIONS US\$M	LATIN AMERICAN OPERATIONS US\$M	EUROPEAN OPERATIONS US\$M	AUSTRALIAN OPERATIONS US\$M	ASIA PACIFIC OPERATIONS US\$M	EQUATOR RE US\$M	EQUATOR RE ELIMINATION US\$M	TOTAL US\$M
<b>2011</b>								
Total assets	14,813	1,039	17,294	11,910	2,059	6,795	(7,173)	46,737
Total liabilities	11,233	770	14,729	9,604	1,636	5,500	(7,173)	36,299
Net assets	3,580	269	2,565	2,306	423	1,295	-	10,438
Property, plant and equipment	134	49	133	119	13	-	-	448
Investment properties	4	1	19	-	4	-	-	28
Intangible assets	3,534	97	650	1,760	24	-	-	6,065
Gross written premium	7,529	768	4,828	4,486	680	3,807	(3,807)	18,291
Gross earned premium revenue – external	7,431	752	4,635	4,355	653	14	-	17,840
Gross earned premium revenue – internal	-	-	-	-	-	3,683	(3,683)	-
Outward reinsurance premium expense	(3,413)	(132)	(1,485)	(588)	(211)	(335)	3,683	(2,481)
Net earned premium	4,018	620	3,150	3,767	442	3,362	-	15,359
Net claims incurred	(2,622)	(351)	(2,054)	(2,617)	(206)	(2,616)	-	(10,466)
Net commission	(264)	(118)	(536)	(488)	(101)	(784)	-	(2,291)
Underwriting and other expenses	(754)	(87)	(417)	(637)	(100)	(113)	-	(2,108)
Underwriting profit	378	64	143	25	35	(151)	-	494
Net investment income on policyholders' funds	62	37	155	218	24	95	-	591
Insurance profit	440	101	298	243	59	(56)	-	1,085
Net investment income on shareholders' funds	60	5	45	42	7	26	-	185
Financing and other costs	(143)	(2)	(45)	(73)	(1)	(11)	-	(275)
Share of net profits of associates	-	-	-	6	-	-	-	6
Amortisation and impairment of goodwill/intangibles	(113)	(7)	(2)	(11)	-	-	-	(133)
Profit before income tax	244	97	296	207	65	(41)	-	868
Income tax expense	(20)	(32)	(22)	(41)	(20)	(14)	-	(149)
Profit after income tax	224	65	274	166	45	(55)	-	719
Profit after income tax attributable to non-controlling interests	-	(1)	-	(6)	(8)	-	-	(15)
Net profit after income tax	224	64	274	160	37	(55)	-	704

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## 3 SEGMENT INFORMATION continued

2010	NORTH AMERICAN OPERATIONS US\$M	LATIN AMERICAN OPERATIONS US\$M	EUROPEAN OPERATIONS US\$M	AUSTRALIAN OPERATIONS US\$M	ASIA PACIFIC OPERATIONS US\$M	EQUATOR RE US\$M	EQUATOR RE ELIMINATION US\$M	TOTAL US\$M
Total assets	11,596	917	15,890	11,320	1,485	5,428	(5,250)	41,386
Total liabilities	8,299	687	13,432	8,926	1,041	3,858	(5,250)	30,993
Net assets	3,297	230	2,458	2,394	444	1,570	-	10,393
Property, plant and equipment	148	37	117	118	12	-	-	432
Investment properties	44	-	19	-	3	-	-	66
Intangible assets	2,831	106	658	1,767	25	-	-	5,387
Gross written premium	4,606	559	4,156	3,707	601	2,479	(2,479)	13,629
Gross earned premium revenue – external	4,563	554	4,008	3,720	587	-	-	13,432
Gross earned premium revenue – internal	-	-	-	-	-	2,363	(2,363)	-
Outward reinsurance premium expense	(2,008)	(100)	(1,415)	(687)	(167)	(56)	2,363	(2,070)
Net earned premium	2,555	454	2,593	3,033	420	2,307	-	11,362
Net claims incurred	(1,594)	(260)	(1,498)	(1,846)	(192)	(1,417)	-	(6,807)
Net commission	(246)	(101)	(437)	(316)	(84)	(575)	-	(1,759)
Underwriting and other expenses	(436)	(63)	(412)	(542)	(88)	(87)	-	(1,628)
Underwriting profit	279	30	246	329	56	228	-	1,168
Net investment income on policyholders' funds	77	26	130	187	21	94	-	535
Insurance profit	356	56	376	516	77	322	-	1,703
Net investment income on shareholders' funds	35	6	31	30	5	17	-	124
Financing and other costs	(102)	(3)	(36)	(71)	(1)	(9)	-	(222)
Share of net profits of associates	-	-	-	5	-	-	-	5
Amortisation and impairment of goodwill/intangibles	(46)	(3)	(1)	(9)	-	-	-	(59)
Profit before income tax	243	56	370	471	81	330	-	1,551
Income tax expense	(44)	(19)	(59)	(96)	(19)	(20)	-	(257)
Profit after income tax	199	37	311	375	62	310	-	1,294
Profit after income tax attributable to non-controlling interests	-	-	(1)	(9)	(6)	-	-	(16)
Net profit after income tax	199	37	310	366	56	310	-	1,278

### (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.

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## 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 52 countries. The class of business mix is shown on page 107 and an analysis of the Group's gross written and net earned premium from insurance and reinsurance business is shown on page 13. The head office function is located in Australia and exists to support the activities of divisional operations as follows:

- North American operations, which writes general insurance and reinsurance business in the US and Bermuda;
- Latin American operations, which writes general insurance business in seven countries in Central and South America;
- European operations, which comprises general insurance business written in the UK and through out mainland Europe; both general insurance and reinsurance business written through Lloyd's of London; and reinsurance business written in Ireland and mainland Europe;
- Australian operations, which writes general insurance throughout Australia providing all major lines of insurance for commercial and personal risks;
- Asia Pacific operations, which comprises general insurance operations in 17 countries; and
- Equator Re, the Group's captive reinsurer, which is based in Bermuda and provides reinsurance protection to related entities.

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 risk margin undertaken at a divisional level is subject to detailed head office review and the probability of adequacy of the Group's insurance liabilities is determined by the Group's chief actuarial officer.

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 Group level in order to provide a level of analysis which is more meaningful, relevant, reliable and comparable year on year. It is considered that 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 below.

### (A) Ultimate liability arising from claims made under insurance contracts

Provision is made for the estimated cost of claims incurred but not settled at the balance sheet date. This provision consists of estimates of both the expected ultimate cost of claims notified to the Group as well as the expected ultimate cost of claims incurred but not reported to the Group (IBNR). The estimated cost of claims includes direct expenses that are expected to be incurred in settling those 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 outstanding claims provision and the associated reinsurance and other recoveries are described below.

### (i) Outstanding claims provision

The Group's process for establishing the outstanding claims provision 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 on the Group's profit or loss and balance sheet are summarised in note 4(A)(vii).

### (ii) Central estimates

The outstanding claims provision comprises the central estimate and a risk margin which is added to the central estimate to achieve the appropriate probability of adequacy. The outstanding claims provision is discounted at risk-free rates of return to reflect the time value of money.

A central estimate is an estimate of the level of claims provision that is intended to contain no intentional under or over estimation. As the Group requires a higher probability that estimates will be adequate over time, a risk margin is added to the central estimate of outstanding claims.

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 outstanding claims provision.

### (iii) Risk margin

Risk margins are held to mitigate the potential for uncertainty in the outstanding claims estimation process. The determination of the appropriate level of risk margin takes into account the uncertainty or variability of each class of business due to factors such as actuarial estimation, data quality and legislative uncertainty, and the diversification benefits achieved by writing a number of classes of business across a number of geographic locations.

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## 4 CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS continued

The measurement of variability by class of business uses 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. The use of a range of outcomes allows a determination of the risk margin required to provide an estimate at a given probability of adequacy, e.g. nine times in 10 (a 90% probability of adequacy). These techniques use standard statistical distributions, and the measure of variability is referred to as the coefficient of variation.

The risk margin required to provide a given probability of adequacy 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.

Whilst there are estimation techniques for determining correlations, they are difficult to apply. The correlations adopted by the Group are normally derived from industry analysis, the Group's historical experience and the judgment of experienced and qualified actuaries.

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. Applying correlations between divisions results in a further diversification benefit to the Group with a consequent impact on the Group's risk margin.

The potential impact of changes in the coefficient of variation assumptions on the Group's profit or loss and balance sheet is summarised in note 4(A)(vii).

### (iv) Assets arising from contracts with reinsurers

Assets arising from 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.

### (v) Expected present value of future cash flows for future claims

The expected present value of future cash flows used to determine future claims and risk margin for the purpose of the liability adequacy test (refer note 21(D)) is determined using the same methods described above. Future claims are those claims expected to arise from claims events occurring after the balance date.

### (vi) Financial assumptions used to determine the outstanding claims provision

#### Discount rates

AASB 1023: General Insurance Contracts 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 range of weighted average risk-free rates for each operating segment is summarised below. For Australian operations, the high end of the range represents the highest individual rate on the Australian government bond yield curve.

	2011 %	2010 %
North American operations	1.06	1.85
Latin American operations	0.14 – 14.05	1.85 – 12.10
European operations	0.82 – 3.53	1.60 – 5.45
Australian operations	0.18 – 4.25	1.13 – 5.70
Asia Pacific operations	0.16 – 4.82	0.49 – 5.70
Equator Re	0.53 – 13.90	0.49 – 5.70

#### Weighted average term to settlement

The relevant discount rate is applied to the anticipated cash flow profile of the outstanding claims provision and 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 net outstanding claims provision, analysed by operating segment and currency, is summarised below.

	2011 YEARS						2010 YEARS					
	US\$	£	A\$	€	OTHER	TOTAL	US\$	£	A\$	€	OTHER	TOTAL
North American operations	2.7	-	-	-	-	2.7	3.1	-	-	-	-	3.1
Latin American operations	1.3	-	-	-	3.0	2.9	0.9	-	-	-	2.9	2.9
European operations	2.6	3.4	3.4	4.8	3.2	3.7	2.5	3.0	3.5	4.4	3.2	3.4
Australian operations	-	-	2.6	-	1.2	2.6	-	-	2.6	-	1.2	2.6
Asia Pacific operations	3.1	-	2.5	2.9	1.8	1.8	3.1	-	2.4	2.8	1.6	1.7
Equator Re	2.1	3.5	2.5	2.9	2.0	2.5	2.5	3.1	1.9	3.4	1.5	2.7
Group	2.5	3.4	2.6	4.6	2.4	2.9	2.8	3.1	2.7	4.4	2.4	3.0

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## (vii) Impact of changes in key variables on the outstanding claims provision

The impact of changes in key variables on the outstanding claims provision is summarised in the table below. 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 as, for example, an increase in interest rates is normally accompanied by an increase in the rate of inflation. As can be seen from the table below, 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 in relation to fixed interest securities is shown in note 5(D)(ii).

	SENSITIVITY %	PROFIT (LOSS)	
		2011 US\$M	2010 US\$M
Central estimate	+5	(552)	(481)
	-5	552	481
Inflation rate	+0.5	(160)	(139)
	-0.5	156	135
Discount rate	+0.5	155	137
	-0.5	(145)	(142)
Coefficient of variation	+1	(123)	(127)
	-1	119	125
Weighted average term to settlement	+10	69	91
	-10	(69)	(92)

## (B) 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.

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)	
		2011 US\$M	2010 US\$M
Discount rate	+1	24	23
	-1	(54)	(75)
Inflation rate	+1	(10)	(43)
	-1	3	8

## (C) 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 cash generating unit or group of cash generating units, which is determined by reference to, amongst other factors, the estimated net profit after tax in the business plan. For details of key assumptions and estimates used, refer note 19(C).

The discount rates used to value cash generating units at 31 December 2011 are included in note 19(C). If the discount rate applied in these calculations was increased by 1% over the rates applied at 31 December 2011, the Group would not be required to reflect an impairment charge (2010 impairment charge of US\$102 million).

## (D) 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.

# NOTES TO THE FINANCIAL STATEMENTS

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## 5 RISK MANAGEMENT

An overview of the Group's risk management framework is provided in the risk management statement on pages 24 to 27 and in the risk management section of the corporate governance statement on pages 53 and 54.

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 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 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, tax planning, 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. 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.

# NOTES TO THE FINANCIAL STATEMENTS

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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 52 countries and 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.

<b>GROSS EARNED PREMIUM</b>	<b>2011 US\$M</b>	<b>2010 US\$M</b>
Property	<b>5,849</b>	3,996
Motor and motor casualty	<b>2,525</b>	1,941
Agriculture and bloodstock	<b>2,266</b>	924
Liability	<b>2,091</b>	1,863
Marine, energy and aviation	<b>1,276</b>	1,196
Workers' compensation	<b>1,266</b>	1,030
Financial and credit	<b>907</b>	845
Professional indemnity	<b>752</b>	706
Accident and health	<b>650</b>	720
Other	<b>258</b>	211
	<b>17,840</b>	13,432

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 outstanding claims provision is primarily performed by actuaries who are not involved in the pricing function and who therefore provide an independent assessment of the provision;
- 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 actuarial officer in order to ensure consistency of provisioning practices across all divisions; and
- approximately 90% of the Group's central estimate is reviewed by external actuaries at least annually.

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 chief executive officer and/or the chief executive officer of global underwriting operations, who generally act after consultation with and based on recommendations from the Group reinsurance forum (GRF).

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## 5 RISK MANAGEMENT continued

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 chief executive officer and/or the chief executive officer of global underwriting operations, who provide 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						TOTAL US\$M
	Aaa US\$M	Aa US\$M	A US\$M	Baa US\$M	SPECULATIVE GRADE US\$M	NOT RATED US\$M	
<b>As at 31 December 2011</b>							
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
<b>As at 31 December 2010</b>							
Cash and cash equivalents	217	1,138	229	20	51	31	1,686
Interest-bearing investments	5,166	14,550	2,981	320	202	54	23,273
Derivative financial instruments	–	20	11	–	–	–	31

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.

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

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.

	PAST DUE BUT NOT IMPAIRED					TOTAL US\$M
	NEITHER PAST DUE NOR IMPAIRED US\$M	0 TO 3 MTHS US\$M	3 TO 6 MTHS US\$M	6 MTHS TO 1 YEAR US\$M	GREATER THAN 1 YEAR US\$M	
<b>As at 31 December 2011</b>						
Premium receivable	1,904	432	91	49	21	2,497
Other debtors	495	37	7	6	12	557
Treasury receivables	8	1	-	-	-	9
Investment receivables	170	-	-	-	-	170
<b>As at 31 December 2010</b>						
Premium receivable	1,781	390	96	25	18	2,310
Other debtors	494	20	7	5	16	542
Treasury receivables	14	-	-	-	-	14
Investment receivables	133	4	1	-	-	138

## (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					NOT RATED US\$M	TOTAL US\$M
		AAA US\$M	AA US\$M	A US\$M	BBB US\$M	SPECULATIVE GRADE US\$M		
Reinsurance recoveries on outstanding claims <sup>(1)</sup>	2011	43	2,129	1,283	32	54	152	3,693
	2010	56	1,435	1,485	19	69	155	3,219
Reinsurance recoveries on paid claims <sup>(1)</sup>	2011	1	921	148	2	5	20	1,097
	2010	428	113	167	2	4	11	725

(1) Net of a provision for impairment.

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					TOTAL US\$M
		NEITHER PAST DUE NOR IMPAIRED US\$M	0 TO 3 MTHS US\$M	3 TO 6 MTHS US\$M	6 MTHS TO 1 YEAR US\$M	GREATER THAN 1 YEAR US\$M	
Reinsurance recoveries on paid claims <sup>(1)</sup>	2011	911	70	27	28	61	1,097
	2010	536	107	26	18	38	725

(1) Net of a provision for impairment.

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## 5 RISK MANAGEMENT continued

### (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 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.

EXPOSURE CURRENCY	SENSITIVITY %	RESIDUAL EXPOSURE		PROFIT (LOSS)	
		2011 US\$M	2010 US\$M	2011 US\$M	2010 US\$M
Sterling	+10	45	144	3	10
	-10			(3)	(10)
Euro	+10	(6)	5	-	-
	-10			-	-
Thai Baht	+10	(124)	(2)	(9)	-
	-10			9	-
Canadian dollar	+10	49	20	3	1
	-10			(3)	(1)
Australian dollar	+10	8	3	1	-
	-10			(1)	-

#### Currency risk in relation to net investment in foreign operations

QBE is exposed to currency risk in relation to:

- the translation of the 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 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.

# NOTES TO THE FINANCIAL STATEMENTS

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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 investments in foreign operations. The basis for the sensitivity calculation is the Group's actual residual exposure at the balance sheet date.

	SENSITIVITY %	RESIDUAL EXPOSURE		EQUITY INCREASE (DECREASE)	
		2011 US\$M	2010 US\$M	2011 US\$M	2010 US\$M
Australian dollar	+10	<b>5,383</b>	5,986	<b>538</b>	599
	-10			<b>(538)</b>	(599)
Sterling	+10	<b>680</b>	632	<b>68</b>	63
	-10			<b>(68)</b>	(63)
Singapore dollar	+10	<b>78</b>	76	<b>8</b>	8
	-10			<b>(8)</b>	(8)
New Zealand dollar	+10	<b>105</b>	98	<b>10</b>	10
	-10			<b>(10)</b>	(10)
Colombian Peso	+10	<b>80</b>	68	<b>8</b>	7
	-10			<b>(8)</b>	(7)
Euro	+10	<b>511</b>	496	<b>51</b>	50
	-10			<b>(51)</b>	(50)
Thai Baht	+10	<b>13</b>	13	<b>1</b>	1
	-10			<b>(1)</b>	(1)

Further information on hedging arrangements is provided in note 12.

## (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 Eurobonds, which were redeemed in August 2010, were issued at variable interest rates and were therefore subject to cash flow interest rate risk; however, the Group elected to manage this risk by using derivative financial instruments.

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)(vii). 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 2011, the average modified duration of cash and fixed interest securities was 0.4 years (2010 0.5 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
<b>At 31 December 2011</b>								
Fixed rate	US\$M	<b>9,119</b>	<b>1,832</b>	<b>338</b>	<b>175</b>	<b>191</b>	<b>634</b>	<b>12,289</b>
Weighted average interest rate	%	<b>1.4</b>	<b>2.1</b>	<b>3.2</b>	<b>3.7</b>	<b>2.1</b>	<b>7.0</b>	<b>1.9</b>
Floating rate	US\$M	<b>3,401</b>	<b>3,108</b>	<b>3,423</b>	<b>2,894</b>	<b>1,951</b>	<b>531</b>	<b>15,308</b>
Weighted average interest rate	%	<b>1.7</b>	<b>3.2</b>	<b>4.2</b>	<b>5.1</b>	<b>5.1</b>	<b>4.6</b>	<b>3.7</b>
<b>At 31 December 2010</b>								
Fixed rate	US\$M	8,960	1,971	906	409	84	623	12,953
Weighted average interest rate	%	2.1	3.2	3.4	5.0	6.0	5.7	2.6
Floating rate	US\$M	2,533	2,208	2,331	1,238	2,114	1,582	12,006
Weighted average interest rate	%	1.9	1.5	3.1	4.6	4.1	4.5	3.1

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.

	SENSITIVITY %	PROFIT (LOSS)	
		2011 US\$M	2010 US\$M
Interest rate movement – interest-bearing financial assets	+0.5	<b>(37)</b>	(44)
	-0.5	<b>32</b>	43

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## 5 RISK MANAGEMENT continued

### (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 2011, 1.1% (2010 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)	
		2011 US\$M	2010 US\$M
ASX 200	+20	17	20
	-20	(17)	(20)
FTSE 100	+20	4	2
	-20	(4)	(2)
EURO STOXX	+20	5	2
	-20	(5)	(2)
S&P 500	+20	11	14
	-20	(11)	(14)

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)	
		2011 US\$M	2010 US\$M
Credit spread movement – corporate interest-bearing financial assets	+0.5	(123)	(104)
	-0.5	116	98

### (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 111.

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 tables summarise the contractual maturity profile of certain of the Group's financial liabilities based on the remaining contractual obligations. Details of call dates of borrowings earlier than the contractual maturity date are included in note 25.

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

	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
<b>As at 31 December 2011</b>						
Trade payables	905	111	8	3	5	1,032
Treasury payables	41	-	-	-	-	41
Investment payables	14	-	-	-	-	14
Borrowings	541	1,577	2,373	283	-	4,774
Contractual undiscounted interest payments	254	496	231	158	-	1,139
<b>As at 31 December 2010</b>						
Trade payables	804	98	5	3	5	915
Treasury payables	30	-	-	-	-	30
Borrowings	28	1,570	1,368	310	-	3,276
Contractual undiscounted interest payments	150	339	144	191	-	824

The Group has no significant concentration of liquidity risk.

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

	2011 US\$M	2010 US\$M
<b>Gross earned premium revenue</b>		
Direct and facultative	15,921	12,180
Inward reinsurance	1,919	1,252
	17,840	13,432
<b>Other revenue</b>		
Reinsurance and other recoveries revenue	2,074	1,068
Reinsurance commission revenue	276	219
	20,190	14,719
<b>Other income</b>		
Interest, dividend and other income	799	558
Net fair value gains on financial assets	-	8
Net fair value gains on investment properties	4	-
Net fair value gains on owner occupied properties	6	-
Realised gains on sale of controlled entities	9	2
Gain on purchase of controlled entity	2	-
Gain on repurchase of debt securities	2	-
Foreign exchange gains	188	141
Share of net profits of associates	6	5
	1,016	714
Income	21,206	15,433

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## 6 INCOME AND EXPENSES continued

### (B) Expenses summary

	2011 US\$M	2010 US\$M
Outward reinsurance premium expense	2,481	2,070
Gross claims incurred	12,540	7,875
Gross commission expense	2,567	1,978
Other acquisition costs	720	630
Underwriting and other expenses <sup>(1)</sup>	1,388	998
Net fair value losses on financial assets	191	–
Net fair value losses on investment properties	–	2
Net fair value losses on owner occupied properties	–	7
Investment expenses	43	41
Financing and other costs	275	222
Amortisation of intangibles and impairment of goodwill/intangibles	133	59
Expenses	20,338	13,882

(1) Includes US\$137 million (2010 US\$175 million) of agency income earned by the Group's agency operations which is treated as a recovery of the Group's underwriting expenses.

### (C) Specific items

	2011 US\$M	2010 US\$M
Defined contribution superannuation plan expense	93	70
Payments on operating leases	85	87
Depreciation of property, plant and equipment	87	59

## 7 INVESTMENT INCOME

	2011 US\$M	2010 US\$M
<b>Interest, dividend and other income</b>		
Dividends received or receivable	17	42
Interest received or receivable	786	511
Other investment income	(4)	5
	799	558
<b>Net fair value (losses) gains on financial assets</b>		
Equities	(19)	(48)
Fixed interest and other	(172)	56
	(191)	8
Net fair value gains (losses) on investment properties	4	(2)
Net fair value gains (losses) on owner occupied properties	6	(7)
Realised gains on sale of controlled entities	9	2
Gain on purchase of controlled equity	2	–
Gain on repurchase of debt securities	2	–
Foreign exchange gains	188	141
Investment and other income	819	700
Investment expenses	(43)	(41)
Net investment and other income	776	659

	POLICYHOLDERS' FUNDS		SHAREHOLDERS' FUNDS		INVESTMENT INCOME	
	2011 US\$M	2010 US\$M	2011 US\$M	2010 US\$M	2011 US\$M	2010 US\$M
Investment and other income	612	555	207	145	819	700
Investment expenses	(21)	(20)	(22)	(21)	(43)	(41)
Net investment and other income	591	535	185	124	776	659

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## 8 CLAIMS INCURRED

### (A) Claims analysis

	2011 US\$M	2010 US\$M
<b>Gross claims incurred and related expenses</b>		
Direct and facultative	10,824	7,089
Inward reinsurance	1,716	786
	12,540	7,875
<b>Reinsurance and other recoveries</b>		
Direct and facultative	1,639	786
Inward reinsurance	435	282
	2,074	1,068
Net claims incurred	10,466	6,807

### (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.

	2011			2010		
	CURRENT YEAR US\$M	PRIOR YEARS US\$M	TOTAL US\$M	CURRENT YEAR US\$M	PRIOR YEARS US\$M	TOTAL US\$M
<b>Gross claims incurred and related expenses</b>						
Undiscounted	13,679	(1,597)	12,082	8,832	(867)	7,965
Discount	(298)	756	458	(489)	399	(90)
	13,381	(841)	12,540	8,343	(468)	7,875
<b>Reinsurance and other recoveries</b>						
Undiscounted	2,981	(983)	1,998	1,311	(248)	1,063
Discount	(34)	110	76	(76)	81	5
	2,947	(873)	2,074	1,235	(167)	1,068
<b>Net claims incurred</b>						
Undiscounted	10,698	(614)	10,084	7,521	(619)	6,902
Discount	(264)	646	382	(413)	318	(95)
	10,434	32	10,466	7,108	(301)	6,807

### (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 above and the current financial year movements in the claims development table.

	2011			2010		
	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)	10,360	(64)	10,296	7,935	(49)	7,886
Acquisitions – central estimate	(448)	–	(448)	(1,161)	–	(1,161)
	9,912	(64)	9,848	6,774	(49)	6,725
Foreign exchange	(4)	(5)	(9)	4	(7)	(3)
Movement in claims settlement costs	392	(12)	380	301	–	301
Movement in discount	(264)	646	382	(413)	318	(95)
Movement in risk margin	401	(525)	(124)	447	(569)	(122)
Other movements	(3)	(8)	(11)	(5)	6	1
Net claims incurred – discounted	10,434	32	10,466	7,108	(301)	6,807

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## 9 INCOME TAX

### (A) Reconciliation of prima facie tax to income tax expense

	2011 US\$M	2010 US\$M
Profit before income tax	868	1,551
Prima facie tax payable at 30%	260	465
Tax effect of permanent differences:		
Untaxed dividends	(3)	(8)
Differences in tax rates	7	(129)
Other, including non-allowable expenses and non-taxable income	(70)	(48)
Prima facie tax adjusted for permanent differences	194	280
Deferred tax asset no longer recognised	(24)	21
Overprovision in prior years	(21)	(44)
Income tax expense	149	257
Analysed as follows:		
Current tax	(72)	306
Deferred tax	242	(5)
Overprovision in prior years	(21)	(44)
	149	257
Deferred tax expense (credit) comprises <sup>(1)</sup> :		
Deferred tax assets recognised in profit or loss	(190)	79
Deferred tax liabilities recognised in profit or loss	432	(84)
	242	(5)

(1) Consolidated deferred tax expense includes US\$28 million (2010 US\$8 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

	2011 US\$M	2010 US\$M
Cash at bank and on hand	835	722
Overnight money	107	164
Cash management trusts	286	516
Term deposits	229	284
	1,457	1,686
Analysed as follows:		
Fixed interest rate	372	293
Floating interest rate	1,085	1,393
	1,457	1,686

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 US\$74 million (2010 US\$150 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.

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## (B) Reconciliation of cash flows from operating activities to profit after income tax

	2011 US\$M	2010 US\$M
Cash flows from operating activities	2,139	1,362
Depreciation of property, plant and equipment	(87)	(59)
Amortisation and impairment of goodwill/intangibles	(133)	(59)
Realised gains on sale of controlled entities	9	2
Gain on repurchase of debt securities	2	–
Loss on sale of plant and equipment	(30)	(21)
Net foreign exchange gains	188	141
Other losses on financial assets	(196)	(6)
Increase in net outstanding claims	(1,562)	(681)
Increase in unearned premium	(451)	(197)
Increase in deferred insurance costs	214	140
Increase in trade debtors	145	395
Increase in net operating assets	100	18
Share of net profit of associates	6	5
Decrease in trade payables	458	325
Increase in tax liabilities	(47)	(54)
Increase in share-based payments	(44)	(40)
Decrease in defined benefit plan surplus/deficit	8	23
Profit after income tax	719	1,294

## 11 INVESTMENTS

	2011 US\$M	2010 US\$M
<b>Fixed interest rate</b>		
Short-term money	6,939	6,589
Government bonds	2,819	2,642
Corporate bonds	2,159	3,309
Unit trusts	–	120
	11,917	12,660
<b>Floating interest rate</b>		
Short-term money	219	394
Government bonds	271	123
Corporate bonds	13,615	10,054
Unit trusts	118	42
	14,223	10,613
<b>Equities</b>		
Listed	300	276
Unlisted	24	27
Exchange traded equity options	2	–
	326	303
Total investments	26,466	23,576
Amounts maturing within 12 months	11,070	9,816
Amounts maturing in greater than 12 months	15,396	13,760
Total investments	26,466	23,576

### (A) Exchange traded equity derivatives

Contractual amounts for forward contracts at the balance sheet date were nil (2010 nil). The credit risk arising from equity derivatives is US\$2 million (2010 nil). All equity derivatives have an expiry date of less than one year.

### (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.

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## 11 INVESTMENTS continued

### (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.

	2011				2010			
	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	474	6,683	1	7,158	512	6,471	–	6,983
Government bonds	1,726	1,363	1	3,090	1,325	1,440	–	2,765
Corporate bonds	–	15,774	–	15,774	–	13,362	1	13,363
Fixed interest trusts	–	118	–	118	–	162	–	162
Equities – listed	299	–	1	300	275	–	1	276
Equities – unlisted	–	–	24	24	–	–	27	27
Exchange traded equity options	2	–	–	2	–	–	–	–
Total investments	2,501	23,938	27	26,466	2,112	21,435	29	23,576

### (D) Movements in level 3 investments

The following table provides an analysis of investments valued with reference to level 3 inputs.

LEVEL 3	2011 US\$M	2010 US\$M
At 1 January	29	59
Purchases	1	26
Disposals	(2)	–
Reclassification out of level 3 investments	–	(55)
Unrealised losses	(1)	–
Foreign exchange	–	(1)
At 31 December	27	29

The reclassification of investments out of level 3 in the prior year resulted from an increased availability of observable market data.

### (E) Restrictions on use

Included in investments are amounts totalling US\$3,491 million (2010 US\$3,564 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 US\$1,048 million (2010 US\$1,267 million) of short-term money.

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## 12 DERIVATIVE FINANCIAL INSTRUMENTS

	ASSETS		LIABILITIES	
	2011 US\$M	2010 US\$M	2011 US\$M	2010 US\$M
<b>Maturing within 12 months</b>				
Forward foreign exchange contracts	42	31	45	92

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. In the Group, US\$42 million (2010 US\$31 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). In the Group, undiscounted contractual amounts to purchase US\$3,033 million (2010 US\$4,822 million) were outstanding at the balance sheet date. All contracts mature within 12 months of the balance date.

### (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).

	2011				2010			
	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	(3)	-	-	(3)	(61)	-	-	(61)

### (D) Hedging arrangements

At the balance date, no derivatives were designated as hedges.

At the balance sheet date, US\$3,750 million of borrowings were designated as hedges of net investments in foreign operations (2010 US\$2,239 million of borrowings and US\$232 million of other liabilities).

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## 13 TRADE AND OTHER RECEIVABLES

	2011 US\$M	2010 US\$M
<b>Trade debtors</b>		
Premium receivable <sup>(1)</sup>	2,497	2,310
Reinsurance and other recoveries <sup>(1)</sup>	1,097	725
Unclosed premium	1,184	975
	<b>4,778</b>	4,010
Other debtors	557	542
Treasury receivables	9	14
Investment receivables	170	138
Trade and other receivables	<b>5,514</b>	4,704
Receivable within 12 months	<b>5,248</b>	4,455
Receivable in greater than 12 months	<b>266</b>	249
Trade and other receivables	<b>5,514</b>	4,704

(1) Net of a provision for impairment.

### (A) Provision for impairment

	PREMIUM RECEIVABLE		REINSURANCE AND OTHER RECOVERIES	
	2011 US\$M	2010 US\$M	2011 US\$M	2010 US\$M
At 1 January	81	69	30	40
Amounts recognised in profit or loss	7	13	3	(3)
Other movements	(9)	–	12	(8)
Foreign exchange	(1)	(1)	–	1
At 31 December	<b>78</b>	81	<b>45</b>	30

### (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

	2011 US\$M	2010 US\$M
Deferred reinsurance premium	771	651
Deferred net commission	1,225	1,032
Deferred acquisition costs	436	320
Deferred insurance costs	<b>2,432</b>	2,003
To be expensed within 12 months	<b>2,250</b>	1,954
To be expensed in greater than 12 months	<b>182</b>	49
Deferred insurance costs	<b>2,432</b>	2,003

	DEFERRED REINSURANCE PREMIUM		DEFERRED NET COMMISSION		DEFERRED ACQUISITION COSTS	
	2011 US\$M	2010 US\$M	2011 US\$M	2010 US\$M	2011 US\$M	2010 US\$M
At 1 January	651	573	1,032	885	320	295
Acquisitions	19	42	61	1	4	–
Costs deferred in financial year	778	533	1,164	934	387	275
Amortisation of costs deferred in previous financial years	(667)	(530)	(1,027)	(827)	(273)	(267)
Foreign exchange	(10)	33	(5)	39	(2)	17
At 31 December	<b>771</b>	651	<b>1,225</b>	1,032	<b>436</b>	320

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## 15 PROPERTY, PLANT AND EQUIPMENT

	OWNER OCCUPIED PROPERTIES US\$M	LEASEHOLD IMPROVEMENTS US\$M	OFFICE EQUIPMENT/ FIXTURES & FITTINGS US\$M	MOTOR VEHICLES US\$M	TOTAL US\$M
<b>2011</b>					
<b>Cost or valuation</b>					
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
<b>Accumulated depreciation and impairment losses</b>					
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
<b>Carrying amount</b>					
At 31 December	198	65	180	5	448

	OWNER OCCUPIED PROPERTIES US\$M	LEASEHOLD IMPROVEMENTS US\$M	OFFICE EQUIPMENT/ FIXTURES & FITTINGS US\$M	MOTOR VEHICLES US\$M	TOTAL US\$M
<b>2010</b>					
<b>Cost or valuation</b>					
At 1 January	179	100	259	10	548
Acquisitions	21	1	8	1	31
Additions	3	8	116	2	129
Revaluations	3	-	-	-	3
Reclassified to investment property	(6)	-	-	-	(6)
Disposals	-	(1)	(24)	(3)	(28)
Foreign exchange	7	8	(2)	-	13
At 31 December	207	116	357	10	690
<b>Accumulated depreciation and impairment losses</b>					
At 1 January	-	32	167	5	204
Disposals	-	-	(2)	(2)	(4)
Depreciation charge for the year	-	11	46	2	59
Foreign exchange	-	1	(2)	-	(1)
At 31 December	-	44	209	5	258
<b>Carrying amount</b>					
At 31 December	207	72	148	5	432

### (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 2011 was US\$192 million (2010 US\$225 million).

### (B) Assets held for sale

At 31 December 2011, owner occupied property with a value of US\$32 million was reclassified to assets held for sale.

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## 16 DEFERRED INCOME TAX

	2011 US\$M	2010 US\$M
Deferred tax assets	86	93
Deferred tax liabilities	(575)	(402)

### (A) Deferred tax assets

(i) The balance comprises temporary differences attributable to:

	2011 US\$M	2010 US\$M
<b>Amounts recognised in profit or loss</b>		
Financial assets – fair value movements	41	40
Provision for impairment	16	15
Employee benefits	60	67
Defined benefit plans	1	3
Insurance provisions	471	399
Deferred tax losses recognised	325	101
Other	123	82
	<b>1,037</b>	<b>707</b>
<b>Amounts recognised in other comprehensive income</b>		
Capitalised expenses	3	6
Defined benefit plans	40	29
	<b>43</b>	<b>35</b>
Deferred tax assets before set-off	<b>1,080</b>	742
Set-off of deferred tax liabilities	(994)	(649)
	<b>86</b>	<b>93</b>
<b>Deferred tax assets before set-off analysed as follows:</b>		
Recoverable within 12 months	301	241
Recoverable in greater than 12 months	779	501
	<b>1,080</b>	<b>742</b>

(ii) Movements:

	2011 US\$M	2010 US\$M
At 1 January	742	839
Amounts recognised in profit or loss	190	(79)
Amounts recognised in other comprehensive income	(8)	4
Acquisitions	162	36
Foreign exchange	(6)	(58)
At 31 December	<b>1,080</b>	<b>742</b>

### (B) Tax losses

The Group has not brought to account US\$90 million (2010 US\$71 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.

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## (C) Deferred tax liabilities

(i) The balance comprises temporary differences attributable to:

	2011 US\$M	2010 US\$M
<b>Amounts recognised in profit or loss</b>		
Intangibles	(323)	(249)
Insurance provisions	(887)	(506)
Foreign currency monetary items	–	(141)
Taxation of Financial Arrangements transitional adjustment	(101)	–
Financial assets – fair value movements	(26)	(70)
Other provisions	(109)	(41)
Other items	(99)	(24)
	<b>(1,545)</b>	<b>(1,031)</b>
<b>Amounts recognised in other comprehensive income</b>		
Owner occupied property	(20)	(18)
Other	(4)	(2)
	<b>(24)</b>	<b>(20)</b>
Deferred tax liabilities before set-off	<b>(1,569)</b>	<b>(1,051)</b>
Set-off of deferred tax assets	<b>994</b>	<b>649</b>
	<b>(575)</b>	<b>(402)</b>
<b>Deferred tax liabilities before set-off analysed as follows:</b>		
Recoverable within 12 months	(247)	(313)
Recoverable in greater than 12 months	(1,322)	(738)
	<b>(1,569)</b>	<b>(1,051)</b>

(ii) Movements:

	2011 US\$M	2010 US\$M
At 1 January	(1,051)	(1,145)
Amounts recognised in profit or loss	(432)	84
Amounts recognised in other comprehensive income	(4)	–
Acquisitions	(94)	(68)
Foreign exchange	12	78
At 31 December	<b>(1,569)</b>	<b>(1,051)</b>

## 17 INVESTMENT PROPERTIES

	2011 US\$M	2010 US\$M
At 1 January	66	63
Additions	5	–
Fair value gains (losses)	4	(2)
Reclassified to assets held for sale	(41)	–
Reclassification (to) from owner occupied property	(6)	6
Foreign exchange	–	(1)
At 31 December	<b>28</b>	<b>66</b>

## (A) Investment properties

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 US\$6 million (2010 US\$5 million).

## (B) Assets held for sale

At 31 December 2011, investment property with a value of US\$41 million was reclassified to assets held for sale.

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## 18 INVESTMENT IN ASSOCIATES

### (A) Movements in carrying amounts

	2011 US\$M	2010 US\$M
At 1 January	53	45
Share of profit	6	5
Other comprehensive income	(2)	7
Additions	-	4
Foreign exchange	(2)	(8)
At 31 December	55	53

### (B) Extracts from entity financial statements

	GROUP SHARE OF:			
	ASSETS US\$M	LIABILITIES US\$M	GROSS WRITTEN PREMIUM US\$M	NET PROFIT AFTER TAX US\$M
<b>2011</b>				
QBE del Istmo Reinsurance Company Inc	135	(84)	64	6
Pacific Re Limited	7	(2)	2	-
Raheja QBE General Insurance Limited	10	(1)	1	-
	152	(87)	67	6

	GROUP SHARE OF:			
	ASSETS US\$M	LIABILITIES US\$M	GROSS WRITTEN PREMIUM US\$M	NET PROFIT AFTER TAX US\$M
<b>2010</b>				
QBE del Istmo Reinsurance Company Inc	122	(76)	56	5
Pacific Re Limited	5	(1)	1	-
Raheja QBE General Insurance Limited	8	-	-	-
	135	(77)	57	5

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## 19 INTANGIBLE ASSETS

2011	IDENTIFIABLE INTANGIBLES						GOODWILL	TOTAL
	LLOYD'S SYNDICATE CAPACITY US\$M	CUSTOMER RELATIONSHIPS US\$M	BRAND NAMES US\$M	INSURANCE LICENCES US\$M	SOFTWARE US\$M	OTHER US\$M	US\$M	US\$M
<b>Cost</b>								
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
<b>Amortisation</b>								
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)
<b>Carrying amount</b>								
At 31 December	82	1,102	69	75	49	22	4,666	6,065

2010	IDENTIFIABLE INTANGIBLES						GOODWILL	TOTAL
	LLOYD'S SYNDICATE CAPACITY US\$M	CUSTOMER RELATIONSHIPS US\$M	BRAND NAMES US\$M	INSURANCE LICENCES US\$M	SOFTWARE US\$M	OTHER US\$M	US\$M	US\$M
<b>Cost</b>								
At 1 January	87	558	39	50	40	14	3,815	4,603
Acquisitions	–	137	18	5	9	12	411	592
Additions/reclassifications	–	9	–	–	–	–	104	113
Foreign exchange	(6)	11	1	2	–	2	243	253
At 31 December	81	715	58	57	49	28	4,573	5,561
<b>Amortisation</b>								
At 1 January	–	(83)	(1)	–	(15)	(9)	–	(108)
Amortisation for the year	–	(45)	(3)	–	(9)	(2)	–	(59)
Foreign exchange	–	(5)	–	–	–	(2)	–	(7)
At 31 December	–	(133)	(4)	–	(24)	(13)	–	(174)
<b>Carrying amount</b>								
At 31 December	81	582	54	57	25	15	4,573	5,387

### (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 for all syndicates from 55% in 2000 to 91% for the 2011 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 are amortised over lives of between four and 21 years depending on the classes of business to which the assets relate.

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## 19 INTANGIBLE ASSETS continued

### (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 is amortised over the relevant period, being in the range of five 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 is amortised over periods ranging from three to 15 years, reflecting the period during which the Group is expected to benefit from the use of the software.

### (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 and at a level 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:

	2011 US\$M	2010 US\$M
North American operations	2,332	2,218
Australian operations	910	911
QBE LMI	787	788
QBE Insurance Europe	233	235
Lloyd's division	240	241
Other	164	180
	<b>4,666</b>	<b>4,573</b>

### (C) Impairment testing of intangible assets

The Group's accounting policy in respect of impairment testing of intangible assets is set out in note 1 (T). The recoverable amount of each cash generating unit is determined by reference to a value in use calculation based on the following key assumptions and estimates:

- discounted cash flow projections for a five year period are included in the calculation. This information is extracted from the latest three year business plan which has been presented to and approved by the board;
- projections for years four and five are based on the final year of the three year business plan assuming growth of 2.5% per annum;
- discount rates are pre-tax and reflect a beta and equity risk premium appropriate to the Group; and
- terminal value is calculated using a perpetuity growth formula based on the cash flow forecast for year five and an appropriate discount rate and terminal growth rate.

The discount rates used to value cash generating units at 31 December 2011 were in a range of 7.2% to 11.9% (31 December 2010 range of 9.9% to 15.2%).

## 20 TRADE AND OTHER PAYABLES

	2011 US\$M	2010 US\$M
Trade payables	1,032	915
Other payables and accrued expenses	730	561
Treasury payables	41	30
Investment payables	14	–
Trade and other payables	<b>1,817</b>	<b>1,506</b>
Payable within 12 months	<b>1,584</b>	<b>1,408</b>
Payable in greater than 12 months	<b>233</b>	<b>98</b>
Trade and other payables	<b>1,817</b>	<b>1,506</b>

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## 21 UNEARNED PREMIUM

### (A) Unearned premium

	2011 US\$M	2010 US\$M
At 1 January	6,788	6,127
Acquisitions	837	214
Deferral of premium on contracts written in the period	6,645	5,348
Earning of premium written in previous periods	(6,194)	(5,189)
Foreign exchange	(7)	288
At 31 December	8,069	6,788
To be earned within 12 months	7,352	6,217
To be earned in greater than 12 months	717	571
Unearned premium	8,069	6,788

### (B) Net premium liabilities

	NOTE	2011 US\$M	2010 US\$M
Unearned premium		8,069	6,788
Deferred insurance costs	14	(2,432)	(2,003)
Net premium liabilities		5,637	4,785

### (C) Expected present value of future cash flows for future claims including risk margin

	2011 US\$M	2010 US\$M
Undiscounted central estimate	5,436	4,178
Risk margin	220	165
	5,656	4,343
Discount to present value	(374)	(454)
Expected present value of future cash flows for future claims including risk margin	5,282	3,889

### (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 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.

The application of the liability adequacy test in respect of the net premium liabilities identified a surplus at 31 December 2011 and 2010.

### (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% (2010 4.4%). This is the risk margin required to give a probability of adequacy of 75% for future claims.

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## 22 OUTSTANDING CLAIMS

### (A) Net outstanding claims

	2011 US\$M	2010 US\$M
Gross outstanding claims	21,374	19,443
Claims settlement costs	453	419
	21,827	19,862
Discount to present value	(1,150)	(1,626)
Gross outstanding claims provision	20,677	18,236
Less than 12 months	7,869	6,431
Greater than 12 months	12,808	11,805
Gross outstanding claims provision	20,677	18,236
Reinsurance and other recoveries on outstanding claims <sup>(1)</sup>	3,808	3,425
Discount to present value	(115)	(206)
Reinsurance and other recoveries on outstanding claims	3,693	3,219
Less than 12 months	1,874	1,227
Greater than 12 months	1,819	1,992
Reinsurance and other recoveries on outstanding claims	3,693	3,219
Net outstanding claims	16,984	15,017
Central estimate	15,783	13,747
Risk margin	1,201	1,270
Net outstanding claims	16,984	15,017

(1) Reinsurance and other recoveries on outstanding claims is shown net of a provision for impairment of US\$35 million (2010 US\$32 million).

### (B) Maturity profile of net outstanding claims

The expected maturity of the Group's discounted net outstanding claims provision is analysed below.

	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
<b>2011</b>							
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 operations	1,664	860	543	351	215	475	4,108
Asia Pacific operations	181	82	48	28	15	30	384
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
<b>2010</b>							
North American operations	880	467	295	185	112	390	2,329
Latin American operations	123	89	23	8	8	58	309
European operations	1,605	1,006	734	577	416	1,241	5,579
Australian operations	1,486	781	495	313	189	424	3,688
Asia Pacific operations	187	77	44	24	13	25	370
Equator Re	923	557	338	272	195	457	2,742
Group	5,204	2,977	1,929	1,379	933	2,595	15,017

An analysis of the weighted average term to settlement of the claims provision is included in note 4A(vi).

### (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)(vi).

The probability of adequacy at 31 December 2011 is 86.3% (2010 89.8%) which is well above APRA's 75% benchmark. The risk margin included in net outstanding claims is 7.6% (2010 9.2%) of the central estimate.

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## (D) Reconciliation of movement in discounted outstanding claims provision

	2011			2010		
	GROSS US\$M	REINSURANCE US\$M	NET US\$M	GROSS US\$M	REINSURANCE US\$M	NET US\$M
At 1 January	18,236	(3,219)	15,017	16,166	(3,302)	12,864
Increase in net claims incurred in current accident year	13,381	(2,947)	10,434	8,343	(1,235)	7,108
Movement in prior year claims provision	(841)	873	32	(468)	167	(301)
Incurred claims recognised in the income statement	12,540	(2,074)	10,466	7,875	(1,068)	6,807
Acquisitions/disposals	607	(66)	541	1,602	(190)	1,412
Claim payments	(10,368)	1,683	(8,685)	(7,515)	1,334	(6,181)
Foreign exchange	(338)	(17)	(355)	108	7	115
At 31 December	20,677	(3,693)	16,984	18,236	(3,219)	15,017

## (E) Claims development – undiscounted net central estimate

	2001 & PRIOR US\$M	2002 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 <sup>(1)</sup> US\$M	TOTAL US\$M
<b>Net claims cost – central estimate:</b>												
At end of accident year	2,312	2,457	3,433	3,750	3,393	6,483	6,138	6,261	8,305	10,360		
One year later	2,247	2,292	3,210	3,794	3,333	6,302	6,246	6,317	8,335			
Two years later	2,248	2,163	3,042	3,535	3,295	6,415	6,218	6,292				
Three years later	2,243	2,124	3,022	3,558	3,241	6,409	6,300					
Four years later	2,230	2,067	2,900	3,571	3,172	6,400						
Five years later	2,220	2,057	2,904	3,528	3,168							
Six years later	2,246	2,075	2,908	3,550								
Seven years later	2,251	2,098	2,865									
Eight years later	2,243	2,046										
Nine years later	2,235											
Current central estimate cost for the 10 most recent accident years	2,235	2,046	2,865	3,550	3,168	6,400	6,300	6,292	8,335	10,360		
Cumulative net claims payments to date	(2,126)	(1,972)	(2,566)	(3,258)	(2,811)	(5,299)	(5,006)	(4,277)	(4,542)	(4,134)		
Net undiscounted central estimate	965	109	74	299	292	357	1,101	1,294	2,015	3,793	6,226	16,525
Foreign exchange												(216)
Net undiscounted central estimate at 31 December 2011												16,309
Discount to present value												(1,035)
Risk margin												1,201
Claims settlement costs												453
Other												56
Net outstanding claims at 31 December 2011												16,984
<b>Net central estimate development</b>												
Increase (decrease) in the year – current year minus prior year	(57)	(8)	(52)	(43)	22	(4)	(9)	82	(25)	30	10,360	10,296

(1) Includes US\$448 million of net central estimate relating to 2011 acquisitions which is not included in net incurred claims.

A reconciliation of the net central estimate development to the net incurred claims in the income statement, analysed between current and prior accident years, 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 2011 cumulative average rate of exchange.

The central estimate claims development table is presented net of reinsurance. With operations in 52 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.

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.

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## 23 PROVISIONS

	PROVISION FOR LONG SERVICE LEAVE US\$M	AMOUNTS PAYABLE UNDER ACQUISITION AGREEMENTS US\$M	OTHER PROVISIONS US\$M	TOTAL PROVISIONS US\$M
<b>2011</b>				
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

	PROVISION FOR LONG SERVICE LEAVE US\$M	AMOUNTS PAYABLE UNDER ACQUISITION AGREEMENTS US\$M	OTHER PROVISIONS US\$M	TOTAL PROVISIONS US\$M
<b>2010</b>				
At 1 January	28	467	41	536
Cash payments	–	(150)	(1)	(151)
Amounts charged (credited) to the income statement	4	7	(4)	7
Other movement	–	113	(13)	100
Acquisitions/disposals	–	11	13	24
Foreign exchange	4	2	3	9
At 31 December	36	450	39	525
Payable within 12 months	29	426	23	478
Payable in greater than 12 months	7	24	16	47
At 31 December	36	450	39	525

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## 24 DEFINED BENEFIT PLANS

	2011 US\$M	2010 US\$M
Defined benefit plan surpluses	1	2
Retirement benefit deficits	(90)	(77)
Post-employment health care benefit deficit	(10)	(9)
	(100)	(86)
Committed future contributions	(2)	(9)
Defined benefit plan deficits	(102)	(95)

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 health care 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 Consulting and Towers Watson. All valuations have been updated for information available at 31 December 2011.

### (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		PRESENT VALUE OF PLAN OBLIGATIONS		SURPLUSES NOT RECOGNISED		NET RECOGNISED SURPLUSES (DEFICITS)	
		2011 US\$M	2010 US\$M	2011 US\$M	2010 US\$M	2011 US\$M	2010 US\$M	2011 US\$M	2010 US\$M
<b>Defined benefit retirement plans<sup>(1)</sup></b>									
Iron Trades insurance staff trust	31 Dec 11	275	242	(226)	(253)	(49)	–	–	(11)
European staff retirement benefit plan	31 Dec 11	9	10	(13)	(12)	–	–	(4)	(2)
Janson Green final salary superannuation scheme	31 Dec 11	180	167	(178)	(167)	(2)	–	–	–
Secura defined benefit plan	31 Dec 11	9	8	(15)	(13)	–	–	(6)	(5)
QBE Australia defined benefit plan	31 Dec 11	31	39	(43)	(38)	–	–	(12)	1
QBE the Americas plan	31 Dec 11	222	212	(286)	(264)	–	–	(64)	(52)
Other plans		2	–	(5)	(6)	–	–	(3)	(6)
		728	678	(766)	(753)	(51)	–	(89)	(75)
<b>Defined benefit post-employment health care plan<sup>(2)</sup></b>									
QBE Regional pension restoration plan	31 Dec 11	–	–	(10)	(9)	–	–	(10)	(9)
		728	678	(776)	(762)	(51)	–	(99)	(84)

(1) Defined benefit retirement plan obligations are funded.

(2) Defined benefit post-employment health care plan obligations are not funded.

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## 24 DEFINED BENEFIT PLANS continued

### (B) Reconciliation

	2011 US\$M	2010 US\$M
Fair value of plan assets at 1 January	678	646
Expected return on plan assets	35	37
Actuarial gains on plan assets	42	27
Employer contributions	13	14
Benefits and expenses paid	(37)	(44)
Acquisitions	-	8
Foreign exchange	(3)	(10)
Fair value of plan assets at 31 December	728	678
Defined benefit obligations at 1 January	(762)	(740)
Current service cost	(1)	(12)
Interest cost	(40)	(40)
Actuarial losses	(13)	(32)
Benefits and expenses paid	37	44
Past service cost	-	2
Curtailments and settlements	-	25
Acquisitions	-	(14)
Foreign exchange	3	5
Defined benefit obligations at 31 December	(776)	(762)
Net deficits at 31 December	(48)	(84)
Surpluses not recognised	(51)	-
Committed future contributions	(2)	(9)
Net deficits recognised in the balance sheet at 31 December	(101)	(93)
	2011 US\$M	2010 US\$M
Net deficits at 1 January	(84)	(94)
<b>Amounts recognised in profit or loss</b>		
Current service cost	(1)	(12)
Interest cost	(40)	(40)
Past service cost	-	2
Expected return on plan assets	35	37
Curtailments and settlements	-	25
	(6)	12
Actuarial gains (losses) included in retained earnings	29	(5)
Employer contributions	13	14
Acquisitions	-	(6)
Foreign exchange	-	(5)
Net deficits at 31 December	(48)	(84)

The charge recognised in profit or loss in the year of US\$6 million (2010 US\$12 million credit) has been included in underwriting expenses. The actual return on plan assets was a gain of US\$77 million (2010 US\$64 million).

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## (C) Amounts included in retained earnings

Cumulative actuarial gains and losses included in retained earnings are as follows:

	2011 US\$M	2010 US\$M
Actuarial losses at 1 January	145	145
Movement in the year	17	–
Actuarial losses at 31 December	162	145
Deferred taxation on actuarial losses at 1 January	(43)	(41)
Movement in the year	(11)	(2)
Deferred taxation on actuarial losses at 31 December	(54)	(43)
Net actuarial losses at 31 December	108	102

## (D) Principal actuarial assumptions

	2011 %	2010 %
Discount rate	3.7 – 8.2	4.0 – 10.1
Expected return on plan assets	4.2 – 7.0	4.2 – 7.0
Future salary increases	2.8 – 8.0	3.0 – 10.0
Future pension increases	1.8 – 5.0	1.9 – 3.4

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

	2011 US\$M	2010 US\$M
Equities	155	162
Bonds	547	490
Property	6	1
Other	20	25
	728	678

## (F) Historical summary

	2011 US\$M	2010 US\$M	2009 US\$M	2008 US\$M	2007 US\$M
Experience gains (losses) arising on plan liabilities	5	1	(7)	27	2
Experience gains (losses) arising on plan assets	42	27	23	(109)	(14)

	2011 US\$M	2010 US\$M	2009 US\$M	2008 US\$M	2007 US\$M
Present value of plan obligations	(776)	(762)	(740)	(648)	(809)
Fair value of plan assets	728	678	646	582	798
Net (deficits) surpluses	(48)	(84)	(94)	(66)	(11)

## (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 2012 amount to US\$15 million.

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## 25 BORROWINGS

	2011 US\$M	2010 US\$M
Payable within 12 months	533	27
Payable in greater than 12 months	4,224	3,216
Total borrowings	4,757	3,243

### (A) Contractual maturity profile of borrowings

Final repayment date:		2011 US\$M	2010 US\$M
<b>Bank loans</b>	<b>Principal amount</b>		
19 January 2011	US\$25 million	–	25
30 June 2011	US\$2 million	–	2
7 July 2012	A\$40 million	41	–
		41	27
<b>Senior debt</b>			
14 March 2014	US\$211 million	209	209
14 March 2014	£191 million	295	295
28 September 2015	£550 million	850	853
		1,354	1,357
<b>Hybrid securities<sup>(1, 2)</sup></b>			
12 May 2030	US\$850 million	865	840
		865	840
<b>Subordinated debt</b>			
30 June 2020 <sup>(3)</sup>	US\$500 million	492	494
1 July 2023	US\$220 million	217	217
15 June 2035	US\$16 million	16	16
15 March 2036	US\$80 million	78	78
15 March 2036	US\$20 million	20	20
14 December 2036	US\$15 million	15	15
24 May 2041	US\$1,000 million	994	–
24 May 2041	£325 million	502	–
		2,334	840
<b>Capital securities<sup>(4)</sup></b>			
No fixed date	US\$151 million	150	150
No fixed date	£9 million (2010 £18 million)	13	29
		163	179
Total borrowings		4,757	3,243

(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 excluding 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) On 30 June 2012, and certain specified dates thereafter, subject to regulatory approval, QBE can redeem the securities for cash. The securities may be converted into QBE ordinary shares at the holder's option on 30 June 2012 and certain specified dates thereafter. Details are provided in note 25(F)(i).

(4) QBE has the option to redeem these securities. Details are provided in note 25(G).

### (B) Finance costs

Finance costs of US\$13 million (2010 US\$15 million) have been capitalised in the year.

### (C) Bank loans

In the normal course of business, bank loans are made to controlled entities and secured by guarantees or letters of comfort given by the company.

### (D) Senior debt

#### (i) Senior notes due 2014

In 2008, the company issued US\$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 10.00% per annum is payable half-yearly on the sterling notes.

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## (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.

## (E) Hybrid securities

### (i) Hybrid securities due 2030

In 2010, the Group raised US\$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 66.9 million shares would be issued based on the accreted value and the share price at 31 December 2011.

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.

## (F) Subordinated debt

### (i) Subordinated debt due 2020

In 2010, the Group raised US\$500 million through the issue of subordinated debt securities with a 10 year maturity. The securities entitle holders to receive interest at a floating rate of 2.5% over the three month US dollar LIBOR rate, payable quarterly in arrears.

The securities are redeemable for cash prior to the ultimate maturity date, at the option of QBE and subject to regulatory approval, on 30 June 2012 and certain specified dates thereafter.

Investors can request the conversion of these securities into a variable number of ordinary shares in the company on 30 June 2012 and certain specified dates thereafter.

In the event of conversion of the securities, the number of shares will depend upon the market price of the shares at the date of conversion. Based on the share price at 31 December 2011, 37.8 million shares would be issued.

### (ii) Subordinated debt due 2023

In 2003, the Group raised US\$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, US\$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 2041

On 24 May 2011, the Group raised US\$1 billion and £325 million (US\$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 7.3% 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%. 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 the Australian Prudential Regulation Authority (APRA) 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.

### (iv) 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.

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## 25 BORROWINGS continued

### (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 US\$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.

US\$399 million and £291 million of capital securities have been 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.

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

	2011 US\$M	2010 US\$M
Bank loans	41	27
Senior notes	1,465	1,508
Hybrid securities	851	857
Subordinated debt	2,155	842
Capital securities	140	151
	<b>4,652</b>	<b>3,385</b>

The fair value of all securities has been estimated using valuation techniques for which all significant inputs are based on observable market data.

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## 26 EQUITY

### (A) Share capital

	NUMBER OF SHARES MILLIONS	US\$M
<b>2011</b>		
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
<b>2010</b>		
Issued ordinary shares, fully paid at 1 January	1,020	6,604
Shares issued under the Employee Share and Option Plan	–	3
Employee options exercised	3	35
Shares issued under Dividend Reinvestment Plan	22	359
Shares issued under Bonus Share Plan	3	–
Foreign exchange	–	971
Issued ordinary shares, fully paid at 31 December	1,048	7,972
Shares notified to the Australian Securities Exchange	1,052	8,006
Less: Plan shares subject to non-recourse loans, derecognised under Australian GAAP	(4)	(34)
Issued ordinary shares, fully paid at 31 December	1,048	7,972

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

	2011 US\$M	2010 US\$M
At 1 January	(1)	(1)
Purchase of shares	(29)	(23)
Shares vested and/or released to participants	28	23
Foreign exchange	–	–
At 31 December	(2)	(1)

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.

### (C) Equity component of hybrid securities

	2011 US\$M	2010 US\$M
At 1 January	132	102
Movement during the period	–	14
Foreign exchange	–	16
At 31 December	132	132

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## 26 EQUITY continued

### (D) Reserves

	2011 US\$M	2010 US\$M
<b>Owner occupied property revaluation reserve<sup>(1)</sup></b>		
At 1 January	19	9
Valuation increase	5	10
Deferred tax	(1)	(2)
Foreign exchange	–	2
At 31 December	23	19
<b>Cash flow hedges reserve<sup>(2)</sup></b>		
At 1 January	–	(7)
Fair value loss	–	(29)
Transfer of loss to income statement	–	34
Taxation	–	(3)
Foreign exchange	–	5
At 31 December	–	–
<b>Foreign currency translation reserve<sup>(3)</sup></b>		
At 1 January	(1,696)	(1,304)
Losses on translation	(37)	(567)
Gains (losses) on hedging transactions	(158)	159
Taxation	(51)	16
At 31 December	(1,942)	(1,696)
<b>Options reserve<sup>(4)</sup></b>		
At 1 January	137	111
Options and conditional rights expense	40	36
Transfers from reserve on vesting of options and conditional rights	(28)	(23)
Taxation	(1)	(4)
Foreign exchange	–	17
At 31 December	148	137
<b>General reserve<sup>(5)</sup></b>		
At 1 January	5	4
Foreign exchange	–	1
At 31 December	5	5
<b>Realised capital profits reserve<sup>(6)</sup></b>		
At 1 January	6	5
Foreign exchange	–	1
At 31 December	6	6
<b>Associates<sup>(7)</sup></b>		
At 1 January	7	–
Movement in the year	(2)	7
At 31 December	5	7
<b>Premium on purchase of non-controlling interests<sup>(8)</sup></b>		
At 1 January	(5)	–
Purchase of non-controlling interest	(16)	(4)
Foreign exchange	–	(1)
At 31 December	(21)	(5)
Total reserves at 31 December	(1,776)	(1,527)

(1) Used to recognise fair value movements in the carrying value of owner occupied property. Refer note 1(S).

(2) Used to record gains or losses on a hedging instrument in a cash flow hedge that are recognised directly in equity. Refer note 1(O)(ii).

(3) 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.

(4) Used to recognise the fair value of instruments issued as share based payments.

(5) Established prior to 1989 for general purposes.

(6) Realised capital profits arising prior to the introduction of capital gains tax in Australia.

(7) Used to recognise other comprehensive income of associates.

(8) Used to recognise the premium paid over net asset value on purchase of a non-controlling interest in a controlled entity.



# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## (E) Capital risk management

QBE's objectives when managing capital are 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.

Controlled entities that are insurance companies are subject to, and are in compliance with, externally imposed capital requirements set and monitored by regulatory bodies. These requirements are in place to ensure sufficient solvency margins for the protection of 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:

- The Group is subject to APRA Level 2 minimum capital requirements. Management actively manages the components of capital in order to achieve an optimal capital adequacy multiple of around 1.5 times APRA's minimum requirement for Level 2 groups.
- All regulated wholly-owned entities are subject to local prudential standards requiring 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 meets 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 2011 was 45.8% (2010 31.5%).
- 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 regulated wholly-owned entities. The Group's policy is to maintain ratings that optimise the balance between providing security to policyholders whilst providing appropriate returns to shareholders. All of our regulated wholly-owned entities are rated A+ or equivalent financial strength rating or higher at 31 December 2011.

In addition to the management reporting and planning processes, the Group has dedicated staff in all business units and divisions responsible for understanding the regulatory capital requirements for each of our operations. The quality of assets (particularly investments and reinsurance recoveries) is monitored on an ongoing basis to ensure issues are identified early and remedial action, where necessary, is taken to restore effective capital performance and levels.

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## 27 DIVIDENDS

### (A) Dividends

	2011	2010	
	INTERIM	FINAL	INTERIM
Dividend per share (Australian cents)	<b>62.0</b>	66.0	62.0
Franking percentage	<b>10%</b>	10%	15%
Franked amount per share (Australian cents)	<b>6.2</b>	6.6	9.3
Dividend payout (A\$M)	<b>677</b>	694	642
Payment date	<b>23 Sept 2011</b>	11 Apr 2011	22 Sept 2010

On 28 February 2012, the directors declared a 25% franked final dividend of 25.0 Australian cents per share payable on 30 March 2012. The final dividend payout is A\$279 million (2010 A\$694 million).

	NOTE	2011 US\$M	2010 US\$M
Previous year final dividend paid on ordinary shares			
Franked		<b>73</b>	125
Unfranked		<b>656</b>	498
		<b>729</b>	623
Interim dividend paid on ordinary shares			
Franked		<b>66</b>	92
Unfranked		<b>596</b>	521
		<b>662</b>	613
Bonus Share Plan dividend forgone	27(C)	<b>(51)</b>	(51)
Total dividend paid		<b>1,340</b>	1,185

### (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 9 March 2012.

### (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 3,656,380 (2010 3,147,306) ordinary shares were issued under the BSP.

### (D) Franking credits

The franking account balance on a tax paid basis at 31 December 2011 was a surplus of A\$15 million (2010 surplus of A\$14 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\$15 million (2010 deficit of A\$16 million).

Following the introduction of the conduit foreign income (CFI) rules effective for the Group from 1 January 2006, shareholders will receive CFI credits for the unfranked portion of the final 2011 dividend. For shareholders not resident in Australia, the dividend will not be subject to Australian withholding tax.

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## 28 EARNINGS PER SHARE

	2011 US\$M	2010 US\$M
Basic earnings per share	64.9	123.7
Diluted earnings per share	61.3	119.6

### (A) Reconciliation of earnings used in calculating earnings per share

	2011 US\$M	2010 US\$M
Net profit after income tax attributable to ordinary equity holders of the company, used in calculating basic earnings per share	704	1,278
Add: finance costs of convertible securities	27	14
Earnings used in calculating diluted earnings per share	731	1,292

### (B) Reconciliation of weighted average number of ordinary shares used in calculating earnings per share

	2011 MILLION	2010 MILLION
Weighted average number of ordinary shares on issue	1,088	1,037
Weighted average number of non-recourse loan shares issued under the Plan	(4)	(4)
Weighted average number of ordinary shares used as the denominator in calculating basic earnings per share <sup>(1)</sup>	1,084	1,033
Weighted average number of dilutive potential ordinary shares relating to:		
Shares issued under the Plan	4	4
Options issued under the Plan	–	1
Convertible securities	105	43
Weighted average number of ordinary shares used as the denominator in calculating diluted earnings per share	1,193	1,081

(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 US\$64.7 cents (2010 US\$123.2 cents). Refer to note 26(A).

## 29 BUSINESS COMBINATIONS

### (A) Acquisitions

The following entities were acquired during the financial year:

On 1 January 2011, a wholly-owned entity acquired the entire share capital of the US operations of Renaissance Re, which includes a US crop and small specialist insurance business. The purchase price was US\$260 million for net tangible assets of US\$171 million.

On 31 January 2011, a wholly-owned entity acquired the entire share capital of Business Debtorinsure (Brokers) Pty Limited. The purchase price was A\$2 million (US\$2 million) for net tangible assets of nil.

On 1 April 2011, a wholly-owned entity acquired the insurance liabilities and matching investment and other assets of Balboa Insurance Company Limited and its affiliates. The purchase price was US\$708 million for net tangible liabilities of US\$5 million. Intangibles identified as part of this acquisition include US\$558 million of renewal rights.

On 1 April 2011, a wholly-owned entity acquired the entire share capital of CUNA Mutual's Australian operations. The purchase price was A\$21 million (US\$22 million) for net tangible assets of A\$19 million (US\$20 million).

Only 1 July 2011, a wholly-owned entity acquired the assets of Stop Loss Concepts, Inc. The purchase price was US\$13 million for net tangible assets of nil.

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## 29 BUSINESS COMBINATIONS continued

The fair value of assets and liabilities arising from acquisitions in the years ended 31 December 2011 and 31 December 2010 were as follows:

	2011				2010			
	BALBOA US\$M	RENAISSANCE RE US\$M	OTHER US\$M	TOTAL US\$M	NAU US\$M	SECURA US\$M	OTHER US\$M	TOTAL US\$M
Cash and cash equivalents	930	61	7	998	15	171	10	196
Investments	–	209	107	316	234	1,110	167	1,511
Trade and other receivables	8	461	5	474	348	349	51	748
Reinsurance and other recoveries on outstanding claims	–	56	10	66	25	159	6	190
Current tax assets	–	–	–	–	5	1	1	7
Other assets	–	–	–	–	–	25	–	25
Deferred insurance costs	47	33	4	84	45	–	(2)	43
Property, plant and equipment	8	2	1	11	8	–	23	31
Deferred tax assets	129	33	–	162	13	14	9	36
Intangible assets	622	60	11	693	127	–	54	181
<b>Total assets</b>	<b>1,744</b>	<b>915</b>	<b>145</b>	<b>2,804</b>	<b>820</b>	<b>1,829</b>	<b>319</b>	<b>2,968</b>
Trade and other payables	147	226	7	380	118	103	56	277
Current tax liabilities	–	8	–	8	–	–	2	2
Unearned premium	651	124	62	837	180	19	15	214
Outstanding claims	249	314	44	607	134	1,340	128	1,602
Provisions	–	–	–	–	–	–	13	13
Defined benefit plan deficit	–	–	–	–	–	6	–	6
Deferred tax liabilities	80	12	2	94	41	17	10	68
Borrowings	–	–	–	–	32	–	6	38
<b>Total liabilities</b>	<b>1,127</b>	<b>684</b>	<b>115</b>	<b>1,926</b>	<b>505</b>	<b>1,485</b>	<b>230</b>	<b>2,220</b>
<b>Net assets acquired</b>	<b>617</b>	<b>231</b>	<b>30</b>	<b>878</b>	<b>315</b>	<b>344</b>	<b>89</b>	<b>748</b>

Trade and other receivables in the table above are shown at fair value. The gross contractual amounts receivable are as follows:

	2011				2010			
	BALBOA US\$M	RENAISSANCE RE US\$M	OTHER US\$M	TOTAL US\$M	NAU US\$M	SECURA US\$M	OTHER US\$M	TOTAL US\$M
Trade and other receivables	10	461	3	474	348	349	52	749

	2011				2010			
	BALBOA US\$M	RENAISSANCE RE US\$M	OTHER US\$M	TOTAL US\$M	NAU US\$M	SECURA US\$M	OTHER US\$M	TOTAL US\$M
<b>Purchase consideration</b>								
Cash	708	270	36	1,014	573	443	132	1,148
Contingent and deferred consideration	–	(10)	–	(10)	–	–	11	11
<b>Total purchase consideration</b>	<b>708</b>	<b>260</b>	<b>36</b>	<b>1,004</b>	<b>573</b>	<b>443</b>	<b>143</b>	<b>1,159</b>
Fair value of net assets acquired	617	231	30	878	315	344	89	748
Goodwill <sup>(1)</sup>	91	29	6	126	258	99	54	411

(1) Other in 2011 is net of a US\$2 million gain on purchase of a controlled entity.

The above information is presented at the exchange rates prevailing at the date of the acquisitions.

The goodwill is attributable to the future profitability of the acquisitions and the synergies expected to arise within the Group.

The acquired businesses contributed premium revenue of US\$2,042 million and net profit after income tax of US\$292 million to the Group for the period from acquisition to 31 December 2011.

If the acquisitions had occurred on 1 January 2011, consolidated gross earned premium and consolidated net profit after income tax for the year ended 31 December 2011 would have been US\$18,318 million and US\$851 million respectively.

The third party costs associated with acquisitions in the current year were US\$2 million.

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## (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) Employee Share and Option Plan

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 pursuant to the offer document of the Plan is eligible to participate in the Plan.

Under the Plan, ordinary shares of the company are offered at the weighted average market price during the five trading days up to the date of the offer. Likewise, the exercise price for options offered under the Plan is 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 granted 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 as set out in the Plan such as termination of employment or breach of condition. 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 in the financial year or 100% of fixed remuneration at 31 December in 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 shares after three years; and
- conditional rights to the value of 50% of the award will be converted to 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 in that year or 100% of base (cash) salary as at 31 December in 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 shares after three years; and
- conditional rights to the value of 60% of the award amount will be converted to shares after five years, with the exception of senior employees in the Group investment division whose conditional rights continue to be converted to shares after three years.

##### All QIS participants

Further shares are issued to executives and other key senior employees 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 on that date. The ultimate vesting of the conditional rights is also contingent on there being no material deterioration of the relevant entity's return on equity during the vesting period.

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## 30 SHARE BASED PAYMENTS continued

### 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 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 in the financial year or 100% of fixed remuneration at 31 December in the financial year immediately prior to the year in which the cash award was 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.

#### 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 shares. The maximum deferred equity award was based on an amount which was the lesser of 66.67% of the STI award earned in the financial year or 100% of base (cash) salary as at 31 December in the financial year immediately prior to the year in which the cash award is paid. The 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 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 on that date. The ultimate vesting of the conditional rights is also contingent on there being no 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 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 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 on the terms permitted by the Plan as described above to persons who hold options to fund the exercise of 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 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 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 ultimate vesting of the conditional rights is also contingent on there being no material deterioration of the Group's return on equity during the vesting period.

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## 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 QBE shares on the third anniversary of the grant of the conditional rights. Further shares are issued 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 on that date. The ultimate vesting of the conditional rights is also contingent on there being no material deterioration of the Group's return on equity during the vesting period.

### (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:

2011		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
GRANT DATE	DATE EXERCISABLE							
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	106,079	(16,727)	(63,230)	1,254,807
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
18 October 2011	31 December 2012	A\$14.05	–	75,814	–	–	–	75,814
			5,449,915	2,624,588	561,174	(1,497,471)	(409,923)	6,728,283

The weighted average share price at the date of vesting of conditional rights during the year ended 31 December 2011 was A\$17.42 (2010 A\$21.25). The weighted average fair value of conditional rights granted during the year ended 31 December 2011 was A\$17.82 (2010 A\$20.90).

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:

2010		FAIR VALUE PER RIGHT AT GRANT DATE	BALANCE AT 1 JAN 2010	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 2010
GRANT DATE	DATE EXERCISABLE							
2 March 2007	1 March 2010	A\$32.68	733,784	–	–	(731,887)	(1,897)	–
4 April 2007	3 April 2010	A\$32.68	29,412	–	936	(30,348)	–	–
4 March 2008	3 March 2011	A\$24.22	1,218,953	–	78,572	(112,387)	(11,633)	1,173,505
4 April 2008	4 April 2011	A\$27.00	40,767	–	2,893	–	–	43,660
1 January 2009	2 January 2012	A\$25.37	21,403	–	1,519	–	–	22,922
6 March 2009	5 March 2012	A\$17.57	1,945,130	812	127,371	(153,281)	(25,440)	1,894,592
5 March 2010	5 March 2013	A\$20.90	–	1,150,894	79,703	(51,197)	(12,461)	1,166,939
5 March 2010	5 March 2015	A\$20.90	–	1,030,459	71,468	(42,903)	(12,461)	1,046,563
31 March 2010	30 March 2013	A\$20.90	–	49,007	1,860	–	–	50,867
31 March 2010	30 March 2015	A\$20.90	–	49,007	1,860	–	–	50,867
			3,989,449	2,280,179	366,182	(1,122,003)	(63,892)	5,449,915

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## 30 SHARE BASED PAYMENTS continued

### (C) Employee options

During the year, the company granted 20,000 options to one qualifying employee. 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 A\$nil.

During 2010, the company granted 20,000 options to one qualifying employee. The market value of the subject shares at the grant date of the options was A\$410,000. The weighted average fair value of the options at the grant date was A\$1.88 per share.

The market value of all shares underlying the options at the balance date was A\$98 million (2010 A\$158 million). 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	

The weighted average share price at the date of exercise of options during the year was A\$18.09 (2010 A\$21.05). The weighted average remaining contractual life of total options outstanding at 31 December 2011 was 1.9 years (2010 2.8 years).

Number of employee options outstanding at 31 December 2011 were as follows:

YEAR OF EXPIRY	FUTURE PERFORMANCE <sup>(1)</sup>	DCP/STI	OTHER <sup>(2)</sup>	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

(1) The future performance options have been issued subject to the achievement of specific performance criteria. Details of the criteria are provided in the remuneration report.

(2) 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.

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

Details of the number of employee options granted, exercised and cancelled or forfeited during 2010 were as follows:

2010						
GRANT DATE	EXERCISE PRICE	BALANCE AT 1 JAN 2010	GRANTED IN THE YEAR	EXERCISED IN THE YEAR	CANCELLED/ FORFEITED IN THE YEAR	BALANCE AT 31 DEC 2010
3 March 2004	A\$11.08	27,750	–	(3,250)	–	24,500
3 March 2005	A\$8.04	135,583	–	(135,583)	–	–
3 March 2005	A\$11.08	150,310	–	(150,310)	–	–
3 March 2005	A\$14.85	1,896,832	–	(1,758,583)	(10,800)	127,449
8 April 2005	A\$14.85	118,587	–	(118,587)	–	–
2 March 2006	A\$20.44	1,933,956	–	(186,860)	(36,014)	1,711,082
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	1,628,220	–	–	(138,668)	1,489,552
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	2,384,319	–	(51,941)	(186,685)	2,145,693
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	3,100,686	1,518	(161,343)	(49,406)	2,891,455
5 March 2010	A\$20.44	–	20,000	–	–	20,000
		11,656,396	21,518	(2,566,457)	(421,573)	8,689,884
Weighted average exercise price		A\$21.00	A\$20.24	A\$15.03	A\$25.66	A\$22.54

Number of employee options outstanding at 31 December 2010 were as follows:

YEAR OF EXPIRY	FUTURE PERFORMANCE	DCP/STI	OTHER	TOTAL OPTIONS
2011	80,000	278,267	–	358,267
2012	–	2,004,426	–	2,004,426
2013	–	1,611,403	–	1,611,403
2014	–	1,843,786	–	1,843,786
2015	–	2,847,502	–	2,847,502
2024	–	–	24,500	24,500
	80,000	8,585,384	24,500	8,689,884
Vested and exercisable at 31 December 2010	–	164,475	24,500	188,975

## (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 those options and conditional rights granted during the year to 31 December 2011 and 31 December 2010, the following significant assumptions were used:

		OPTIONS		CONDITIONAL RIGHTS	
		2011	2010	2011	2010
Share price on grant date	A\$	<b>17.41</b>	20.50	<b>13.67 – 19.00</b>	20.50 – 20.83
Fair value of instrument at grant date	A\$	<b>nil</b>	1.88	<b>14.05 – 18.44</b>	20.90
Risk-free interest rate	%	<b>4.75</b>	4.25	<b>4.75</b>	4.25
Expected share price volatility	%	<b>20.0</b>	25.0	<b>20.0</b>	25.0
Expected dividend yield	%	<b>7.0</b>	5.0	<b>7.0</b>	5.0
Expected life of instrument	years	<b>0.1</b>	1.0	<b>1.2 – 5.0</b>	3.0 – 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.

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## 30 SHARE BASED PAYMENTS continued

### (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 280,225 (2010 241,960). The weighted average market price on the issue date was A\$13.85 (2010 A\$16.78).

### (F) Share based payment expense

Total expenses arising from share based payment transactions during the year included in underwriting expenses were as follows:

	2011 US\$M	2010 US\$M
Options provided under the DCP	5	7
Conditional rights provided under the DCP	35	29
Shares provided under the SIP	4	4
	<b>44</b>	<b>40</b>

## 31 KEY MANAGEMENT PERSONNEL

### (A) Key management personnel – compensation

	2011 US\$000	2010 US\$000
Short-term employee benefits	19,508	23,342
Post employment benefits	458	513
Other long-term employment benefits	685	144
Share based payments	8,275	7,755
Termination benefits	7,286	1,871
	<b>36,212</b>	<b>33,625</b>

Details of key management personnel and their remuneration are shown in the remuneration report on page 61 to 86.

### (B) Key management personnel – equity instruments

#### (i) Options and conditional rights provided as remuneration

For additional details of equity instruments (options and conditional rights) 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 61 to 86. No equity instruments were provided to non-executive directors.

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## (ii) Conditional rights holdings

Details of the movements in the number of conditional rights to ordinary shares in the company provided as remuneration to the key management personnel are provided below.

2011	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 <sup>(1)</sup>
<b>NUMBER OF RIGHTS</b>						
<b>Executive director</b>						
FM O'Halloran	218,629	105,695	20,223	(43,660)	–	300,887
<b>Other key management personnel</b>						
G Brader	12,862	8,519	1,620	(2,879)	–	20,122
SP Burns	342,692	104,012	30,514	(98,111)	–	379,107
NG Drabsch	97,634	108,435	9,538	(21,310)	–	194,297
C Fagen	19,266	9,484	2,115	(4,591)	–	26,274
D Fogarty	46,873	11,976	4,270	(10,062)	–	53,057
MJ Goodwin	60,203	39,259	8,288	(4,808)	–	102,942
J Neal	185,571	71,985	17,539	(57,200)	–	217,895
BM Nicholls	47,768	16,266	4,784	(9,407)	–	59,411
DA Ramsay	56,258	18,470	5,491	(12,040)	–	68,179
J Rumppler	32,263	42,690	6,006	(6,356)	–	74,603
JM Smith	45,905	14,587	4,438	(9,784)	–	55,146
GB Thwaites	43,368	14,778	4,321	(8,796)	–	53,671
<b>Former key management personnel</b>						
TW Ibbotson <sup>(2)</sup>	69,158	32,638	4,497	(84,837)	–	21,456
V McLenaghan	148,727	59,527	15,960	(25,954)	–	198,260 <sup>(3)</sup>

(1) None of these conditional rights were vested or exercisable at 31 December 2011.

(2) Mr Ibbotson ceased employment on 31 August 2011. As part of his redundancy arrangements, the vesting of 73,211 conditional rights was accelerated into this financial year. The 21,456 conditional rights remaining at 31 December 2011 will vest on 6 March 2016, subject to remuneration committee approval. These conditional rights will continue to accrue dividends under the BSP.

(3) As part of Mr McLenaghan's redundancy arrangements, the vesting of 149,210 conditional rights was accelerated to 21 January 2012. The remaining conditional rights will vest on 6 March 2016, subject to remuneration committee approval. These conditional rights will continue to accrue dividends under the BSP.

2010	BALANCE AT 1 JAN 2010	GRANTED IN THE YEAR	DIVIDENDS ATTACHING IN THE YEAR	VESTED AND TRANSFERRED IN THE YEAR	CANCELLED/ FORFEITED IN THE YEAR	BALANCE AT 31 DEC 2010 <sup>(1)</sup>
<b>NUMBER OF RIGHTS</b>						
<b>Executive director</b>						
FM O'Halloran	138,562	98,014	12,401	(30,348)	–	218,629
<b>Other key management personnel</b>						
SP Burns	268,892	86,827	22,707	(35,734)	–	342,692
NG Drabsch	66,447	39,224	6,469	(14,506)	–	97,634
D Fogarty	33,997	16,970	3,106	(7,200)	–	46,873
MJ Goodwin	27,909	30,040	3,991	(1,737)	–	60,203
TW Ibbotson	45,459	26,194	4,584	(7,079)	–	69,158
V McLenaghan	105,148	48,978	9,856	(15,255)	–	148,727
BM Nicholls	36,886	20,324	3,165	(12,607)	–	47,768
DA Ramsay	37,404	23,212	3,727	(8,085)	–	56,258
J Rumppler	17,715	16,788	2,138	(4,378)	–	32,263
JM Smith	30,431	18,876	3,044	(6,446)	–	45,905
GB Thwaites	27,162	18,336	2,874	(5,004)	–	43,368

(1) None of these conditional rights were vested or exercisable at 31 December 2010.

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## 31 KEY MANAGEMENT PERSONNEL continued

### (iii) DCP option holdings

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.

2011	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 <sup>(1)</sup>	EXERCISE COST AT 31 DEC 2011 A\$000
<b>Executive director</b>							
FM O'Halloran	347,957	-	-	-	347,957	94,771	7,858
<b>Other key management personnel</b>							
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
J 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
<b>Former key management personnel</b>							
TW Ibbotson <sup>(2)</sup>	124,669	-	(27,767)	-	96,902	96,902	2,084
V McLenaghan <sup>(3)</sup>	171,617	-	-	-	171,617	39,141	3,806

(1) All options are exercisable at A\$20.44 with the exception of Mr Brader's options which are exercisable at A\$24.22 and Mr Ibbotson's accelerated options which are shown below.

(2) In accordance with the terms of his departure, Mr Ibbotson's unvested options (71,971) vested on 31 August 2011. All vested options then expire 12 months from this date. 12,088 options are exercisable at A\$32.68, 19,187 options are exercisable at A\$24.22 and 40,696 are exercisable at A\$17.57.

(3) In accordance with the terms of his departure, Mr McLenaghan's unvested options (132,476) vested on 21 January 2012. All vested options then expire 12 months from this date.

2010	BALANCE AT 1 JAN 2010	GRANTED IN THE YEAR	EXERCISED IN THE YEAR	CANCELLED/ FORFEITED IN THE YEAR	BALANCE AT 31 DEC 2010 <sup>(1)</sup>	EXERCISE COST AT 31 DEC 2010 A\$000
<b>Executive director</b>						
FM O'Halloran	466,544	-	(118,587)	-	347,957	7,858
<b>Other key management personnel</b>						
SP Burns	537,075	-	(163,522)	-	373,553	8,313
NG Drabsch	228,899	-	(67,350)	-	161,549	3,591
D Fogarty	95,680	-	(12,014)	-	83,666	1,841
MJ Goodwin	52,039	-	(10,033)	-	42,006	842
TW Ibbotson	124,669	-	-	-	124,669	2,497
V McLenaghan	220,104	-	(48,487)	-	171,617	3,806
BM Nicholls	123,260	-	(19,158)	-	104,102	2,376
DA Ramsay	124,045	-	(33,423)	-	90,622	2,010
J Rumpler	60,727	-	(15,217)	-	45,510	1,022
JM Smith	101,341	-	(27,009)	-	74,332	1,644
GB Thwaites	62,484	-	(8,825)	-	53,659	1,190

(1) None of these options were vested or exercisable at 31 December 2010.

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## (iv) 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 <sup>(1)</sup>	EXERCISE COST AT 31 DEC A\$000
<b>Key management personnel</b>							
SP Burns	<b>2011</b>	<b>80,000</b>	<b>20,000</b>	–	–	<b>100,000<sup>(2)</sup></b>	<b>2,044</b>
	2010	60,000	20,000	–	–	80,000	1,635

(1) 100,000 options are vested and exercisable at 31 December 2011 (2010 nil).

(2) All future performance options vested on 28 February 2011 and were due to expire on 1 April 2011. On 31 March 2011, the expiry date of these options was extended to 31 March 2012.

## (v) 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.

2011	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
<b>Non-executive directors</b>							
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	–
<b>Executive director</b>							
FM O'Halloran	1,404,806	43,660	–	2,000	110,767	1,561,233	1,040,411
<b>Other key management personnel</b>							
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
J Neal	1,199	57,200	–	(10,784)	4,612	52,227	–
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
<b>Former key management personnel</b>							
TW Ibbotson	37,866	84,837	27,767	(100,978)	–	49,492 <sup>(1)</sup>	–
V McLenaghan	266,047	25,954	–	–	19,377	311,378	119,466

(1) Mr Ibbotson ceased employment on 31 August 2011. His interest in shares is shown at that date.

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## 31 KEY MANAGEMENT PERSONNEL continued

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.

2010	INTEREST IN SHARES AT 1 JAN 2010	CONDITIONAL RIGHTS VESTED	OPTIONS EXERCISED	SHARES PURCHASED (SOLD)	DIVIDENDS REINVESTED IN THE YEAR	INTEREST IN SHARES AT 31 DEC 2010	INTEREST IN SHARES AT 31 DEC 2010 SUBJECT TO NON-RECOURSE LOANS
NUMBER OF SHARES							
<b>Non-executive directors</b>							
LF Bleasel AM	57,604	–	–	10,000	–	67,604	–
DM Boyle	8,697	–	–	4,740	–	13,437	–
JM Green	10,281	–	–	14,700	–	24,981	–
IF Hudson	9,221	–	–	1,550	588	11,359	–
BJ Hutchinson AM	63,496	–	–	15,150	–	78,646	–
CLA Irby	15,000	–	–	7,889	–	22,889	–
IYL Lee	26,749	–	–	–	–	26,749	–
<b>Executive director</b>							
FM O'Halloran	1,158,560	30,348	118,587	16,650	80,661	1,404,806	956,504
<b>Other key management personnel</b>							
SP Burns	54,695	35,734	163,522	(193,522)	10,713	71,142	3,792
NG Drabsch	184,682	14,506	67,350	(106,485)	14,861	174,914	168,786
D Fogarty	49,827	7,200	12,014	(12,014)	4,523	61,550	21,643
MJ Goodwin	13,017	1,737	10,033	(10,033)	1,047	15,801	6,532
TW Ibbotson	30,787	7,079	–	–	–	37,866	–
V McLenaghan	202,305	15,255	48,487	–	–	266,047	109,809
BM Nicholls	33,935	12,607	19,158	(65,700)	–	–	–
DA Ramsay	215,952	8,085	33,423	–	–	257,460	92,318
J Rumpler	58,595	4,378	15,217	–	–	78,190	56,975
JM Smith	21,149	6,446	27,009	(32,009)	–	22,595	–
GB Thwaites	31,137	5,004	8,825	(1,761)	3,192	46,397	2,382

### (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

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
<b>Executive director</b>						
FM O'Halloran	3,032	–	–	3,032	228	3,032
<b>Other key management personnel</b>						
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
<b>Former key management personnel</b>						
TW Ibbotson	–	412	(412)	–	–	412
V McLenaghan <sup>(1)</sup>	815	–	(95)	720	55	815

(1) Mr McLenaghan repaid his loan on 3 February 2012.

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

	BALANCE AT 1 JAN 2010 A\$000	LOANS MADE IN THE YEAR A\$000	REPAYMENTS A\$000	BALANCE AT 31 DEC 2010 A\$000	INTEREST NOT CHARGED A\$000	HIGHEST BALANCE IN THE PERIOD A\$000
<b>2010</b>						
<b>Executive director</b>						
FM O'Halloran	1,271	1,761	–	3,032	168	3,032
<b>Other key management personnel</b>						
NG Drabsch	–	1,000	(1,000)	–	5	1,000
MJ Goodwin	–	149	(149)	–	–	149
V McLenaghan	142	720	(47)	815	47	862
DA Ramsay	516	496	(64)	948	58	1,012
J Rumppler	13	226	(10)	229	13	239
JM Smith	–	401	(401)	–	4	401
GB Thwaites	121	131	(5)	247	15	252

## (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.

	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
<b>2011</b>						
<b>Executive director</b>						
FM O'Halloran	4,227	–	–	4,227	318	4,227
<b>Other key management personnel</b>						
SP Burns	22	–	(22)	–	–	22
NG Drabsch	1,979	–	(23)	1,956	148	1,979
C Fagen	267	–	–	267	20	267
D Fogarty	87	–	–	87	7	87
MJ Goodwin	35	–	–	35	3	35
DA Ramsay	876	–	(70)	806	63	876
J Rumppler	349	–	(33)	316	25	349
GB Thwaites	43	–	–	43	3	43
<b>Former key management personnel</b>						
V McLenaghan <sup>(1)</sup>	881	–	–	881	66	881

(1) Mr McLenaghan repaid his loan on 3 February 2012.

## (iii) Other loans

Under the terms of his contract of employment, and as a result of his relocation to Australia from the UK, Mr Neal benefited from an interest free loan of A\$2,736,000 to purchase residential property. The loan agreement commenced on 16 December 2010 and the loan was repaid on 18 May 2011. Interest not charged on this loan amounted to A\$80,000.

## (D) Other transactions with key management personnel and their personally related parties

### FM O'Halloran – retirement benefits

Mr O'Halloran joined QBE in June 1976. 14 of his years with the Group have been in the position of chief executive officer, with four years as director of operations, seven years as director of finance, five years as chief financial officer and the remainder as Group financial controller. On 1 January 1998, a controlled entity entered into a retirement benefit arrangement with Mr O'Halloran, which is in addition to his entitlement under the QBE Australia defined benefit plan. This arrangement was revised during 2009. On his retirement, he will receive a lump sum payment of 100% of his fixed remuneration for the year prior to the date of his retirement. As a condition of this arrangement, Mr O'Halloran has entered into a non-compete agreement for three years from the date of his retirement.

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## 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(M).

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 US\$1,412 million (2010 US\$1,075 million) were issued in support of the Group's participation in Lloyd's. 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 totalling US\$44 million (2010 US\$101 million). A cash call would be made first on the assets held in trust funds and only 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.

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 US\$36 million (2010 US\$122 million) may be payable in the future.

## 33 CAPITAL EXPENDITURE COMMITMENTS

	2011 US\$M	2010 US\$M
Capital expenditure commitments contracted but not provided for in the financial statements (not later than one year)	39	13

## 34 OPERATING LEASE COMMITMENTS

	2011 US\$M	2010 US\$M
Payable:		
Not later than one year	70	80
Later than one year but not later than five years	164	172
Later than five years	231	254
Total future minimum lease payments under non-cancellable operating leases	465	506

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## 35 REMUNERATION OF AUDITORS

	2011 US\$000	2010 US\$000
<b>PricewaterhouseCoopers (PwC) – Australian firm<sup>(1)</sup></b>		
Audit or review of financial reports of the parent entity	1,374	1,149
Audit of financial reports of controlled entities	2,844	2,422
Audit of statutory returns	685	404
Other audit assurance services	763	164
Taxation services	261	8
Actuarial services	106	56
Advisory services	31	28
	<b>6,064</b>	4,231
<b>Related practices of PwC – Australian firm (including overseas PwC firms)<sup>(1)</sup></b>		
Audit of financial reports of controlled entities	8,747	7,129
Audit of statutory returns	1,650	1,006
Other audit assurance services	67	470
Taxation services	1,117	994
Actuarial services	720	9
Advisory services	3,164	22
	<b>15,465</b>	9,630
	<b>21,529</b>	13,861
Audit and assurance services	16,130	12,744
Other services	5,399	1,117
	<b>21,529</b>	13,861
<b>Other auditors</b>		
Audit of financial reports of controlled entities	626	410

(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.

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## 36 RELATED PARTIES

	COUNTRY OF INCORPORATION/FORMATION	EQUITY HOLDING	
		2011 %	2010 %
<b>(A) Parent entity</b>			
QBE Insurance Group Limited	Australia		
<b>(B) Controlled entities<sup>(1)</sup></b>			
ALS Green Slip Group Pty Limited	Australia	<b>100.00</b>	100.00
Anex Jenni & Partner AG	Switzerland	<b>100.00</b>	100.00
Atlasz Real Estate and Management Company Limited (in liquidation)	Hungary	<b>100.00</b>	100.00
Austral Mercantile Collections Pty Limited	Australia	<b>100.00</b>	100.00
Australian Aviation Underwriting Pool Pty Limited	Australia	<b>100.00</b>	100.00
BCO Insurance Agency of Texas Inc	US	<b>100.00</b>	100.00
BCO Surplus Lines Inc	US	<b>100.00</b>	100.00
Blue Ridge Indemnity Company	US	<b>100.00</b>	100.00
Blue Ridge Insurance Company	US	–	100.00
British Marine Managers Limited	UK	<b>100.00</b>	100.00
Burnett & Company Inc	US	<b>100.00</b>	100.00
Burnett Holdings Inc	US	<b>100.00</b>	100.00
Burnett Insurance Management Services Inc	US	<b>100.00</b>	100.00
Business Debtorinsure (Brokers) Pty Limited	Australia	<b>100.00</b>	–
CHU Underwriting Agencies (UK) Limited	UK	<b>100.00</b>	100.00
CHU Underwriting Agencies Pty Limited	Australia	<b>100.00</b>	100.00
Community Association Underwriters of America Inc	US	<b>100.00</b>	100.00
Corporate Underwriting Agencies Pty Limited	Australia	<b>100.00</b>	100.00
CUNA Mutual Life Australia Limited	Australia	<b>100.00</b>	–
Davis Garvin Agency Inc	US	–	100.00
Deep South of California Inc	US	<b>100.00</b>	100.00
Deep South Surplus Inc	US	<b>100.00</b>	100.00
Deep South Surplus of Florida LLC	US	<b>100.00</b>	100.00
Deep South Surplus of Texas Management LLC	US	<b>100.00</b>	100.00
Deep South Surplus of Texas LP <sup>(3)</sup>	US	–	–
Elders Insurance (Underwriting Agency) Pty Limited	Australia	<b>75.00</b>	75.00
Elders Insurance Agencies Pty Limited	Australia	<b>100.00</b>	100.00
Elders Insurance Limited	Australia	<b>100.00</b>	100.00
Ensign Dedicated No.1 Limited	UK	–	100.00
Equator Reinsurances Limited	Bermuda	<b>100.00</b>	100.00
FAI Insurances (Fiji) Limited	Fiji	<b>100.00</b>	100.00
General Casualty Company of Wisconsin	US	<b>100.00</b>	100.00
General Casualty Insurance Company	US	<b>100.00</b>	100.00
Greenhill Baia Underwriting GmbH	Germany	<b>100.00</b>	100.00
Greenhill International Insurance Holdings Limited	UK	<b>100.00</b>	100.00
Greenhill Sturge Underwriting Limited	UK	<b>100.00</b>	100.00
Greenhill Underwriting Espana Limited	UK	<b>100.00</b>	100.00
Hoosier Insurance Company	US	<b>100.00</b>	100.00
Hyfield Company Limited <sup>(2)</sup>	Thailand	<b>49.00</b>	49.00
Invivo Medical Pty Limited	Australia	<b>50.00</b>	50.00
Iron Trades Management Services Limited	UK	<b>100.00</b>	100.00
Lantana Insurance Limited	Bermuda	<b>100.00</b>	–
Lifeco Re Limited	UK	<b>100.00</b>	100.00
Lifeco SRO	Czech Republic	<b>100.00</b>	100.00
Limit Corporate Members Limited	UK	<b>100.00</b>	100.00
Limit Holdings Limited	UK	<b>100.00</b>	100.00
Limit No 1 Limited	UK	–	100.00
Limit No 2 Limited	UK	<b>100.00</b>	100.00

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

	COUNTRY OF INCORPORATION/ FORMATION	EQUITY HOLDING	
		2011 %	2010 %
Limit No 3 Limited	UK	–	100.00
Limit No 4 Limited	UK	–	100.00
Limit No 5 Limited	UK	–	100.00
Limit No 6 Limited	UK	–	100.00
Limit No 7 Limited	UK	100.00	100.00
Limit No 10 Limited	UK	100.00	100.00
Mantis Reef II Limited <sup>(3)</sup>	Cayman Is	–	–
Mantis Reef II Pledge Limited <sup>(3)</sup>	Cayman Is	–	–
MBP Holdings Limited	UK	100.00	100.00
Mortgage & Auto Solutions Inc	US	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	–
Newport Management Corporation	US	100.00	–
North Pointe Casualty Insurance Company	US	–	100.00
North Pointe Financial Services Inc	US	100.00	100.00
North Pointe Insurance Company	US	100.00	100.00
NP Capital Trust 1 <sup>(3)</sup>	US	–	–
Operador Logistico de Soat-Ols SA	Ecuador	50.99	50.99
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	60.00	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 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 (formerly CNA Aseguradora de Riesgos del Trabajo SA)	Argentina	100.00	100.00
QBE AS (in liquidation)	Slovakia	100.00	100.00
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 <sup>(3)</sup>	Jersey	–	–
QBE Capital Funding II LP <sup>(3)</sup>	Jersey	–	–
QBE Capital Funding III Limited	Jersey	100.00	–
QBE Capital Funding IV Limited	Jersey	100.00	–
QBE Compania Argentina de Seguros SA	Argentina	100.00	–
QBE Corporate Limited	UK	100.00	100.00
QBE Denmark A/S (formerly QBE Nordic Aviation Insurance A/S)	Denmark	100.00	100.00
QBE de Mexico Compania de Seguros SA de CV	Mexico	99.99	99.99

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## 36 RELATED PARTIES continued

	COUNTRY OF INCORPORATION/FORMATION	EQUITY HOLDING	
		2011 %	2010 %
QBE Chile Seguros Generates	Chile	100.00	–
QBE Employee Share Trust <sup>(3)</sup>	Australia	–	–
QBE European Operations plc (formerly QBE International Holdings (UK) 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 (formerly Sterling National Corporation)	US	100.00	100.00
QBE FIRST Enterprises LLC (formerly Sterling National Enterprises LLC)	US	100.00	100.00
QBE FIRST Insurance Agency Inc (formerly Sterling National Insurance Agency Inc)	US	100.00	100.00
QBE FIRST Property Tax Solutions LLC (formerly Sterling Property Tax Solutions LLC)	US	100.00	100.00
QBE Funding V Limited	Jersey	100.00	100.00
QBE Funding Trust V <sup>(3)</sup>	Jersey	–	–
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	51.00
QBE Insurance (Philippines) Inc	Philippines	59.00	59.00
QBE Insurance (PNG) Limited	PNG	100.00	100.00
QBE Insurance (Thailand) Co Limited <sup>(2)</sup>	Thailand		
Thai resident entities		23.67	23.67
Non-Thai resident entities		24.87	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 (formerly Minster Court Asset Management (UK) Limited)	UK	100.00	100.00
QBE Investment Management Pty Limited (formerly Minster Court Asset 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 <sup>(3)</sup>	Ireland	–	–
QBE Latin America Insurance Holdings SL	Spain	100.00	100.00
QBE Lenders' Mortgage Insurance Limited	Australia	100.00	100.00
QBE Makedonija <sup>(4)</sup>	Macedonia	65.23	65.23
QBE Management (Ireland) Limited	Ireland	100.00	100.00
QBE Management Company (Bermuda) Limited	Bermuda	100.00	100.00
QBE Management Inc	US	100.00	100.00
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

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

	COUNTRY OF INCORPORATION/ FORMATION	EQUITY HOLDING	
		2011 %	2010 %
QBE Marine Underwriting Agency Pte Limited	Singapore	100.00	70.00
QBE Mortgage Insurance (Asia) Limited	Hong Kong	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 (Europe) Limited	Ireland	100.00	100.00
QBE Reinsurance (UK) Limited	UK	100.00	100.00
QBE Reinsurance Corporation	US	100.00	100.00
QBE Seguros SA	Colombia	97.76	97.63
QBE Seguros Colonial SA (formerly Colonial Compania de Seguros y Reaseguros 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 Holdings Inc	US	100.00	–
QBE Stonington Services Inc	US	100.00	–
QBE UK Finance I Limited (in liquidation)	UK	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 <sup>(3)</sup>	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	–
RGM Asegurando LTDA	Colombia	51.00	51.00
Ridgwell Fox & Partners (Underwriting Management) Limited	UK	100.00	100.00
Secura NV	Belgium	100.00	100.00
Seattle Specialty Insurance Services Inc	US	100.00	100.00
Sinkaonamahasarn Company Limited <sup>(2)</sup>	Thailand	49.00	49.00
SIU LLC	US	100.00	100.00
SLG Benefits and Insurance LLC	US	100.00	100.00
Southeastern Claims Services Inc	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
SRL Underwriting Limited	UK	–	100.00
Stahl Intermediaries Inc	US	100.00	100.00
Standfast Corporate Underwriters Limited	UK	100.00	100.00
Star Trust <sup>(3)</sup>	Cayman Is	–	–
Stonington Insurance Company	US	100.00	–
Stonington Lloyds Insurance Company	US	100.00	–
Strakh-Consult (in liquidation)	Ukraine	100.00	100.00
The MiniBus & Coach Club Limited	UK	100.00	100.00

# NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2011

## 36 RELATED PARTIES continued

	COUNTRY OF INCORPORATION/FORMATION	EQUITY HOLDING	
		2011 %	2010 %
Torch Dedicated Corporate Member Limited	UK	–	100.00
Travelon Pty Limited	Australia	<b>100.00</b>	100.00
Underwriting Agencies of Australia (Holdings) Pty Limited	Australia	<b>97.50</b>	92.50
Underwriting Agencies of Australia Pty Limited	Australia	<b>97.50</b>	92.50
Unigard Indemnity Company	US	<b>100.00</b>	100.00
Unigard Insurance Company	US	<b>100.00</b>	100.00
United Security Insurance Company	US	–	100.00
Universal Underwriting Agencies Pty Limited	Australia	<b>100.00</b>	100.00
Visionex 2000 Limited	UK	<b>100.00</b>	100.00
Westwood Insurance Agency	US	<b>100.00</b>	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, NP Capital Trust 1, 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) The shareholding in QBE Makedonija equates to 73.50% (2010 73.50%) of the voting rights.

(5) All equity in controlled entities is held in the form of shares or through contractual arrangements.

### (C) Associates

	COUNTRY OF INCORPORATION	INVESTMENT	
		2011 %	2010 %
Pacific Re Limited	Papua New Guinea	<b>30.97</b>	30.97
QBE Del Istmo Reinsurance Company Inc	Panama	<b>38.37</b>	38.37
Raheja QBE General Insurance Company	India	<b>26.00</b>	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
Related party transactions with key management personnel	Note 31(D)
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

FOR THE YEAR ENDED 31 DECEMBER 2011

## 37 PARENT ENTITY FINANCIAL INFORMATION

### (A) Summarised financial data of QBE Insurance Group Limited (the company)

	COMPANY	
	2011 US\$M	2010 US\$M
Profit for the year	969	1,383
Other comprehensive income for the year	11	14
Total comprehensive income	980	1,397
Assets due within 12 months <sup>(1)</sup>	325	579
Shares in controlled entities	17,410	15,986
Total assets	17,735	16,565
Liabilities payable within 12 months <sup>(2)</sup>	3,153	2,595
Borrowings	2,133	2,097
Total liabilities	5,286	4,692
Net assets	12,449	11,873
Share capital	8,939	7,972
Equity component of hybrid securities	132	132
Options reserve	90	78
Retained profits	3,288	3,691
Total equity	12,449	11,873

(1) Includes amounts due from QBE Group companies of US\$304 million (2010 US\$480 million).

(2) Includes amounts due to QBE Group companies of US\$2,956 million (2010 US\$2,428 million).

### (B) Guarantees and contingent liabilities

The company had the following contingent liabilities:

	COMPANY	
	2011 US\$M	2010 US\$M
Letters of credit issued in support of the Group's participation in Lloyd's of London	1,412	1,075
Letters of credit issued in support of insurance provisions of controlled entities	1,175	745
Guarantees to investors in hybrid securities	850	850
Guarantees to investors in capital securities	1,016	1,018

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 2011 (2010 nil).



## DIRECTORS' DECLARATION

In the directors' opinion:

- (a) the financial statements and notes set out on pages 90 to 161 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 2011 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 chief executive officer and chief financial officer required by section 295A of the *Corporations Act 2001*.

Signed in SYDNEY this 28th day of February 2012 in accordance with a resolution of the directors.



**BJ Hutchinson AM**  
Director



**FM O'Halloran**  
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 2011, 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 Group). The Group comprises the company and the entities it controlled at the year 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 opinions.

## 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 Group's financial position as at 31 December 2011 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 61 to 86 of the directors' report for the year ended 31 December 2011. 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 2011 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 the QBE Insurance Group Limited (the Group) for the year ended 31 December 2011 included on the QBE Insurance Group Limited web site. The Group'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

KG Smith  
Partner

Sydney  
28 February 2012

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# 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, 4 April 2012

City Recital Hall, Angel Place, 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: +61 2 8280 7158

Facsimile: +61 2 9287 0303

Internet: [www.linkmarketservices.com.au](http://www.linkmarketservices.com.au)

(Link investor service centre website)

Email: [registrars@linkmarketservices.com.au](mailto:registrars@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. Please quote your HIN.

## 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 at the Link investor service centre website. You will be asked to provide either your SRN or HIN, your surname and postcode.

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.

## Annual report mailing list

Amendments to the Corporations Act 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](http://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 “communication options” on the Link investor service centre website.

The half yearly results summary to 30 June 2012 will be mailed with the interim dividend. The next annual report for the year ending 31 December 2012 will be distributed in March 2013. QBE does not produce a concise financial report.



## SHAREHOLDER INFORMATION

### 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.

### Conduit foreign income (CFI)

Shareholders will receive CFI credits in respect of the whole unfranked portion of QBE dividends. These credits exempt non-resident shareholders from Australian withholding tax.

### 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.

### 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.

### 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

Internet: [www.qbe.com](http://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.

# SHAREHOLDER INFORMATION

## RECENT QBE DIVIDENDS

DATE PAID	TYPE	RECORD DATE	AUSTRALIAN CENTS PER SHARE	FRANKING %
12 April 2002	final	25 March 2002	13.5	15
3 October 2002	interim	13 September 2002	16.5	12
11 April 2003	final	19 March 2003	18.5	12
25 September 2003	interim	1 September 2003	20.0	15
25 March 2004	final	9 March 2004	22.0	30
20 September 2004	interim	30 August 2004	24.0	50
23 March 2005	final	7 March 2005	30.0	50
16 September 2005	interim	29 August 2005	33.0	50
29 March 2006	final	10 March 2006	38.0	50
14 September 2006	interim	1 September 2006	40.0	60
2 April 2007	final	14 March 2007	55.0	60
21 September 2007	interim	10 September 2007	57.0	60
26 March 2008	final	6 March 2008	65.0	50
17 September 2008	interim	1 September 2008	61.0	20
31 March 2009	final	11 March 2009	65.0	20
22 September 2009	interim	1 September 2009	62.0	20
30 March 2010	final	10 March 2010	66.0	20
22 September 2010	interim	30 August 2010	62.0	15
11 April 2011	final	10 March 2011	66.0	10
23 September 2011	interim	31 August 2011	62.0	10

## TOP 20 SHAREHOLDERS AS AT 31 JANUARY 2012

NAME	NUMBER OF SHARES	% OF TOTAL <sup>(1)</sup>
HSBC Custody Nominees (Australia) Limited	366,282,151	32.83
National Nominees Limited	159,359,805	14.29
JP Morgan Nominees Australia Limited	146,145,720	13.10
Citicorp Nominees Pty Limited	52,970,949	4.75
Cogent Nominees Pty Limited	16,370,133	1.47
JP Morgan Nominees Australia Limited	12,755,198	1.14
Australian Foundation Investment Company Limited	5,884,655	0.53
AMP Life Limited	5,791,835	0.52
Perpetual Trustee Company Limited	4,657,678	0.42
Argo Investments Limited	3,799,668	0.34
UBS Wealth Management Australia Nominees Pty Ltd	3,660,410	0.33
Navigator Australia Ltd	2,808,226	0.25
QBE Management Services Pty Ltd <sup>(2)</sup>	2,752,324	0.25
Bond Street Custodians Limited	2,742,022	0.25
Milton Corporation Limited	2,705,729	0.24
Queensland Investment Corporation	2,411,641	0.22
RBC Dexia Investor Services Australia Nominees Pty Limited	2,266,152	0.20
Nulis Nominees (Australia) Limited	1,931,086	0.17
Custodial Services Limited	1,777,786	0.16
M F Custodians Ltd	1,734,004	0.16
Total	798,807,172	71.62

(1) Percentage of total at date of notice.

(2) Reflects amounts held in trust for staff under the terms of employee share plans.

# SHAREHOLDER INFORMATION

## QBE SUBSTANTIAL SHAREHOLDERS AS AT 31 JANUARY 2012

NAME	NUMBER OF SHARES	% OF TOTAL <sup>(1)</sup>	DATE OF NOTICE
Aberdeen Asset Management plc (and its associated entities)	154,524,837	14.14	14 September 2011
Commonwealth Bank of Australia Limited	66,763,270	6.11	22 June 2011

(1) Percentage of total at date of notice.

## DISTRIBUTION OF SHAREHOLDERS AND SHAREHOLDINGS AS AT 31 JANUARY 2012

SIZE OF HOLDING	NUMBER OF SHAREHOLDERS	%	NUMBER OF SHARES	%
1 to 1,000	96,244	58.95	45,850,008	4.11
1,001 to 5,000	57,639	35.30	123,688,421	11.09
5,001 to 10,000	6,187	3.79	43,410,144	3.89
10,001 to 100,000	3,049	1.87	66,566,744	5.97
100,001 and over	153	0.09	836,030,375	74.94
Total	163,272	100.00	1,115,545,692	100.00

## SHAREHOLDINGS OF LESS THAN A MARKETABLE PARCEL AS AT 31 JANUARY 2012

	SHAREHOLDERS		SHARES	
	NUMBER	% OF TOTAL	NUMBER	% OF TOTAL
Holdings of 44 or fewer shares	4,099	2.51	99,832	0.01

# FINANCIAL CALENDAR AND ASX ANNOUNCEMENTS

## FINANCIAL CALENDAR

### 2012

28 February	Profit and dividend announcement for the year ended 31 December 2011 Annual report available on website
5 March	Notice of meeting and proxy form mailed to shareholders Annual report mailed as requested
5 March	Shares begin trading ex dividend
9 March	Record date for determining shareholders' entitlement to 2011 final dividend
30 March	2011 final dividend paid
4 April	Annual General Meeting
30 June	Half year end
17 August*	Profit and dividend announcement for the six months ending 30 June 2012
24 August*	Shares begin trading ex dividend
30 August*	Record date for determining shareholders' entitlement to 2012 interim dividend
24 September*	2012 interim dividend paid
31 December	Year end

\* Dates shown are provisional and may be subject to change.

## MATERIAL ANNOUNCEMENTS TO THE ASX

### 2012

12 January	Provided market update on 2011 preliminary result and 2012 outlook
12 January	Announced trading halt

### 2011

22 December	Change in substantial holding for Elders
22 December	Change in substantial holding for Austbrokers
28 November	Issued provisional 2012 financial calendar
25 October	CFO presentation to Citi conference
22 September	Announced Standard & Poor's reaffirmation of their QBE LMI rating as AA- (stable)
25 August and 9 September	Announced interim dividend details
19 August	Announced half year result
11 August	Announced new Group executive appointment
21 July	Announced changes to divisional reporting structure
2 June	Announced completed acquisition of Balboa insurance portfolio
19 May	Announced issue of GBP subordinated debt
18 May	Announced issue of US\$ subordinated debt
6 April	Announced issue of shares for dividend underwriting
1 April	Announced completed acquisition of the Australian operations of CUNA Mutual
21 March	Trading policy update
15 March	Announced commencement of a sponsored Level 1 depository receipts program
9 March	Announced DCP option exercise
7 March	Announced completed acquisition of Renaissance Re's insurance operations in the US
4 March	AGM notice of meeting
1, 14 and 21 March	Announced final dividend and dividend pricing details
28 February	Announced 2010 results
8, 10 February, 4, 29 March and 6 April	Announced changes to directors' interests in the company
4 February, 14 March and 14 June	Market update
3 February	Announced trading halt pending market announcement
27 January	Announced acquisition of the Australian operations of CUNA Mutual

# 10 YEAR HISTORY

FOR THE YEAR ENDED 31 DECEMBER

		2011	2010	2009	2008	2007	2006	2005	2004	2003	2002
Gross written premium	US\$M	<b>18,291</b>	13,629	11,239	11,015	10,391	7,839	7,171	6,484	5,407	4,184
Gross earned premium	US\$M	<b>17,840</b>	13,432	10,943	10,773	10,353	7,610	6,990	6,340	5,061	3,899
Net earned premium	US\$M	<b>15,359</b>	11,362	9,446	9,293	8,552	6,166	5,630	5,016	3,909	3,056
Claim ratio	%	<b>68.2</b>	59.9	60.3	57.6	54.3	55.8	59.9	61.3	63.3	67.6
Commission ratio	%	<b>14.9</b>	15.5	16.2	17.2	18.5	17.0	16.9	17.5	18.2	17.7
Expense ratio	%	<b>13.7</b>	14.3	13.1	13.7	13.1	12.5	12.3	12.4	12.3	12.4
Combined operating ratio	%	<b>96.8</b>	89.7	89.6	88.5	85.9	85.3	89.1	91.2	93.8	97.7
Investment income											
before investment gains/losses	US\$M	<b>955</b>	660	838	1,237	839	575	470	421	252	224
after investment gains/losses	US\$M	<b>776</b>	659	1,159	1,199	1,132	732	631	486	323	142
Financing and other costs	US\$M	<b>275</b>	222	191	223	189	115	87	102	56	40
Insurance profit	US\$M	<b>1,085</b>	1,703	1,609	1,830	1,895	1,351	982	686	406	220
Insurance profit to net earned premium	%	<b>7.1</b>	15.0	17.0	19.7	22.2	21.9	17.4	13.7	10.4	7.2
Operating profit											
before income tax	US\$M	<b>868</b>	1,551	1,891	2,028	2,135	1,521	1,161	825	495	168
after income tax and non-controlling interests	US\$M	<b>704</b>	1,278	1,532	1,558	1,612	1,121	832	634	370	151
Number of shares on issue <sup>(1)</sup>	millions	<b>1,116</b>	1,052	1,025	987	886	819	794	745	672	615
Shareholders' funds	US\$M	<b>10,386</b>	10,311	9,164	7,834	7,435	4,962	3,735	3,155	2,491	1,657
Total assets	US\$M	<b>46,737</b>	41,386	36,723	33,967	34,737	25,079	21,753	19,592	15,372	11,538
Net tangible assets per share <sup>(1)</sup>	US\$	<b>3.92</b>	4.76	4.63	4.02	5.99	4.70	3.49	3.21	3.14	2.22
Borrowings to shareholders' funds <sup>(1)</sup>	%	<b>45.8</b>	31.5	29.1	32.9	40.8	37.6	41.8	44.8	40.3	49.3
Basic earnings per share <sup>(1)</sup>	US cents	<b>64.7</b>	123.2	152.1	174.1	187.7	139.7	108.6	91.1	56.0	23.1
Diluted earnings per share	US cents	<b>61.3</b>	119.6	149.9	172.2	181.8	131.1	99.7	80.7	50.2	23.5
Returns on average shareholders' funds	%	<b>6.8</b>	13.1	18.0	22.3	26.0	25.8	24.2	22.5	17.8	10.1
Dividend per share	Australian cents	<b>87.0</b>	128.0	128.0	126.0	122.0	95.0	71.0	54.0	42.0	35.0
Dividend payout	A\$M	<b>956</b>	1,336	1,306	1,187	1,068	774	556	392	281	213
Cash flow from operations	US\$M	<b>2,139</b>	1,362	1,344	1,886	1,988	1,541	1,514	1,561	1,353	819
Total investments and cash <sup>(2)</sup>	US\$M	<b>28,024</b>	25,328	22,448	19,995	21,552	15,755	12,891	11,709	8,888	6,454

(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

<b>Accident year experience</b>	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.
<b>Attritional claims ratio</b>	Total claims with a net cost of less than US\$2.5 million as a percentage of net earned premium.
<b>Broker</b>	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.
<b>Capacity</b>	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.
<b>Casualty insurance</b>	Insurance that is primarily concerned with the losses caused by 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.
<b>Catastrophe reinsurance</b>	A form of excess of loss reinsurance that, subject to specified limits, indemnifies the insured for the amount of loss in excess of a specified retention with respect to an accumulation of claims resulting from a catastrophe event or series of events.
<b>Claim</b>	The amount payable under a contract of insurance or reinsurance arising from a loss relating to an insured event.
<b>Claims incurred</b>	The aggregate of all claims paid during an accounting period adjusted by the change in the claims provision for that accounting period.
<b>Claims provision</b>	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.
<b>Claims ratio</b>	Net claims incurred as a percentage of net earned premium.
<b>Combined operating ratio</b>	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.
<b>Commission ratio</b>	Net commission expense as a percentage of net earned premium.
<b>Deferred acquisition costs</b>	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.
<b>Excess of loss reinsurance</b>	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.
<b>Expense ratio</b>	Underwriting and administrative expenses as a percentage of net earned premium.
<b>Facultative reinsurance</b>	The reinsurance of individual risks through a transaction between the reinsurer and the cedent (usually the primary insurer) involving a specified risk.
<b>General insurance</b>	Generally used to describe non-life insurance business including property and casualty insurance.
<b>Gross claims incurred</b>	The amount of claims incurred during an accounting period before deducting reinsurance recoveries.
<b>Gross earned premium (GEP)</b>	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.
<b>Gross written premium (GWP)</b>	The total premium on insurance underwritten by an insurer or reinsurer during a specified period, before deduction of reinsurance premium.

# GLOSSARY OF INSURANCE TERMS

<b>Incurred but not reported (IBNR)</b>	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.
<b>Insurance profit</b>	The sum of the underwriting profit (loss) and investment income on assets backing policyholders' funds.
<b>Insurance solvency ratio</b>	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.
<b>Inward reinsurance</b>	The reinsurance or assumption of risks written by another insurer.
<b>Large individual risk and catastrophe claims ratio</b>	The aggregate of claims each with a net cost of US\$2.5 million or more as a percentage of net earned premium.
<b>Lenders' mortgage insurance (LMI)</b>	A policy which protects the lender (e.g. a bank) against non-payment or default on a residential property loan.
<b>Lloyd's</b>	Insurance and reinsurance market in London. It is not a company but is a society of individuals and corporate underwriting members.
<b>Long-tail</b>	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.
<b>Maximum event retention (MER)</b>	The largest loss to which an insurer will be exposed (taking into account the probability of that loss at a return period of one in 250 years) due to a concentration of risk exposures, after netting off any potential reinsurance assets and inward and outward reinstatement premiums.
<b>Net claims incurred</b>	The amount of claims incurred during an accounting period after deducting reinsurance recoveries.
<b>Net claims ratio</b>	Net claims incurred as a percentage of net earned premium.
<b>Net earned premium (NEP)</b>	Net written premium adjusted by the change in net unearned premium for a year.
<b>Net investment income</b>	Gross investment income net of foreign exchange gains and losses and investment expenses.
<b>Net underwriting profit (loss)</b>	The amount of profit (loss) from insurance activities exclusive of net investment income and capital gains or losses.
<b>Net written premium (NWP)</b>	The total premium on insurance underwritten by an insurer during a specified period after the deduction of premium applicable to reinsurance.
<b>Outstanding claims provision</b>	The amount of provision established for claims and related claims expenses that have occurred but have not been paid.
<b>Policyholders' funds</b>	Those financial assets held to fund the insurance provisions of the Group.
<b>Premium</b>	Amount payable by the insured or reinsured in order to obtain insurance or reinsurance protection.
<b>Proportional reinsurance</b>	A type of reinsurance in which the original insurer and the reinsurer share claims in the same proportion as they share premiums.
<b>Recoveries</b>	The amount of claims recovered from reinsurance, third parties or salvage.
<b>Reinsurance</b>	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 cedent or ceding company and is said to place outward reinsurance.



## GLOSSARY OF INSURANCE TERMS

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<b>Reinsurance to close</b>	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.
<b>Reinsurer</b>	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.
<b>Retention</b>	That amount of liability for which an insurance company will remain responsible after it has completed its reinsurance arrangements.
<b>Retrocession</b>	Reinsurance of a reinsurer by another reinsurance carrier.
<b>Survival ratio</b>	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.
<b>Syndicate</b>	A member, or group of members, underwriting insurance business at Lloyd's through the agency of a managing agent.
<b>Treaty reinsurance</b>	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.
<b>Underwriting</b>	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.
<b>Underwriting expenses</b>	The aggregate of policy acquisition costs, excluding commissions, and the portion of administrative, general and other expenses attributable to underwriting operations.
<b>Underwriting profit (loss)</b>	The amount of profit (loss) from insurance activities exclusive of net investment income and capital gains or losses.
<b>Underwriting year</b>	The year in which the contract of insurance commenced or was underwritten.
<b>Unearned premium</b>	The portion of a premium representing the unexpired portion of the contract term as of a certain date.
<b>Written premium</b>	Premiums written, whether or not earned, during a given period.

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