2018 HALF YEAR REPORT

QBE INSURANCE GROUP LIMITED

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QBE Insurance Group Limited Half Year Report to 30 June 2018
ABN 28 008 485 014

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

2018 half year snapshot[1]

Shareholder highlights

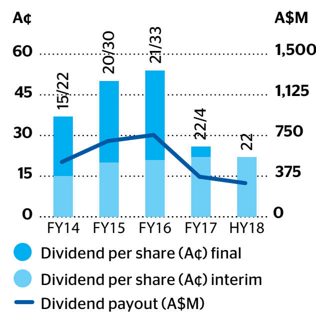
Dividend per share (A¢)

22¢

Unchanged from HY17

Dividend payout (A$M)

297



Basic earnings per share

26.4¢

HY17 **25.1¢**

Return on average shareholders' funds

8.2%

HY17 **6.6%**

Financial highlights[2]

Combined operating ratio (COR)

95.4%

HY17 **96.8%**

Gross written premium by class of business

	HY18 (%)	HY17 (%)
Commercial & domestic property	27.8	28.0
Agriculture	16.7	17.1
Motor & motor casualty	14.7	14.7
Public/product liability	11.1	10.8
Workers' compensation	6.8	7.2
Marine energy & aviation	6.8	6.9
Professional indemnity	6.2	6.4
Accident & health	5.8	4.3
Financial & credit	3.2	3.3
Other	0.9	1.3

Net earned premium ($M)

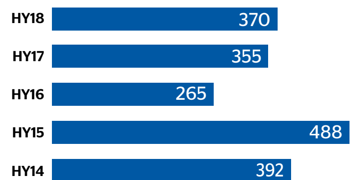
5,647

↓ **1%** from HY17

Net profit after income tax ($M)

370

↑ **4%** from HY17



Underwriting result ($M)

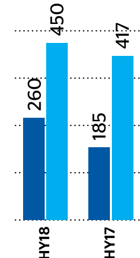
260

↑ **41%** from HY17

Insurance profit ($M)

450

↑ **8%** from HY17



Net earned premium by type

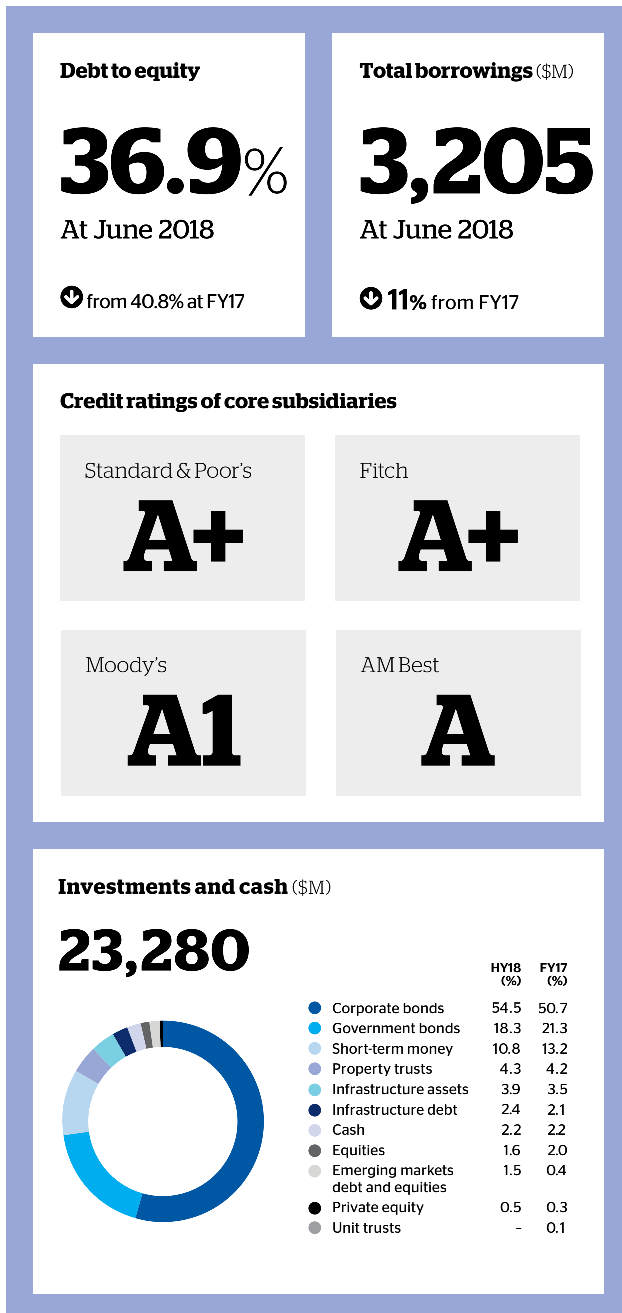
93% direct and facultative insurance

7% inward reinsurance

1 The information in the tables above is extracted or derived from the Group's half year financial statements included on pages 38 to 53 of this Half Year Report. The Group Chief Financial Officer's report sets out further analysis of the results to assist in comparison of the Group's performance against 2018 targets provided to the market.

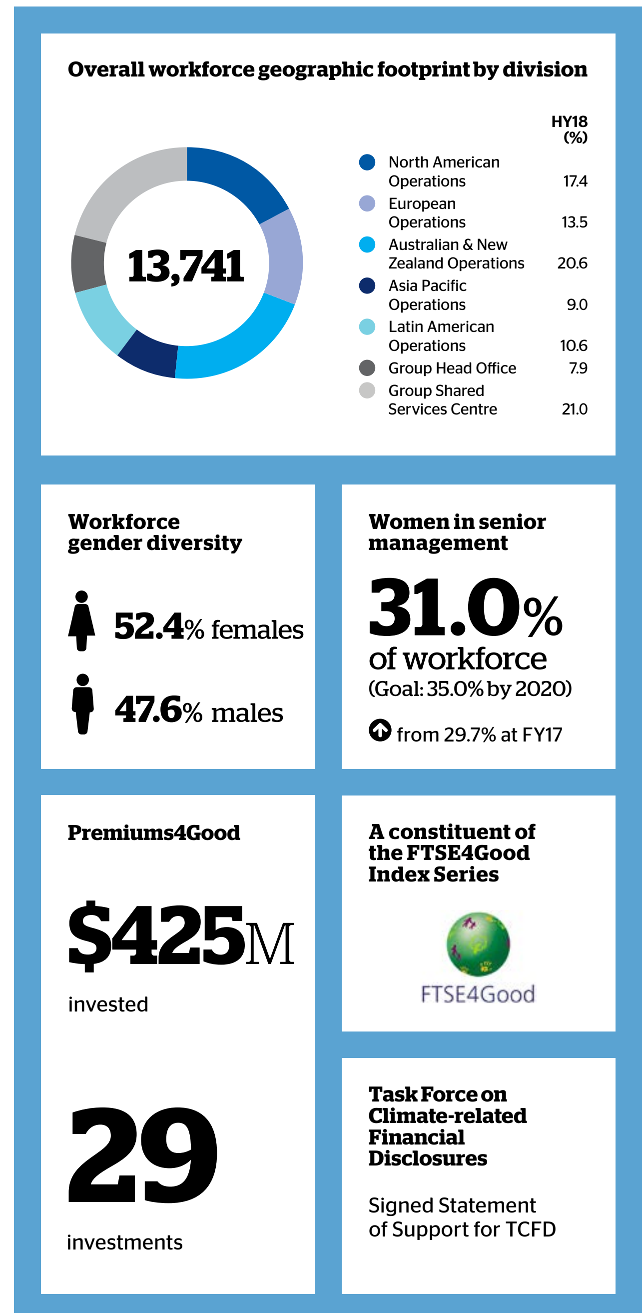
2 2017 and 2018 figures reflect results for continuing operations only.

Operational highlights



	HY18 (%)	FY17 (%)
Corporate bonds	54.5	50.7
Government bonds	18.3	21.3
Short-term money	10.8	13.2
Property trusts	4.3	4.2
Infrastructure assets	3.9	3.5
Infrastructure debt	2.4	2.1
Cash	2.2	2.2
Equities	1.6	2.0
Emerging markets debt and equities	1.5	0.4
Private equity	0.5	0.3
Unit trusts	-	0.1

Environmental and social highlights



	HY18 (%)
North American Operations	17.4
European Operations	13.5
Australian & New Zealand Operations	20.6
Asia Pacific Operations	9.0
Latin American Operations	10.6
Group Head Office	7.9
Group Shared Services Centre	21.0

We started 2018 with a clear plan to accelerate the reshaping of the company to create a stronger and simpler QBE. While the journey is still in its early stages, it is pleasing to report meaningful progress against each of our seven priorities together with a 2018 interim financial performance that is in line with our full year guidance, underpinned by an improvement in the attritional claims ratio.

Overview

Our 2018 business plan anticipated a combined operating ratio in the 95.0–97.5% range, predicated on an improved attritional claims ratio reflecting the global implementation of the Cell Performance Review discipline, early benefits from Brilliant Basics and premium rate increases.

During the first half, our underwriting operations performed in line with expectation with the Group's adjusted combined operating ratio of 95.8% [1,2,3] around the mid-point of the full year guidance range. This represents a meaningful improvement on the 2017 full year combined operating ratio of 98.2% [1,4,5] after adjusting for excess catastrophe losses and is underpinned by an improvement in the attritional claims ratio (excluding Crop and LMI) to 51.3% [2,3] from 52.5% [2,5].

Adjusted net profit after tax fell 18% to $380 million from $464 million in the prior period, primarily reflecting a significantly lower annualised net investment return of 2.1% which is below our target for the year of 2.5–3.0%. Investment performance in the half year fell short of expectations due to rising interest rates in the US and UK, as well as increasing market volatility. Although solid, growth asset returns moderated after especially strong returns in the prior period.

The Group achieved an average premium rate increase of 4.6% [2,6] during the half which represents a considerable improvement from the 1.0% [2,6] increase during the prior period. Following the extreme catastrophe activity of the preceding half, it is pleasing to see a strong recovery in our capital ratios with the PCA multiple strengthening to 1.74x from 1.64x and debt to equity improving to 36.9% from 40.8% at 31 December 2017.

The Board has declared a 2018 interim dividend of 22 Australian cents per share, in line with the 2017 interim dividend of 22 Australian cents per share. Our dividend policy is designed to ensure we reward shareholders relative to cash profit while maintaining sufficient capital for future investment and growth of the business. Inclusive of the A$100 million of QBE shares purchased and cancelled, the payout for the 2018 half year is up 31% relative to the prior period.

Most importantly, we delivered a sound underwriting result alongside good progress in relation to each of our seven priorities for 2018.

1 Excludes the impact of changes in risk-free rates used to discount net outstanding claims.
2 Continuing operations basis.
3 Excludes transaction to reinsure Hong Kong construction workers' compensation liabilities.
4 Excludes one-off impact on the Group's underwriting result due to the Ogden decision in the UK.
5 Excludes transactions to reinsure US liabilities.
6 Excludes premium rate changes relating to CTP.

Simplify QBE

QBE has historically been too complex, in terms of both geography and product mix. Our objective is to simplify the business so that QBE operates only in markets and products where we have a competitive advantage and can deliver attractive returns and profitable growth.

Since the start of the year, we have progressed four major workstreams that contribute to the simplification agenda.

The first is our exit from Latin America. In February 2018, we entered into an agreement with Zurich Insurance Group to sell the division (excluding Puerto Rico) providing a clean break at an attractive premium to book value.

The transaction is progressing as planned and, following receipt of the required regulatory approvals, we recently completed the sale of our operations in Argentina and Brazil. The sale of operations in Ecuador, Colombia and Mexico is expected to complete by 31 December 2018. All of our Latin American operations (including our operations in Puerto Rico) are reported as held for sale and as discontinued operations at the balance date and, notably, continued to record underwriting losses with a combined operating ratio of 112.5% in the first half compared with a full year 2017 combined operating ratio of 110.0%.

In Asia Pacific, we have sold our business in Thailand and entered into a reinsurance transaction to address profitability challenges in our Hong Kong construction workers' compensation portfolio. A reinsurance agreement with Swiss Re was completed in March and completely removes our exposure to a challenged portfolio that contributed $37 million to the division's $100 million full year 2017 underwriting loss.

We also recently announced the sale of our travel insurance business in Australia to nib, the operator of Australia's third-largest travel insurer. Travel insurance is very much a scale and (high claims frequency) logistics business. A review of our offering identified that we did not have a strong position in this market and without significant investment would not be able to generate an acceptable return. As a result, we concluded this business would be better owned by a market participant committed to investing in the travel segment for the longer term.

Finally, the sale of our North American personal lines business is currently underway, a business that delivers annualised gross written premium of approximately $350 million. The business has a high level of operational complexity and cost, and we do not have the scale or competitive advantage necessary to deliver consistent underwriting profitability.

Together, these simplification initiatives will result in the exiting of businesses and portfolios that generated an underwriting loss of over $200 million in 2017.

Brilliant Basics

Embedding the Brilliant Basics program across QBE is central to every element of our strategy and will define our company for many years to come. Brilliant Basics seeks to ensure we achieve a consistent level of excellence across underwriting, pricing and claims management everywhere that we do business, across all countries and portfolios. Our activities in this area are closely connected with our priority of "Building for the Future", as the adoption of advanced and developing technologies is set to revolutionise all elements of the insurance business. Successful application of the most appropriate technologies will be fundamental to delivering and maintaining Brilliant Basics.

After an early version was piloted in Australian & New Zealand Operations during the final quarter of 2016, the Brilliant Basics program is now being implemented across the Group with activities including:

- implementation of a new set of Group Underwriting Standards;
- implementation of a new set of Group Claims Standards;
- detailed assessment of existing pricing models;
- upgrading of pricing models to incorporate data and analytics and machine learning;
- embedding divisional Chief Underwriting Officers and their teams in every division;
- establishment of a new Group Chief Underwriting Office to oversee consistent implementation of Brilliant Basics across underwriting and pricing; and
- redesigning our core claims processes to reduce costs, drive further indemnity savings and improve customer service.

Progress was made in each of these workstreams during the first half of the year.

While full implementation of Brilliant Basics will take several years and will involve the transformation of QBE's culture and business practices to consistently deliver world-class underwriting and claims management, I am confident that this program will drive significant improvement in QBE's performance. This is evidenced by the successful turnaround of Australian & New Zealand Operations. After delivering an attritional claims ratio of 65.1% (excluding LMI) in the first half of 2016, the introduction of many of the Brilliant Basics program and performance management disciplines now being rolled out across the Group contributed to an improvement in this measure to 59.1% in the half year under review.

Drive performance management

Alongside Brilliant Basics, we have implemented the Cell Performance Review process: an intensive, detailed and action-oriented underwriting performance management process across QBE.

During the half we completed over 300 cell reviews across the four divisions involving over 100 cells globally. The review process requires each cell owner to present their strategy, a comprehensive review of current performance and a detailed plan to deliver the budgeted underwriting result (equating to an appropriate risk-adjusted return on capital) for the year. The cell owner identifies key risk factors and decisions are made on how those risks should be managed and the appropriate action taken. Decisions made in the cell review may include rate increases for specific segments, more selective underwriting, claims actions and/or shifts in distribution. Decisive action following these reviews has contributed to a 1.2% reduction in the Group's attritional claims ratio (excluding Crop and LMI) from 52.5% [1,2] for full year 2017 to 51.3% [1,3] in the current period.

Attending cell reviews with me are the Group Chief Financial Officer, Group Chief Operating Officer and Group Chief Risk Officer as well as the relevant divisional executives including the Chief Executive Officer, Chief Financial Officer, Chief Underwriting Officer, Chief Risk Officer, Chief Actuary and Head of Claims.

The review process is an effective way of driving accountability through the organisation while identifying performance issues and corrective action at an early stage. The process also assists in identifying any products or portfolios that do not fit with our broader objective that QBE will only operate in markets where we have a competitive advantage and can deliver profitable growth.

In addition to the obvious and significant performance enhancement benefits, the Cell Performance Review process provides an opportunity to identify and promote top talent from within QBE, and to identify and develop growth strategies in areas of opportunity.

Further reposition North America

Positioning our North American Operations as a specialist industry-focused commercial insurer is central to our plans for the division. Once the proposed exit from the personal lines business is complete, we will benefit from the rationalisation of systems, processes and our back office to drive significant cost savings. In advance of these projects, the division's underwriting result for the first half benefited from a strengthened approach to expense management coupled with early benefits from embedding elements of the Cell Performance Review process and the Brilliant Basics program.

Upon completion of the personal lines exit, North American Operations will be focused on four core segments: Crop, Specialty, Property & Casualty (P&C) including programs and mid-market commercial as well as QBE Re, each of which are areas where QBE has a strong capability and a reasonable market position.

Remediate Asia

We have committed to a comprehensive remediation of our Asia Pacific business including exiting unprofitable lines of business, driving a sharper underwriting focus and reducing costs.

Delivering on these plans will take some time, and the improvement in the combined operating ratio to 107.8% from 109.1% in the prior period belies the extent of remediation undertaken and the level of underlying performance improvement achieved during the half. Excluding prior accident year claims development, the improvement in the combined operating ratio to 102.5% from 109.9% for FY2017 is more indicative of the underlying progress.

Remediation activities already undertaken include the sale of our Thai business, exiting from Hong Kong construction workers' compensation and the shedding of significant higher hazard marine, property and engineering business, particularly in Hong Kong, Singapore and Indonesia. In aggregate, remediation activities are underway across 18 portfolios in Asia Pacific Operations and we have exited whole sub-segments such as Indonesian marine hull where the industry risk profile was simply unacceptable.

While the improvement achieved to date is encouraging, it is clear that we will need to reduce expenses going forward as Asia Pacific Operations' premium pool contracts.

1 Continuing operations basis.
2 Excludes transactions to reinsure US liabilities.
3 Excludes transaction to reinsure Hong Kong construction workers' compensation liabilities.

Talent and culture

During the half we significantly strengthened the Group Executive team to provide the optimal breadth of skills and experience to execute on our strategic priorities. New hires to the team included Vivek Bhatia (Chief Executive Officer, Australian & New Zealand Operations), Inder Singh (Group Chief Financial Officer) and Peter Grewal (Group Chief Risk Officer).

We will be appointing a Group Chief Underwriting Officer in the current half. This will be a new Group Executive position for QBE and will play a key role in driving the Cell Performance Review process as well as owning the implementation of the Brilliant Basics program in relation to pricing and risk selection.

In addition to the Group Executive changes, the senior management team has been strengthened with the appointment of a new Group Chief Information Officer, Group Head of Internal Audit and a Head of Talent and Culture.

Ensuring we have the right culture across QBE to deliver on our strategic plan is an ongoing area of focus for the Executive Committee. With this in mind, the focal point of the recent Group Leadership Forum in Sydney in May 2018 was the alignment of 160 leaders from across our divisions around our newly defined cultural attributes – being fast paced, accountable, technical experts, courageous, diverse, customer centred and team oriented. Following the Leadership Forum, the process of embedding these attributes across our operations is well underway.

Build for the future

Looking beyond our immediate priorities for 2018, we are focused on building a company that is innovative, customer centred, agile and technology-enabled. Integral to this ambition is QBE Ventures, which we formed in early 2017 as an internal venture fund to partner with innovative technology companies relevant to QBE's operations and strategic agenda.

QBE Ventures made two investments in 2017, and we have followed this up with two further investments thus far in 2018.

Our first investment was in RiskGenius, a digital platform with Google-like search functionality, using algorithms to compare and analyse the language of insurance policies and endorsements. RiskGenius learns from searches and records and streamlines document sharing. Less than a year after this partnership was formed, the entire Specialty team in our North American Operations is using RiskGenius. Our second investment was in Cytora, and we are currently testing and embedding Cytora's ability to make use of large volumes of unstructured data to improve our risk selection process, especially in property underwriting.

In May 2018, we announced an investment in a New York-based start-up called HyperScience which has developed an artificial intelligence platform that captures and analyses information from documents and handwritten forms. This platform will provide us with the opportunity to automate a range of tasks, and we recently completed the first implementation of the HyperScience platform within the claims department of our Australian & New Zealand Operations.

This was followed last month by our investment in Jupiter Intelligence, an emerging leader in predicting and managing climate risk. Jupiter provides data and analytics services to better predict and manage risks from weather and rising sea levels, storm intensification and changing temperatures caused by medium to long-term climate change. Jupiter is focused on quantifying these risks and has developed tools to help customers in North America plan for hazards from one hour to 50 years into the future, all the way down to the level of an individual building. We will be working closely with the Jupiter team to find innovative ways to leverage their data and analytics across our business – from underwriting and pricing, to providing resilience management and thought leadership to our customers across the globe.

Earlier this year QBE confirmed its support for the recommendations of the Financial Stability Board's Taskforce on Climate-related Financial Disclosures (TCFD) that were released during 2017. We have provided an overview of our TCFD action plan on pages 8 and 9 of this Half Year Report. Delivering on this action plan is a priority across the Group and will require that we draw upon a range of internal and external expertise. Our partnership with Jupiter will play an important role in the proposed review of our underwriting strategy to incorporate detailed analysis of climate-related risks and opportunities.

In closing, I am confident that we have the right program of work underway to meaningfully transform our business and am encouraged by our early progress. There remains much work to do to improve our underwriting and risk selection, reduce costs and improve our results and I look forward to reporting to you on our progress as we strive to deliver better outcomes for our stakeholders.

Pat Regan
Group Chief Executive Officer

Task Force on Climate-related Financial Disclosures

The Financial Stability Board released the final recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) in June 2017, providing a framework for consistent climate-related financial risk disclosure for use by investors, lenders, insurers and other stakeholders.

The TCFD recommendations are structured around four thematic areas that represent core elements of how companies operate: governance, strategy, risk management, and metrics and targets. The TCFD recognises that meaningful adoption of the recommendations will be achieved over a three to five-year timeframe as understanding and modelling of climate-related issues become more widespread and disclosures mature accordingly.

QBE believes that the TCFD recommendations establish a strong and consistent framework for improving climate-related risk management and disclosure.

QBE's climate risk journey

As a general insurer, QBE is aware of the risks and opportunities presented by climate change. It is widely recognised that continued global warming will lead to increasingly unpredictable, and potentially more severe, weather events with significant economic and social consequences.

For QBE specifically, and the insurance sector more broadly, climate-related risks and opportunities constitute a key issue affecting our core business. This was most recently highlighted by the series of global natural disasters occurring in 2017 which caused an estimated $330 billion[1] of economic losses, resulting in the costliest year in the history of the insurance industry, with a record $138 billion[1] of insured losses.

As well as the physical risks and opportunities associated with climate change, we are cognisant of potential transition risks (related to policy, legal, technology or market changes) associated with the global shift towards a lower-carbon economy consistent with the 2015 Paris Agreement.

We therefore need to work with our customers and communities to mitigate these risks and support the uptake of opportunities arising from these changing dynamics.

Our commitment

Following our review of the TCFD report, we signed the public Statement of Support and are now on our journey to implement the TCFD recommendations over the proposed three to five-year period. This will include disclosures in our Annual Report that track our climate-related risk management. Recognising the importance of providing timely communications to our stakeholders regarding our progress, this update sets out our progress over the first six months of this reporting period and our proposed actions over the coming years consistent with the TCFD's four thematic areas.

Our approach and progress

As an insurance company, our financial strength and long-term sustainability rely on effective risk management. Our Group Board recognises that climate change requires an integrated approach to managing climate-related risks and opportunities. This has been reflected in the strengthening of our governance structure and increased focus on this risk in both Board and executive forums throughout 2018. This includes:

- formal quarterly updates to the Group Board;
- regular updates to the Board Risk and Capital Committee;
- regular updates to the Group Executive Committee; and
- engagement with divisional boards and committees.

Whilst we are confident that we have an appropriate governance framework at the Group level, we will continue to embed stronger governance of climate-related risk in our divisional operations during the remainder of 2018.

We established a cross-functional Climate Change Working Group in late 2017 consisting of senior representatives from across our business and chaired by our Group Chief Risk Officer and Group Financial Controller. This forum supports the Group Executive Committee and Group Board in identifying and managing climate-related risks and opportunities across the business.

Stress and scenario testing is already central to our risk management. We apply a range of modelling techniques to better understand our exposure to potential events and claims scenarios to improve our decision-making. This capability is critical to managing our exposure to possible events such as natural catastrophes and economic shocks.

Assessing the impact of extreme but plausible events also helps us to better prepare for such situations and ensures that our risk exposure is aligned with our Board-approved risk appetite. Specifically, we will be leveraging the insights gained from our recent investment in Jupiter Intelligence, which provides data and analytics to better predict and manage risks associated with longer-term climate changes. This will help us provide resiliency management and thought leadership to our customers in North America. We will continue to strengthen our stress and scenario testing focused on climate-related risks, informed by more detailed analysis of our exposures as set out on the following page.

Industry collaboration

Collaboration with key industry, government and other stakeholders is an important part of how we, our customers and communities will successfully navigate the challenges and opportunities posed by climate change.

Key areas of collaboration for us include our involvement with the UN Environment Programme – Finance Initiative (UNEP FI), the United Nations Principles for Sustainable Insurance and United Nations-supported Principles

1 Swiss Re, sigma No 1/2018.

for Responsible Investment, which provide an opportunity to leverage global insights and ensure we are aligned to industry-leading practice. Recognising the importance of an industry-aligned approach to climate scenario analysis modelling, we have also joined the UNEP FI's insurance industry TCFD pilot group.

In addition, we continue to participate in a range of other climate and sector-related initiatives – including the Investor Group on Climate Change, the Insurance Council of Australia's climate change action committee and the Actuaries Institute climate change working group.

Next steps

During the first half of this year, we undertook further analysis of the Group's exposure to climate-related risk. This included completion of a high-level impact analysis to guide the focus of future analysis of our exposures and opportunities, in turn informing the development of a plan for implementing the TCFD recommendations.

This initial assessment sets the platform for the next stage of work that is currently underway, including:

- reviewing and strengthening our divisional governance around climate change;
- establishing our ESG Risk team;
- undertaking more detailed analysis of our exposures to climate risk in various products and markets;
- ensuring our risk management processes incorporate consideration of physical, transition and liability risks; and
- identifying existing and emerging opportunities to assist our customers as they navigate the transition to a lower-carbon economy.

Further discussion on our progress towards full TCFD disclosures will be included in our 2018 Annual Report.

> **"Climate risk is an area of increasing focus for the Board, management and our industry. We are very pleased that so many shareholders share our interest in improved understanding and disclosure in this area."**
>
> **Marty Becker**
> **Chairman**

QBE's TCFD action plan

TCFD published June 2017

	DESCRIPTION	ACTION	2017	2018	2019	2020
Governance	**Disclose the organisation's governance around climate-related risks and opportunities**	**Board:** • Strengthen Group Board and Committee oversight of climate-related issues		Action completed		
		• Strengthen divisional governance of climate-related issues		Target completion date		
		Management: • Establish senior cross-functional, cross-divisional Climate Change Working Group to support the Board and management in identifying and managing climate-related risks and opportunities	Action completed			
		• Sign TCFD Statement of Support with commitment to begin disclosures in February 2019		Action completed		
Strategy	**Disclose the actual and potential impacts of climate-related risks and opportunities on the organisation's businesses, strategy and financial planning where such information is material**	• Complete high level impact assessment of physical, transition and liability risks and opportunities across the business over the short, medium and long term		Action completed		
		• Review investment strategy to ensure it appropriately reflects consideration of climate-related risks and opportunities		Commencement date ··· Target completion date		
		• Complete further detailed analysis of climate-related risks and opportunities in priority underwriting portfolios		Commencement date ···	··· Target completion date	
		• Review underwriting strategy in line with detailed analysis of climate-related risks and opportunities			Commencement date ··· Target completion date	
		• Participate in the UNEP FI insurance industry TCFD pilot group on scenario analysis		Commencement date ···	··· Target completion date	
		• Integrate additional climate-related scenario analysis into strategic planning across the business			Commencement date ···	··· Target completion date
Risk Management	**Disclose how the organisation identifies, assesses and manages climate-related risks**	• Establish ESG Risk team to coordinate ongoing integration of climate-related risks and opportunities across the business		Target completion date		
		• Review Enterprise Risk Management Strategy and Framework to ensure they appropriately reflect climate change considerations		Target completion date		
		• Review risk classes, risk appetites and risk management standards and processes to ensure that climate change risks are properly reflected		Commencement date ··· Target completion date		
		• Integrate multi-year scenario analysis into risk management strategy			Commencement date ···	··· Target completion date
Metrics & Targets	**Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material**	• Disclose scope 1, 2 and 3 operational greenhouse gas emissions	Action completed			
		• Evaluate metrics and targets for assessing climate-related risks and opportunities that are in line with strategy and risk management processes			Commencement date ···	··· Target completion date
		• Disclose metrics and performance against targets for assessing climate-related risks and opportunities				Commencement date ··· Target completion date

KEY ○ Commencement date ··· Continued in progress • Target completion date ✓ Action completed

The rollout of the Cell Performance Review process and Brilliant Basics is already benefiting earnings quality and resilience, while the Group's capital and gearing metrics have improved materially.

General overview

I assumed the role of Group Chief Financial Officer in April 2018 having spent the previous 15 months as Chief Financial Officer of Australian & New Zealand Operations, including a brief period as acting Chief Executive Officer of that division.

Much of my time in Australian & New Zealand Operations was spent on the rollout and implementation of the Cell Performance Review process and the Brilliant Basics program, both of which were piloted in Australian & New Zealand Operations before being implemented more broadly across the Group in early 2018. Although Australian & New Zealand Operations had been reporting acceptable headline underwriting results, inadequate performance management had allowed the business to become overly reliant upon a few high-performing cells while a number were loss making and many cells were producing marginal returns at best. Both earnings quality and earnings resilience were poor thereby increasing the risk of earnings surprises as the external operating environment changed. With the Cell Performance Review process now embedded in the fabric and culture of Australian & New Zealand Operations, earnings quality and resilience has improved significantly as evidenced by the 2018 interim result.

Consistent with my previous role, improving earnings quality and resilience across the Group more broadly will be a major focus. Critical to that objective is the successful rollout, embedding and refining of the Cell Performance Review process and the Brilliant Basics program. For a Group of our size and diversity, the earnings surprises of recent years are unacceptable.

While I am confident that the Cell Performance Review process and Brilliant Basics program will improve underwriting discipline and encourage a more performance and return oriented culture, a more granular approach to capital allocation will also play a critical role in driving the right behaviours and strategic decisions. In this regard, we are refining our approach to capital allocation to ensure that individual cells are delivering acceptable risk-adjusted returns to maximise return on equity.

During 2018, we have undertaken a series of transactions to reduce complexity and simplify the portfolio including:

- The sale of our Latin American Operations narrows our geographical footprint and focuses QBE's ambition on being an "international" as distinct from a "global" insurer, with meaningful operations in the major insurance market hubs.

  Subsequent to 30 June 2018, we completed the sale of our operations in Argentina and Brazil for consideration of $244 million resulting in a profit on sale before tax of $125 million [1]. We expect to complete the sale of our operations in Colombia, Ecuador and Mexico by 31 December 2018. Including the sales already completed and our updated expectations regarding Colombia, Ecuador and Mexico, we anticipate total consideration of $385 million resulting in an estimated cash profit on sale before tax of $125 million [2] compared with $409 million and $100 million respectively as previously advised.

1 Excludes a foreign currency translation reserve (FCTR) reclassification charge of around $216 million (out of equity into the profit or loss statement). This is a non-cash item and will not impact shareholders' funds or QBE's regulatory or ratings agency capital base.

2 Excludes a FCTR reclassification charge of around $240 million (out of equity into the profit or loss statement). This is a non-cash item and will not impact shareholders' funds or QBE's regulatory or ratings agency capital base.

- On 27 March 2018, we reinsured 100% of our ongoing exposure to Hong Kong construction workers' compensation including $166 million of potentially volatile claims liabilities. Having contributed $37 million of the division's $100 million underwriting loss in 2017, a clean exit from this business materially reduces Asia Pacific Operations' risk profile while significantly improving underwriting profitability and earnings certainty.
- On 3 August 2018, we announced the sale of our Australian & New Zealand travel insurance business to nib. This business has a poor track record of profitability and lacks scale relative to its major competitors. Annual gross written premium is around $55 million.
- Our operations in Puerto Rico are held for sale at 30 June 2018.
- Work continues on our planned exit from North American personal lines which we plan to finalise by year-end. The decision to exit reflects our sub-scale position in US personal lines and will enable further material cost efficiencies by facilitating the decommissioning of legacy systems and downsizing of the regional office footprint.

During the second half of 2018, we will complete the negotiation of the Group's 2019 reinsurance program. Since 2015, a key feature of our program has been a deeply "in-the-money" large individual risk and catastrophe aggregate program with a single reinsurer. This program served us well in 2017; however, our growing exposure to a single reinsurer is not optimal and the time value of money is an important consideration, particularly in a rising interest rate environment.

Going forward, we plan to move to a more conventional "out-of-the-money" reinsurance structure with significantly higher protection for catastrophe risk including a lower event retention, increased limit and increased coverage for non-peak zones, supplemented by catastrophe aggregate or sideways protection. Our objective is to optimise balance sheet protection, capital credit, cost and earnings variability.

As our proposed structure is likely to be "out-of-the-money" the variability of modelled reinsurance recoveries versus actual reinsurance recoveries is likely to increase, translating to an increased probability of actual earnings being higher or lower than planned earnings.

With respect to the recently announced 2018 interim result, I would like to discuss three broad areas:

1. Financial performance.
2. Investment strategy and performance.
3. Financial strength and capital management.

1. Financial performance

QBE reported a statutory net profit after tax of $358 million, up 4% from $345 million in the first half of 2017 while cash profit after tax was also up 3% to $385 million from $372 million.

Adjusted net profit after tax fell 18% to $380 million [1] from $464 million [2] in the prior period, reflecting a reduced level of positive prior accident year claims development and significantly lower investment returns.

The Group's adjusted combined operating ratio increased to 95.8% [1,3,4] from 94.5% [2,3,4] in the prior period, with an improvement in the attritional claims ratio more than offset by a reduced level of positive prior accident year claims development.

From my perspective, the key themes to emerge from the 2018 interim result are set out overleaf:

Gross written premium [4]

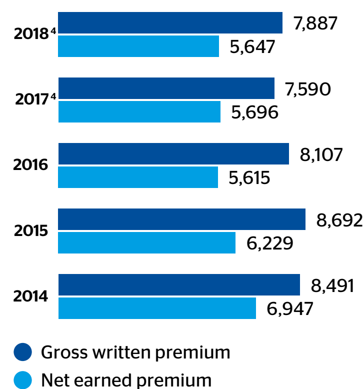
$7,887M

↑ **4%** from 2017

Net earned premium [4]

$5,647M

↓ **1%** from 2017



1 Excludes transaction to reinsure Hong Kong construction workers' compensation liabilities.
2 Excludes one-off impact on the Group's underwriting result due to the Ogden decision in the UK.
3 Excludes the impact of changes in risk-free rates used to discount net outstanding claims.
4 Continuing operations basis.

(a) Much improved performance in North America after a difficult 2017

North American Operations reported a combined operating ratio of 97.8% [1], down modestly from 98.2% [1] in the prior period. In addition to positive prior accident year claims development in Crop, it was pleasing to see net nil development across the rest of the portfolio which indicates that the reserve strengthening and more conservative ultimate claims ratio assumptions adopted at 31 December 2017 were appropriate.

While the attritional claims ratio increased relative to the prior period reflecting the adoption of more conservative ultimate claims ratio assumptions in the second half of 2017 coupled with business mix changes, there are clear signs of improvement relative to the 2017 exit attritional claims ratio.

Premium rate increases averaged 3.1% compared with only 0.9% in the prior period.

(b) Good progress on Asia Pacific remediation

The improvement in the combined operating ratio to 108.5% [1,2] from 109.1% [1] in the prior period belies the extent of remediation undertaken and the level of underlying improvement achieved in Asia Pacific Operations during the half and is better compared with the FY2017 combined operating ratio of 115.5% [1].

Remediation initiatives include the sale of our business in Thailand, exiting from Hong Kong construction workers' compensation and shedding of significant higher hazard marine, property and engineering business, particularly in Hong Kong, Singapore and Indonesia.

Although still highly competitive, the level of price competition in Asia Pacific Operations has abated somewhat with an average premium rate increase of 0.3% achieved compared with a reduction of 3.9% in the prior period.

(c) Significant improvement in European Operations' current accident year profitability

European Operations recorded another strong result with a combined operating ratio of 94.5% [1]. Although up from 91.3% [1,3] in the prior period due to a reduced level of positive prior accident year claims development, current accident year profitability improved significantly underpinned by improvement in the attritional claims ratio.

While competition remains intense as evidenced by lower new business volumes, the soft pricing cycle has abated with average premium rate increases of 4.8% representing a welcome change from the 1.1% average premium rate reduction in the prior period.

Nonetheless, we remain vigilant with respect to underwriting discipline.

(d) Further improvement in the quality of the Australian & New Zealand Operations' result

Performance improvement in Australian & New Zealand Operations is continuing with a strong focus on pricing, risk selection and claims management which is fully embedded in to the Cell Performance Review process that has been in place now for 18 months. Earnings quality and resilience (as measured by the spread of underwriting profit contribution by cell) continues to improve.

Although up slightly from the prior period, the combined operating ratio of our Lenders' Mortgage Insurance (LMI) business has stabilised around full year 2017 levels. Notwithstanding reduced LMI earnings and a lower level of positive prior accident year claims development, Australian & New Zealand Operations' combined operating ratio was stable at 92.3% [1], underpinned by a 1.4% improvement in the attritional claims ratio or 1.9% excluding LMI.

Pricing momentum remains strong with rate increases averaging 6.6% [4] compared with 5.0% [4] in the prior period.

2. Investment strategy and performance

Our investments delivered an annualised net return of 2.1% compared with 3.6% in the prior period.

Investment performance fell short of expectations in the first half of 2018, with the fixed income portfolio adversely impacted by capital losses driven by steepening yield curves (albeit the impact on profit was partially offset by the impact of higher risk-free rates used to discount net outstanding claims) and a modest widening in credit spreads. Our short duration stance coupled with active tactical management protected the portfolio from what would otherwise have been a much more meaningful adverse impact.

Growth asset returns were solid, albeit down from especially strong returns in the prior corresponding period.

3. Financial strength and capital management

The Group's capital position remains strong when measured against both regulatory and rating agency capital requirements. Our APRA PCA multiple increased to 1.74x from 1.64x at 31 December 2017 and our S&P capital is now back above 'AA' minimum levels. Our improved capital strength reflects de-risking initiatives such as the Hong Kong construction workers' compensation reinsurance transaction, a reduction in the prescribed capital amount due to benign catastrophe experience, lower risk charges due to catastrophe claims settlements and the stronger US dollar, particularly against the Australian dollar and sterling.

At 30 June 2018, QBE's debt to equity ratio was 36.9%, down from 40.8% at 31 December 2017 and slightly above our benchmark range of 25%–35%. This reflects the debt buybacks undertaken during the half partly offset by a strengthening of the US dollar against major currencies which adversely impacted our reported shareholders' funds.

1 Excludes the impact of changes in risk-free rates used to discount net outstanding claims.
2 Excludes transaction to reinsure Hong Kong construction workers' compensation liabilities.
3 Excludes one-off impact on the Group's underwriting result due to the Ogden decision in the UK.
4 Excludes premium rate changes relating to CTP.

The probability of adequacy (PoA) of outstanding claims was broadly stable at 90.2%, around the mid-point of our targeted PoA range of 87.5%–92.5%.

As announced in February 2017, QBE established a three-year cumulative on-market share buyback facility of up to A$1 billion, with a target of not more than A$333 million in any one calendar year. During the first half of 2018, QBE purchased A$100 million of QBE shares resulting in the cancellation of 10.4 million shares or 0.8% of issued capital. Since commencement of the buyback, QBE has purchased A$239 million of QBE shares resulting in the cancellation of 23.3 million shares or 1.7% of issued capital.

Group head office cash flows

FOR THE HALF YEAR ENDED 30 JUNE	2018 US$M	2017 US$M
Opening head office cash balance	**1,035**	1,007
Total divisional remittances	**364**	653
Net interest on parent entity borrowings	**(117)**	(34)
Gross organic cash flow	**247**	619
Dividends paid	**(42)**	(335)
Net organic cash flow	**205**	284
Other (including share purchases)	**(501)**	(302)
Closing head office cash balance	**739**	989

Cash remittances from the operating divisions were $364 million, down from $653 million in the prior period reflecting the retention of capital in North American Operations and Equator Re following the severe catastrophe claims of the preceding half.

Coverage of the interim dividend by total divisional remittances remains strong at 1.6x.

Operating and financial performance

Summary income statement

	STATUTORY RESULT		ADJUSTMENTS		ADJUSTED RESULT	
FOR THE HALF YEAR ENDED 30 JUNE	2018 US$M	2017 US$M	2018 US$M	2017 US$M	2018[1] US$M	2017[2,3] US$M
Gross written premium	**7,887**	7,590	**–**	6	**7,887**	7,596
Gross earned premium	**6,697**	6,547	**–**	(65)	**6,697**	6,482
Net earned premium	**5,647**	5,696	**190**	2	**5,837**	5,698
Net claims expense	**(3,564)**	(3,727)	**(166)**	154	**(3,730)**	(3,573)
Net commission	**(947)**	(936)	**1**	–	**(946)**	(936)
Underwriting and other expenses	**(876)**	(848)	**2**	–	**(874)**	(848)
Underwriting result	**260**	185	**27**	156	**287**	341
Net investment income on policyholders' funds	**190**	232	**–**	–	**190**	232
Insurance profit	**450**	417	**27**	156	**477**	573
Net investment income on shareholders' funds	**97**	192	**–**	–	**97**	192
Financing and other costs	**(135)**	(164)	**–**	–	**(135)**	(164)
Gains on sale of entities	**2**	2	**–**	–	**2**	2
Share of net profits of associates	**–**	1	**–**	–	**–**	1
Amortisation and impairment of intangibles	**(20)**	(20)	**–**	–	**(20)**	(20)
Profit before income tax from continuing operations	**394**	428	**27**	156	**421**	584
Income tax expense	**(29)**	(74)	**(5)**	(37)	**(34)**	(111)
Profit after income tax from continuing operations	**365**	354	**22**	119	**387**	473
Loss after income tax from discontinued operations	**(12)**	(10)	**–**	–	**(12)**	(10)
Non-controlling interest	**5**	1	**–**	–	**5**	1
Net profit after income tax	**358**	345	**22**	119	**380**	464

1 Excludes transaction to reinsure Hong Kong construction workers' compensation liabilities.
2 Excludes one-off impact on the Group's underwriting result due to the Ogden decision in the UK.
3 Excludes M&LS fronting.

Overview of the 2018 interim result

The preceding table shows the statutory result excluding items which materially distort key performance indicators.

2018 excludes a transaction to reinsure Hong Kong construction workers' compensation liabilities which reduced net earned premium by $190 million and net claims expense by $166 million while adversely impacting commission and underwriting expenses by $1 million and $2 million respectively. The transaction is one-off in nature and impacts year-on-year comparison of net earned premium and underwriting ratios, depressing the net claims ratio and inflating the combined commission and expense ratio.

The 2017 interim statutory profit in the table is similarly presented after excluding:

- a $154 million increase in the Group's net central estimate of outstanding claims reflecting the increase in the statutory discount rates applicable to UK personal injury liabilities and a related $2 million reinsurance charge (the Ogden decision); and
- our Mortgage & Lender Services (M&LS) business was sold in 2015; however, we continued to front this business on a progressively reducing basis until March 2017, with no impact on net premium or profit (and an immaterial impact on gross written premium in 2017).

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

QBE entered into an agreement in February 2018 to sell its operations in Argentina, Brazil, Colombia, Ecuador and Mexico. All of our Latin American Operations (including Puerto Rico) are reported as a disposal group held for sale at 30 June 2018, with the results of our Latin American Operations accordingly presented separately as discontinued operations for both the current and prior period. For the current half year, the discontinued operations reported a net loss after tax of $12 million compared with a loss of $10 million in the prior period, primarily as a result of higher than expected net claims costs and additional expenses associated with the sale transaction.

The Group reported a 2018 interim net profit after tax of $380 million, down 18% from $464 million in the prior period, primarily due to a reduced level of positive prior accident year claims development and significantly lower investment income.

The Group's effective tax rate was 8%, well down from 19% in the prior period reflecting the utilisation of US tax losses and the recognition of additional deferred tax assets, which more than offset higher tax expense associated with the increased proportion of Group profits generated in Australia.

Excluding amortisation of intangibles and other non-cash items, cash profit after tax for the half was $385 million, up 3% from $372 million in the prior period.

On a constant currency basis, gross written premium increased by 1% reflecting premium rate driven growth in North American, European and Australian & New Zealand Operations, largely offset by remediation in Asia Pacific Operations and a significant reduction in NSW CTP premium following recent legislative reform. On the same basis, net earned premium was flat relative to the prior period with the increase in gross written premium offset by increased reinsurance costs.

The combined operating ratio increased to 95.8% [1] from 94.5% [1] in the prior period reflecting an improvement in the attritional claims ratio and a reduction in the net cost of large individual risk and catastrophe claims, more than offset by a reduced level of positive prior accident year claims development.

The annualised net investment return on policyholders' funds fell to 2.1% from 3.4% in the prior period, contributing 3.3% to the insurance profit margin compared with 4.1% in the first half of 2017. While returns on growth assets were marginally lower, fixed income returns were well down reflecting mark-to-market losses on sovereign and corporate bonds compared with significant gains in the prior period.

The Group reported an insurance profit of $477 million, down 17% from $573 million in the prior period, primarily due to a reduced level of positive prior accident year claims development and lower investment income. As a result, the insurance profit margin fell to 8.2% from 10.1% in the prior period.

Consistent with investment income on policyholders' funds, investment income on shareholders' funds was significantly lower at $97 million compared with $192 million in the prior period.

Financing and other costs fell to $135 million from $164 million in the prior period, primarily reflecting the non-recurrence of costs associated with the settlement of the class action in 2017.

1 Excludes the impact of changes in risk-free rates used to discount net outstanding claims liabilities.

Cash profit [1]

FOR THE HALF YEAR ENDED 30 JUNE	2018 US$M	2017 US$M
Cash profit before tax	**418**	461
Tax expense on cash profit	**(38)**	(90)
Loss attributable to non-controlling interest	**5**	1
Net cash profit after tax	**385**	372
Amortisation and impairment of intangibles after tax [2]	**(27)**	(27)
Net profit after income tax	**358**	345
Return on average shareholders' funds	**8.2%**	6.6%
Basic earnings per share – cash basis (US cents)	**28.5**	27.2
Dividend payout ratio (percentage of cash profit) [3]	**59%**	61%

1 Cash profit is presented on a statutory basis.
2 $16 million of pre-tax amortisation expense is included in underwriting expenses (2017 $17 million).
3 Dividend payout ratio is calculated as the total AUD dividend divided by cash profit converted to AUD at the average rate of exchange for the period.

Premium income

Gross written premium increased 4% to $7,887 million from $7,596 million in the prior period.

On an average basis and compared with the first half of 2017, the Australian dollar, sterling and euro appreciated against the US dollar by 2%, 8% and 11% respectively. Currency movements favourably impacted gross written premium by $205 million relative to the prior period.

Gross written premium increased 1% on a constant currency basis. This reflects premium rate driven growth in North American and European Operations largely offset by a remediation-led contraction in Asia Pacific Operations coupled with a slight contraction in Australian & New Zealand Operations due to legislative changes in NSW CTP which drove a significant premium rate reduction.

Assisted by continued strong pricing conditions in Australian & New Zealand Operations, Group-wide premium rate increases averaged 4.6% [1] compared with an average increase of 1.0% [1] in 2017. Pricing conditions improved in all divisions but especially in European, North American and Asia Pacific Operations.

North American Operations reported a 3% increase in gross written premium, underpinned by an average premium rate increase of 3.1% compared with 0.9% in the prior period. Growth in accident & health within Specialty coupled with modest growth in Property & Casualty was partially offset by the cancellation of two large programs in 2017.

Although up 9% on a headline basis, European Operations' gross written premium was up only 3% on a constant currency basis. Improved pricing conditions gave rise to an average premium rate increase of 4.8% compared with a reduction of 1.1% in the prior period. Premium rate increases were partially offset by the non-renewal of unprofitable accounts and a targeted reduction in new business volumes in underperforming and/or under priced classes as identified by the Cell Performance Review process.

Australian & New Zealand Operations reported a 1% reduction in gross written premium on a constant currency basis. An average premium rate increase of 6.6% [1] compared with 5.0% [1] in the prior period was more than offset by a significant reduction in NSW CTP premium following legislative reform and a targeted reduction in new business volumes in selected classes of business. Excluding the impact of CTP premium rate reductions, gross written premium increased 3% on a constant currency basis with retention stable across the portfolio.

Asia Pacific gross written premium fell 17% on a constant currency basis. This reflected the sale of our business in Thailand coupled with exiting Hong Kong construction workers' compensation and Indonesian marine hull businesses and the accelerated remediation of marine, property and engineering, particularly in Hong Kong and Singapore. Although the region remains highly competitive, price competition has abated somewhat with an average premium rate increase of 0.3% achieved during the half compared with a reduction of 3.9% in the prior period.

Net earned premium increased 2% to $5,837 million from $5,698 million in the prior period but was flat on a constant currency basis. Growth in gross written premium was more than offset by increased reinsurance costs including additional North American Crop premium cessions due to favourable prior accident year claims development and an increase in Equator Re's external quota share.

1 Excludes premium rate changes relating to CTP.

Underwriting performance

Key ratios – Group

FOR THE HALF YEAR ENDED 30 JUNE	2018		2017	
	STATUTORY %	ADJUSTED [1] %	STATUTORY %	ADJUSTED [2] %
Net claims ratio	**63.1**	**63.9**	65.4	62.7
Net commission ratio	**16.8**	**16.2**	16.5	16.4
Expense ratio	**15.5**	**15.0**	14.9	14.9
Combined operating ratio	**95.4**	**95.1**	96.8	94.0
Adjusted combined operating ratio [3]	**96.1**	**95.8**	97.3	94.5
Insurance profit margin	**8.0**	**8.2**	7.3	10.1

1 Excludes transaction to reinsure Hong Kong construction workers' compensation liabilities.
2 Excludes one-off impact on the Group's underwriting result due to the Ogden decision in the UK.
3 Excludes the impact of changes in risk-free rates used to discount net outstanding claims.

Divisional performance

Contributions by region

FOR THE HALF YEAR ENDED 30 JUNE	GROSS WRITTEN PREMIUM		NET EARNED PREMIUM		COMBINED OPERATING RATIO		INSURANCE PROFIT BEFORE INCOME TAX	
	2018 US$M	2017 US$M	2018 US$M	2017 US$M	2018 %	2017 %	2018 US$M	2017 US$M
North American Operations	**2,896**	2,803	**1,678**	1,712	**95.4**	98.3	**132**	71
European Operations [1]	**2,614**	2,393	**1,731**	1,532	**94.3**	88.7	**169**	231
Australian & New Zealand Operations	**2,040**	2,007	**1,802**	1,705	**92.6**	92.5	**213**	209
Asia Pacific Operations [2]	**350**	409	**282**	317	**107.8**	109.1	**(18)**	(25)
Equator Re	**1,250**	1,375	**314**	419	**92.0**	80.6	**42**	91
Equator Re elimination [3]	**(1,242)**	(1,375)	**–**	–	**–**	–	**–**	–
Corporate adjustments	**(21)**	(16)	**30**	13	**–**	–	**(61)**	(4)
Group adjusted	**7,887**	7,596	**5,837**	5,698	**95.1**	94.0	**477**	573
Reinsurance transaction	**–**	–	**(190)**	–	**0.3**	–	**(27)**	–
Ogden adjustment	**–**	–	**–**	(2)	**–**	2.8	**–**	(156)
M&LS fronting	**–**	(6)	**–**	–	**–**	–	**–**	–
Group statutory	**7,887**	7,590	**5,647**	5,696	**95.4**	96.8	**450**	417
Direct and facultative	**7,079**	6,850	**5,250**	5,298	**95.7**	96.7	**403**	392
Inward reinsurance	**808**	740	**397**	398	**91.4**	97.5	**47**	25
Group statutory	**7,887**	7,590	**5,647**	5,696	**95.4**	96.8	**450**	417

1 Excludes one-off adverse impact on the Group's underwriting result due to the Ogden decision in the UK in 2017.
2 Excludes transaction to reinsure Hong Kong construction workers' compensation liabilities in 2018.
3 Non-eliminated Equator Re gross written premium relates to minority interests in Lloyd's Syndicate 386.

Incurred claims

The Group's net claims ratio deteriorated slightly to 63.9% from 62.7% in the prior period, mainly reflecting a reduced level of positive prior accident year claims development.

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

Analysis of net claims ratio

FOR THE HALF YEAR ENDED 30 JUNE	2018		2017	
	STATUTORY %	ADJUSTED [1] %	STATUTORY %	ADJUSTED [2] %
Attritional claims	**54.9**	**53.1**	53.2	53.2
Large individual risk and catastrophe claims	**10.0**	**9.7**	10.3	10.3
Impact of reinsurance transaction	**(0.4)**	**–**	–	–
Claims settlement costs	**3.4**	**3.4**	3.0	3.0
Claims discount	**(1.6)**	**(1.6)**	(1.2)	(1.2)
Net incurred central estimate claims ratio (current accident year)	**66.3**	**64.6**	65.3	65.3
Changes in undiscounted prior accident year central estimate	**(0.9)**	**(0.9)**	(2.6)	(2.6)
Impact of reinsurance transaction	**(2.5)**	**–**	–	–
Impact of Ogden	**–**	**–**	2.7	–
Changes in discount rates	**(0.7)**	**(0.7)**	(0.5)	(0.5)
Movement in risk margins	**0.1**	**0.2**	0.2	0.2
Other (including unwind of prior year discount)	**0.8**	**0.7**	0.3	0.3
Net incurred claims ratio (current financial year)	**63.1**	**63.9**	65.4	62.7

1 Excludes transaction to reinsure Hong Kong construction workers' compensation liabilities.
2 Excludes one-off impact on the Group's underwriting result due to the Ogden decision in the UK.

Excluding Crop insurance and LMI, the attritional claims ratio improved to 51.3% from 51.8% in the prior period. Improvement in European and Australian & New Zealand Operations more than offset an increase in North American Operations.

Excluding Crop insurance, North America Operations' attritional claims ratio increased 2.2% relative to the prior period. This reflected more cautious ultimate claims ratio assumptions adopted at 31 December 2017 and thereafter, coupled with a change in the claims allocation methodology between attritional and large individual risk claims in Specialty as well as an increased contribution from Specialty that ordinarily operates at a higher attritional claims ratio relative to the rest of the North American portfolio. Given the adoption of more cautious ultimate claims ratio assumptions and the claims allocation methodology change, the attritional claims ratio of 52.1% is better compared with the 2017 full year attritional claims ratio of 53.2%.

European Operations' attritional claims ratio improved 3.2% reflecting underlying improvement coupled with the non-recurrence of numerous temporary impacts including the Ogden decision, additional one-off reinsurance expense and the post-Brexit devaluation of sterling, partially offset by business mix changes that will be ongoing during the second half.

Australian & New Zealand Operations' attritional claims ratio fell by 1.9% (1.4% including LMI) with improvement observed across most of the portfolio including significant reductions in commercial packages, CTP and workers' compensation.

Asia Pacific Operations' attritional claims ratio was broadly unchanged from the prior period but improved significantly relative to the second half of 2017 which was heavily impacted by an increased frequency in medium sized attritional claims following a disappointing lapse in risk selection and underwriting discipline. The improvement in the attritional claims ratio since year end reflects the early impact of remediation initiatives including the sale of our business in Thailand, exiting Hong Kong construction workers' compensation and Indonesian marine hull businesses and the re-underwriting of marine, property and engineering portfolios, particularly in Hong Kong and Singapore.

Equator Re's attritional ratio improved due to a reduction in proportional business which ordinarily operates at a higher attritional claims ratio relative to excess of loss business.

Analysis of attritional claims ratio

FOR THE HALF YEAR ENDED 30 JUNE	2018		2017	
	NEP US$M	ATTRITIONAL %	NEP US$M	ATTRITIONAL %
Rest of portfolio	**5,378**	**51.3**	5,216	51.8
Crop insurance	**354**	**87.0**	373	80.6
LMI	**105**	**28.6**	109	25.2
QBE Group adjusted	**5,837**	**53.1**	5,698	53.2

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

Large individual risk and catastrophe claims

FOR THE HALF YEAR ENDED 30 JUNE 2018	COST US$M	% OF NEP
Total catastrophe claims	**110**	**1.9**
Total large individual risk claims	**455**	**7.8**
Total large individual risk and catastrophe claims	**565**	**9.7**

FOR THE HALF YEAR ENDED 30 JUNE 2017	COST US$M	% OF NEP
Total catastrophe claims	220	3.9
Total large individual risk claims	363	6.4
Total large individual risk and catastrophe claims	583	10.3

The total net cost of catastrophe claims fell to $110 million or 1.9% of net earned premium compared with $220 million or 3.9% in the prior period, reflecting benign experience in North American and Australian & New Zealand Operations while catastrophe claims normalised in European Operations relative to an especially benign prior period.

Although the gross cost of large individual risk claims fell 10% relative to the prior period reflecting favourable frequency trends, the net cost increased to $455 million or 7.8% of net earned premium from $363 million or 6.4% in the prior period due to reduced aggregate recoveries. Reduced large individual risk claim activity in European and Australian & New Zealand Operations was partially offset by increased activity in North American Operations.

As summarised in the table overleaf, the currency weighted average risk-free rate used to discount net outstanding claims liabilities increased to 1.77% as at 30 June 2018 from 1.50% as at 31 December 2017. US dollar and sterling risk-free rates increased strongly, while euro risk-free rates fell appreciably.

Weighted average risk-free rates

CURRENCY		30 JUNE 2018 [1]	31 DECEMBER 2017 [1]	30 JUNE 2017 [1]	31 DECEMBER 2016 [2]
Australian dollar	%	**2.29**	2.31	2.17	2.26
US dollar	%	**2.80**	2.36	2.16	2.04
Sterling	%	**1.10**	0.92	0.89	0.68
Euro	%	**0.30**	0.42	0.45	0.19
Group weighted average	%	**1.77**	1.50	1.40	1.33
Estimated impact of discount rate benefit (charge)	$M	**40**	68	30	(80)

1 Continuing operations basis.
2 Excludes discount rate impact due to Argentine peso.

The increase in risk-free rates gave rise to an underwriting benefit of $40 million that reduced the net claims ratio by 0.7% compared with $30 million in the prior period that reduced the net claims ratio by 0.5%. Given the longer duration of our euro denominated net claims liabilities, the fall in euro risk-free rates during the period disproportionately reduced the overall impact of higher weighted average risk-free rates on the Group's underwriting result.

The result included $51 million of positive prior accident year claims development that benefited the claims ratio by 0.9% compared with $147 million or 2.6% of favourable development in the prior period.

Excluding $59 million of positive prior accident year claims development pertaining to North American Crop insurance that is matched by additional premium cessions under the MPCI scheme (resulting in a nil profit impact) but including a $48 million benefit in European Operations due to a lengthening of the expected future claims payment patterns, prior accident year claims development is better stated at $40 million or 0.7% of net earned premium compared with $112 million or 1.9% in the prior period.

The Group's overall net positive prior accident year claims development of $40 million largely comprised:

- North American Operations recorded $43 million of positive development compared with $33 million of adverse development in the prior period, reflecting a Crop release (that was not matched by additional premium cessions under the MPCI scheme) with net nil development across the rest of the portfolio. This is a pleasing outcome after many periods of lingering adverse development with respect to the non-Crop claims liabilities;
- European Operations recorded $39 million of positive development compared with $131 million in the prior period, reflecting the aforementioned payment pattern benefit and a net reserve strengthening of $9 million primarily driven by European casualty business;
- Australian & New Zealand Operations reported $62 million of positive development compared with $78 million in the prior period, largely reflecting the continuing absence of any notable claims inflation across most long-tail classes;
- Asia Pacific Operations reported $15 million of adverse development primarily due to late notification of short-tail claims; and
- Equator Re reported $80 million of adverse development, up from $49 million in the prior period, largely relating to the September 2017 Mexican earthquakes coupled with reduced recoveries projected on older year aggregate reinsurance treaties.

Commission and expenses

The Group's combined commission and expense ratio improved marginally to 31.2% from 31.3% in the prior period.

The commission ratio improved to 16.2% from 16.4% in the prior period. European Operations' ratio fell due to the non-recurrence of commission adjustments and one-off reinsurance spend in the prior period. This was partially offset by a reduction in North American Crop premium where the net commission ratio is negligible and higher commission expense in the Australian & New Zealand LMI business following a change in reinsurance that resulted in reduced ceding commissions.

The Group's expense ratio increased marginally to 15.0% from 14.9% in the prior period. Cost savings from efficiency initiatives were more than offset by the loss of managed fund fee income in Australian & New Zealand Operations that was historically recognised as a reduction in expenses, a reduction in North American Crop premium that enjoys an especially low expense ratio as well as costs associated with implementation of the Brilliant Basics program and various other strategic initiatives.

Income tax expense

The Group's income tax expense of $34 million equated to an effective tax rate of 8% compared with $111 million and 19% respectively in the prior period. The especially low effective tax rate reflects the utilisation of US tax losses and the recognition of additional deferred tax assets, which more than offset higher tax expense associated with the increased proportion of Group profits generated in Australia.

During the half, QBE paid $198 million in corporate income tax to tax authorities globally, including A$124 million in Australia. Income tax payments in Australia benefit our dividend franking account, the balance of which stood at A$335 million as at 30 June 2018. The Group is therefore capable of fully franking A$782 million of dividends.

The dividend franking percentage will remain at 30% in 2018 consistent with the franking rate applied to the 2017 final dividend paid in April 2018 in accordance with the benchmark franking rule. The expected increase in profitability of non-Australian operations is anticipated to reduce the franking account balance over time.

Balance sheet

Capital management summary

During the first half of 2018, the Group focused on returning capital adequacy to the especially strong levels seen prior to the extreme catastrophe experience of the preceding half. At 30 June 2018, the Group's indicative APRA PCA multiple was 1.74x, up from 1.64x at 31 December 2017 and 1.69x at 30 June 2017, and our S&P capital is now back above 'AA' minimum levels.

During 2018 and following detailed annual reviews, the major rating agencies revised their outlooks on the Group as follows:

- On 30 May 2018, Moody's upgraded QBE insurance Group Limited's (the parent entity) issuer credit rating (ICR) of from 'Baa1' to 'A3' due to a change in ratings methodology for holding companies. The outlook remained "negative". On 14 June 2018, Moody's then affirmed the ICR at 'A3' and the insurer financial strength (IFS) ratings of its core subsidiaries at 'A1'. The outlook remained "negative".
- On 1 June 2018, Standard & Poor's affirmed the parent entity's ICR at 'A-' as well as the ICR and IFS ratings on QBE's core operating entities at 'A+'. The outlook was affirmed at "stable".
- On 13 June 2018, A.M. Best affirmed the long-term ICR of the parent entity and its main operating subsidiaries at 'bbb+' and 'a+' respectively and the IFS of the main operating subsidiaries at 'A'. The Group's outlook was affirmed at "stable".
- On 24 July 2018, Fitch Ratings affirmed the long-term issuer default rating (IDR) at 'A-' and the IFS ratings of its subsidiaries at 'A+' (Strong). The ratings have been removed from Rating Watch Negative and the ratings outlook is "stable".

As announced in February 2017, QBE established a three-year cumulative on-market share buyback facility of up to A$1 billion, with a target of not more than A$333 million in any one calendar year. During the first half of 2018, QBE purchased A$100 million of QBE shares resulting in the cancellation of 10.4 million shares or 0.8% of issued capital. Since commencement of the buyback, QBE has purchased A$239 million of QBE shares resulting in the cancellation of 23.3 million shares or 1.7% of issued capital.

Capital summary

AS AT	30 JUNE 2018 US$M	31 DECEMBER 2017 US$M
Net assets	**8,725**	8,901
Less: intangible assets	**(2,933)**	(3,079)
Net tangible assets	**5,792**	5,822
Add: borrowings	**3,205**	3,616
Total capitalisation	**8,997**	9,438

AS AT	30 JUNE 2018 [1] US$M	31 DECEMBER 2017 [2] US$M
QBE's regulatory capital base	**8,870**	8,974
APRA's Prescribed Capital Amount (PCA)	**5,112**	5,488
PCA multiple	**1.74x**	1.64x

1 Indicative APRA PCA calculation at 30 June 2018.
2 APRA PCA multiple at 31 December 2017 is presented consistent with APRA returns finalised subsequent to year end.

During the second half of 2018, our focus will be on maintaining the Group's capital position within our target PCA range of 1.6–1.8x and further reducing our ratio of borrowings to shareholders' funds to be closer to the target range of 25%–35%.

Key financial strength ratios

	BENCHMARK		30 JUNE 2018	31 DECEMBER 2017
Debt to equity	25% to 35%	%	**36.9**	40.8
Debt to tangible equity		%	**55.6**	62.6
PCA multiple	1.6x to 1.8x	x	**1.74**	1.64
Premium solvency [1]		%	**49.6**	46.7
Probability of adequacy of outstanding claims	87.5% to 92.5%	%	**90.2**	90.0

1 Premium solvency ratio is calculated as the ratio of net tangible assets to adjusted net earned premium.

Borrowings

At 30 June 2018, total borrowings stood at $3,205 million, down $411 million or 11% from $3,616 million at 31 December 2017.

During the half, the Group embarked on two liability management exercises:

- The buyback in March 2018 of $291 million of senior unsecured debt securities due 25 May 2023.
- The buyback in June 2018 of $100 million of senior unsecured debt securities due 10 October 2022.

At 30 June 2018, QBE's ratio of borrowings to shareholders' funds was 36.9%, down from 40.8% at 31 December 2017 and slightly above our target range of 25%–35%. This reflects the debt buybacks undertaken during the half partly offset by a strengthening of the US dollar against major currencies which adversely impacted our reported shareholders' funds. Debt to tangible equity was 55.6%, down from 62.6% at 31 December 2017.

Gross interest expense on long term borrowings was unchanged from the prior period at $105 million. The weighted average annual cash cost of borrowings outstanding at the balance date increased from 5.8% at 31 December 2017 to 6.6% at 30 June 2018, reflecting the repurchase of $391 million of senior debt which has a lower coupon relative to the Group's capital qualifying subordinated debt.

At 30 June 2018, 77% of the Group's debt counted towards regulatory capital, up from 70% at 31 December 2017, reflecting the repurchase and cancellation of non-qualifying senior debt during the half.

Borrowings maturity [1]

AS AT	30 JUNE 2018 %	31 DECEMBER 2017 %
Less than one year	**–**	–
One to five years	**30**	29
More than five years	**70**	71

1 Based on first call date.

Borrowings profile

AS AT	30 JUNE 2018 %	31 DECEMBER 2017 %
Senior debt	**7**	17
Subordinated debt	**81**	72
Additional tier 1 securities	**12**	11

Further details of borrowings are set out in note 4.1 to the financial statements.

Net outstanding claims liabilities

AS AT	30 JUNE	31 DECEMBER			
	2018 US$M	2017 US$M	2016 US$M	2015 US$M	2014 US$M
Net central estimate	**12,776**	14,029	12,693	14,119	15,595
Risk margin	**1,161**	1,239	1,088	1,260	1,353
Net outstanding claims	**13,937**	15,268	13,781	15,379	16,948
	%	%	%	%	%
Probability of adequacy of outstanding claims (PoA)	**90.2**	90.0	89.5	89.0	88.7
Weighted average discount rate	**1.8**	1.7	1.5	1.9	1.7
Weighted average term to settlement (years)	**3.4**	3.1	2.9	3.0	2.8

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

At 30 June 2018, risk margins in net outstanding claims were $1,161 million or 9.1% of the net central estimate of outstanding claims compared with $1,239 million or 8.8% of the net central estimate of outstanding claims at 31 December 2017. Excluding foreign exchange movements and risk margins held for sale, risk margins increased $1 million during the half compared with a $13 million increase in the prior period.

The PoA was broadly stable at 90.2%. A slight increase in risk margins as a percentage of the net central estimate was largely offset by an increase in the coefficient of variation, primarily due to the loss of diversification benefit associated with the held for sale Latin American claims reserves.

Intangible assets

The carrying value of identifiable intangibles and goodwill at 30 June 2018 was $2,933 million, down from $3,079 million at 31 December 2017.

During the period, the carrying value of intangibles reduced by $146 million, primarily due to a $112 million foreign exchange impact coupled with $29 million of intangibles being designated as held for sale at 30 June 2018 following the announced sale of QBE's Latin American Operations. Amortisation expense of $36 million more than offset net additions in the period which comprised the capitalisation of expenditure in relation to various information technology projects.

At 30 June 2018, QBE reviewed all material intangibles for indicators of impairment, consistent with the Group's policy and the requirements of the relevant accounting standard. A detailed impairment test was completed in relation to our North American goodwill balance of $843 million, which indicated headroom at the balance date of $75 million compared with nil at 31 December 2017. The valuation remains highly sensitive to a range of assumptions, particularly increases in the forecast combined operating ratio used in the terminal value calculation and changes in discount rate and long-term investment assumptions.

Details of the sensitivities associated with this valuation are included in note 1.2.2 to the financial statements.

Investment performance and strategy

The investment portfolio delivered an annualised net return of 2.1% for the half compared with 3.6% in the prior period, with a solid performance from growth assets unable to compensate for low fixed income returns.

While developed market equities registered only modest gains over the period and emerging market equities declined, strong income and asset revaluation gains within our unlisted property and infrastructure asset portfolios allowed growth assets overall to generate an annualised return of 9.0% for the six months to 30 June 2018.

In contrast, annualised fixed income returns of 1.2% were adversely impacted by mark-to-market capital losses (approximately 0.5% annualised) as short dated risk-free yields rose, particularly for US Treasuries and UK Gilts. Our short duration stance coupled with active tactical management protected the portfolio from what would otherwise have been a much more significant adverse impact.

Credit spread widening also generated mark-to-market capital losses (approximately 0.2% annualised); however, these were modest in comparison to the re-pricing of sovereign yield curves.

Notwithstanding potentially adverse impacts to global growth and market sentiment from escalating tariff and trade tensions, US economic momentum and US Federal Reserve rhetoric are both consistent with further interest rate rises and higher short dated Treasury yields.

While interest rates in the Eurozone and Australia are likely to remain on hold for another 12 months or so, the looming end to European Central Bank quantitative easing and continued at or above trend growth rates suggest the path of least resistance remains upwards for short dated yields. As yields continue to normalise across the remainder of 2018, we are likely to modestly extend the duration of our fixed income portfolio (particularly in USD), although it will likely remain below two years overall.

The running yield of the fixed income portfolio at 30 June 2018 was 2.1%, up from 1.7% at 31 December 2017 and 1.5% a year earlier.

We believe risk asset sentiment will remain volatile in the short term and our relatively conservative positioning will allow us to participate as appropriate in market dislocations or opportunities presented.

The outlook for the full year return is highly dependent upon the mark-to-market implications of movements in bond yields, with further rises a key downside risk to our 2.25%–2.75% [1] target investment return range.

Total cash and investments at 30 June 2018 was $23.3 billion, down 11% from $26.1 billion at 31 December 2017. The reduction in cash and investments during the half primarily reflected an $0.8 billion impact from the stronger US dollar, a $0.7 billion impact from the settlement of the 2017 North American loss portfolio transfer and the recently completed Hong Kong construction workers' compensation reinsurance transaction, $0.5 billion of debt and equity buybacks, $0.5 billion of Latin American investments held for sale at 30 June 2018 and $0.3 billion of claims payments pertaining to the extreme 2017 catastrophe experience.

1 Full year 2018 investment return target range revised to exclude Latin American Operations held for sale at 30 June 2018.

Total net investment income

	POLICYHOLDERS' FUNDS		SHAREHOLDERS' FUNDS		TOTAL	
FOR THE HALF YEAR ENDED 30 JUNE	2018 US$M	2017 US$M	2018 US$M	2017 US$M	2018 US$M	2017 US$M
Income on growth assets	**78**	104	**46**	84	**124**	188
Fixed interest, short-term money and cash income	**86**	160	**51**	111	**137**	271
Gross investment income [1]	**164**	264	**97**	195	**261**	459
Investment expenses	**(6)**	(6)	**(3)**	(5)	**(9)**	(11)
Net investment income	**158**	258	**94**	190	**252**	448
Foreign exchange gain (loss)	**8**	(22)	**–**	–	**8**	(22)
Other income (expenses)	**24**	(4)	**3**	2	**27**	(2)
Net investment income and other income	**190**	232	**97**	192	**287**	424

1 Includes total realised and unrealised losses on investments of $60 million (2017 $158 million gains) comprising losses on investments supporting policyholders' funds of $37 million (2017 $86 million gains) and shareholders' funds of $23 million (2017 $72 million gains).

Annualised gross and net investment yield

FOR THE HALF YEAR ENDED 30 JUNE	YIELD ON INVESTMENT ASSETS BACKING POLICYHOLDERS' FUNDS		YIELD ON INVESTMENT ASSETS BACKING SHAREHOLDERS' FUNDS		TOTAL	
	2018 %	2017 %	2018 %	2017 %	2018 %	2017 %
Gross investment yield [1]	**2.1**	3.5	**2.1**	4.0	**2.1**	3.7
Net investment yield [2]	**2.1**	3.4	**2.0**	3.9	**2.1**	3.6
Net investment income and other income yield [3]	**2.5**	3.1	**2.1**	4.0	**2.3**	3.4

1 Gross investment 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 gross investment income less investment management expenses as a percentage of average investment assets backing policyholders' or shareholders' funds as appropriate.

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

Total investments and cash

AS AT	INVESTMENT ASSETS BACKING POLICYHOLDERS' FUNDS		INVESTMENT ASSETS BACKING SHAREHOLDERS' FUNDS		TOTAL	
	30 JUNE 2018 US$M	31 DECEMBER 2017 US$M	30 JUNE 2018 US$M	31 DECEMBER 2017 US$M	30 JUNE 2018 US$M	31 DECEMBER 2017 US$M
Cash and cash equivalents	**311**	368	**200**	204	**511**	572
Short-term money	**1,539**	2,228	**986**	1,234	**2,525**	3,462
Government bonds	**2,597**	3,589	**1,664**	1,987	**4,261**	5,576
Corporate bonds	**7,732**	8,523	**4,954**	4,720	**12,686**	13,243
Infrastructure debt	**336**	361	**216**	201	**552**	562
Unit trusts	**–**	18	**–**	11	**–**	29
Strategic equities	**–**	–	**50**	85	**50**	85
Other developed market equities	**202**	280	**129**	155	**331**	435
Emerging market equity	**141**	71	**91**	39	**232**	110
Emerging market debt	**67**	–	**43**	–	**110**	–
Infrastructure assets	**553**	575	**354**	319	**907**	894
Private equity	**68**	49	**43**	27	**111**	76
Unlisted property trusts	**604**	696	**387**	386	**991**	1,082
Investment properties	**8**	10	**5**	5	**13**	15
Total investments and cash	**14,158**	16,768	**9,122**	9,373	**23,280**	26,141

Interest bearing financial assets

S&P SECURITY GRADING

AS AT	30 JUNE 2018 %	31 DECEMBER 2017 %
AAA	**16**	15
AA	**33**	34
A	**40**	39
<A	**11**	12

Currency mix of investments

AS AT	MARKET VALUE OF GROWTH ASSETS		MARKET VALUE OF TOTAL INVESTMENTS AND CASH	
	30 JUNE 2018 %	31 DECEMBER 2017 %	30 JUNE 2018 %	31 DECEMBER 2017 %
US dollar	**55**	53	**30**	29
Australian dollar	**30**	32	**30**	31
Sterling	**7**	5	**19**	18
Euro	**8**	10	**10**	10
Other	**–**	–	**11**	12

Interim dividend

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

The interim dividend for 2018 is 22 Australian cents per share, in line with the 2017 interim dividend of 22 Australian cents per share.

The dividend will be 30% franked and is payable on 5 October 2018. The dividend reinvestment programs remain at a nil discount with any demand for shares under the dividend reinvestment plan to be satisfied by the acquisition of shares on-market.

The 2018 interim dividend payout is A$297 million or 59% of cash profit calculated by converting cash profit to Australian dollars at the average exchange rate during the period. Inclusive of A$100 million of QBE shares purchased and cancelled, the payout for the 2018 half year is A$397 million, up 31% from A$302 million in the prior period.

Closing remarks

There are some clear operational and financial priorities for the Group across the remainder of 2018:

- deliver a 2018 full year combined operating ratio within the revised target range of 95.0%–97.0% [1];
- complete the exit from Latin America;
- renegotiate the Group's reinsurance protections for the 1 January 2019 renewal;
- continue to execute on profit improvement plans in North America;
- drive the necessary actions to improve profitability in Asia Pacific;
- further improve on the strong underwriting results achieved in European and Australian & New Zealand Operations;
- institutionalise the Cell Performance Review discipline across all the divisions;
- ensure the successful rollout of the Brilliant Basics program; and
- continue to maximise divisional cash remittances to the Group head office.

I look forward to reporting on our progress with the release of our 2018 full year results.

Inder Singh
Group Chief Financial Officer

1 Full year 2018 combined operating ratio target range revised to exclude Latin American Operations held for sale at 30 June 2018.

North American Operations

Russ Johnston
Chief Executive Officer • North American Operations

Gross written premium (US$M)
2,896
↑ 3% from 2017

Net earned premium (US$M)
1,678
↓ 2% from 2017

Underwriting result (US$M)
78
↑ 179% from 2017

Insurance profit (US$M)
132
↑ 86% from 2017

Combined operating ratio[1]
97.8%
2017 98.2%

Insurance profit margin
7.9%
2017 4.1%

2018 overview

North American Operations is a specialist industry-focused commercial insurer and reinsurer with four business units: Property & Casualty (P&C), Specialty, Crop and QBE Re (part of QBE's global reinsurance business).

In the first half of 2018, North American Operations initiated a number of Brilliant Basics improvements. We have leveraged this work to refine our appetite around property, aviation and cyber risks, while also updating our underwriting and pricing models to support better risk selection and pricing. Cell reviews have been implemented which are allowing us to identify and respond more quickly to both positive and negative trends. While improvements as a result of the Cell Performance Review process will be iterative, the early returns are encouraging.

During the half we achieved an average premium rate increase of 3.1% compared with 0.9% in the prior period. While our accident & health business achieved rate increases of up to 10%, several lines of business continue to see lower than expected rate increases, most notably in property, while workers' compensation rates continue to soften reflecting strong profitability and state-mandated loss-cost factors.

The interim result benefited from positive prior accident year claims development in Crop while the remainder of the portfolio reported net nil development. This is a pleasing outcome and indicates that the reserve strengthening and more conservative ultimate claims ratio assumptions adopted at 31 December 2017 were appropriate.

We expect to exit personal lines during the second half. The decision to exit reflects our sub-scale position in this segment and will enable material cost savings due to the decommissioning of legacy systems and downsizing of the regional office footprint.

To reduce the impact of a tariff-related fall in the price of soybeans, in April we purchased out-of-the money soybean put options with strikes ranging from 15%–25% below spot. While the price of soybean has fallen by around 10% since the contract price was set for the purposes of the multi-peril crop insurance scheme (MPCI), any impact on our Crop business will be materially offset by our derivative gains.

Operating and financial performance

Underwriting performance

North American Operations reported a combined operating ratio of 95.4% compared with 98.3% in the prior period.

The underwriting result included a $40 million benefit from higher risk-free rates used to discount net outstanding claims compared with a $2 million adverse impact in the prior period. Excluding this impact, the combined operating ratio improved to 97.8% from 98.2% in the prior period.

Premium growth was broadly in line with the average premium rate increase with business shed due to portfolio remediation initiatives essentially offset by targeted growth in preferred business lines, particularly in accident & health within Specialty and profitable elements of our program segment.

The underwriting result benefited from positive prior accident year claims development that more than offset a largely business mix driven increase in the attritional claims ratio. Benign catastrophe experience was more than offset by increased large individual risk claims activity in the P&C property book and revised reinsurance protection on the Specialty book.

The result was particularly impacted by Crop where significant positive prior accident year claims development resulted in an additional $59 million of MPCI reinsurance expense that suppressed net earned premium, thereby artificially inflating attritional and commission and expense ratios.

Expense savings realised in the half were partially offset by higher commissions resulting from changes to the reinsurance of our Specialty business as well as the introduction of the small-commercial business outsourcing arrangement with Arrowhead which commenced in July 2017.

Premium income

Gross written premium increased 3% to $2,896 million from $2,803 million in the prior period. An average premium rate increase of 3.1% coupled with growth in accident & health within Specialty and profitable segments of our program portfolio

1 Excludes the impact of changes in risk-free rates used to discount net outstanding claims.

more than offset the prior-year cancellation of two poorly performing programs and the maintenance of a highly disciplined approach to new business acceptances in QBE Re.

Excluding a one-time impact from a change in premium recognition accounting with respect to accident & health, Specialty gross written premium increased 25% to $477 million, primarily driven by growth in accident & health, aviation, healthcare and inland marine while professional liability was flat reflecting pricing conditions. Crop premium was flat at $1,155 million with growth in policy count offset by lower crop prices and lower MPCI pricing volatility. P&C premium declined 3% to $1,104 million driven by the aforementioned prior year program terminations. QBE Re premium declined 5%, driven by remediation initiatives, particularly in casualty.

Net earned premium decreased by 2% to $1,678 million from $1,712 million in the prior period driven by increased Crop cessions to the Federal Government due to significant positive prior accident year claims development. Excluding this impact, net earned premium was broadly stable.

Claims expense

North American Operations reported a net claims ratio of 63.5%, down from 66.8% in the prior period reflecting positive prior accident year claims development that more than offset an increase in the attritional claims ratio.

The attritional claims ratio increased to 59.1% from 56.2% in the prior period, partly due to the distorting impact of additional Crop reinsurance cessions. Excluding Crop, the attritional claims ratio increased to 52.1% from 49.9% in the prior period. This reflected more cautious ultimate claims ratio assumptions adopted at 31 December 2017 and thereafter, coupled with a change in the claims allocation methodology between attritional and large individual risk claims in Specialty. The attritional claims ratio was also impacted by an increased contribution from Specialty that ordinarily operates at a higher attritional claims ratio relative to the rest of the portfolio. Given the adoption of more cautious ultimate claims ratio assumptions and the claims allocation methodology change, the attritional claims ratio (excluding Crop) of 52.1% is better compared with the 2017 full year attritional claims ratio of 53.2%.

The net cost of large individual risk and catastrophe claims was 6.8% of net earned premium compared with 7.3% in the prior period. While catastrophe experience was benign relative to the prior period, the net cost of large risk claims increased, largely due to the change in reinsurance support for Specialty coupled with several unusual risk claims.

Positive prior accident year claims development contributed $102 million or 6.1% of net earned premium compared with only $2 million in the prior period. Excluding $59 million of Crop development that is matched by additional premium cessions under the MPCI scheme (resulting in a nil profit impact), prior accident year claims development is better stated at $43 million or 2.5% of net earned premium compared with $33 million or 1.9% of adverse development in the prior period. Crop also accounted for the residual $43 million of positive development with the remainder of the portfolio pleasingly reporting net nil development compared with $56 million of adverse development in the prior period.

The result also included a $32 million risk margin charge equating to 1.9% of net earned premium compared with a $14 million or 0.8% charge in the prior period.

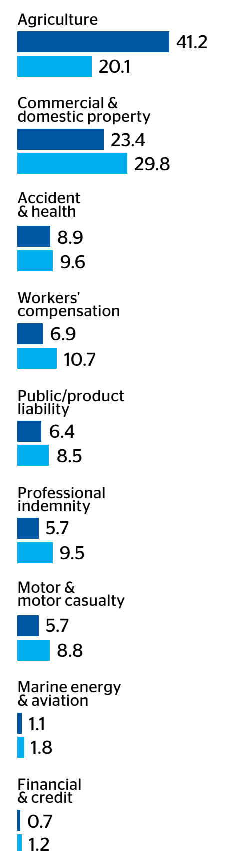
Commission and expenses

The combined commission and expense ratio increased slightly to 31.9% from 31.5% in the prior period.

The net commission ratio increased to 16.0% from 15.5% in the prior year. This reflected the additional Crop reinsurance cessions, the Arrowhead outsourcing arrangement and the aforementioned change in reinsurance protection for Specialty that resulted in reduced exchange commissions.

The expense ratio improved slightly to 15.9% from 16.0% in the prior period, due to operating efficiencies (including Arrowhead) as a result of ongoing cost discipline partially offset by increased Crop reinsurance cessions. Excluding this impact, the expense ratio improved to 15.3% from 15.7% in the prior period.

Gross written premium and net earned premium by class of business (%)



Underwriting result

FOR THE HALF YEAR ENDED 30 JUNE		2018	2017	2016	2015 [1]	2014 [1]
Gross written premium	US$M	**2,896**	2,803	2,818	3,109	2,472
Gross earned premium	US$M	**2,162**	2,187	2,184	2,309	2,259
Net earned premium	US$M	**1,678**	1,712	1,710	1,832	1,917
Net incurred claims	US$M	**1,066**	1,144	1,225	1,145	1,152
Net commission	US$M	**268**	266	288	329	357
Expenses	US$M	**266**	274	265	361	377
Underwriting result	US$M	**78**	28	(68)	(3)	31
Net claims ratio	%	**63.5**	66.8	71.6	62.5	60.1
Net commission ratio	%	**16.0**	15.5	16.8	18.0	18.6
Expense ratio	%	**15.9**	16.0	15.5	19.7	19.7
Combined operating ratio	%	**95.4**	98.3	104.0	100.2	98.4
Adjusted combined operating ratio [2]	%	**97.8**	98.2	100.5	100.6	–
Insurance profit margin	%	**7.9**	4.1	(1.5)	1.6	2.9

1 Comparability of prior period data is reduced due to the sale of M&LS.
2 Excludes the impact of changes in risk-free rates used to discount net outstanding claims.

European Operations

Richard Pryce
Chief Executive Officer • European Operations

Gross written premium (US$M)
2,614
↑ 9% from 2017[1]

Net earned premium (US$M)
1,731
↑ 13% from 2017[2]

Underwriting result (US$M)
99
↓ 42% from 2017[3]

Insurance profit (US$M)
169
↓ 27% from 2017[3]

Combined operating ratio[4]
94.5%
2017 91.3%[3]

Insurance profit margin
9.8%
2017 15.1%[3]

2018 overview

Although not market-wide, trading conditions continued to improve with an average renewal premium rate increase of 4.8% achieved during the first half of 2018 compared with a reduction of 1.1% in the prior period. The principal area of improvement is in those insurance and reinsurance sectors impacted by the 2017 catastrophe activity. Elsewhere, we are experiencing mixed trading conditions. UK commercial motor and UK casualty continue to record improvements, in part due to the ongoing effect of the Ogden decision, and there are more encouraging signs in financial lines. Aggressive competition is ongoing in most other classes and territories.

There are early signs of some competitors rationalising their portfolios in response to reduced profitability. Whilst we expect this to continue as planning for the next renewal season progresses, we do not believe that this signals a wholesale shift in market conditions. The PRA's well publicised 'Dear CEO' letter highlighting the market conditions facing specialist general insurers and the Lloyd's Performance Director's strict guidance on performance and planning indicate that the London Market is currently navigating a particularly challenging period.

We remain focused on maintaining underwriting discipline with regular reviews of all portfolios, as well as undertaking more granular and independent reviews of any poorly performing portfolio or sub-portfolio as required. As part of the Brilliant Basics program, we have reviewed our underwriting governance and pricing capabilities and expect to make further investments in the latter over the next 24 months.

Our Brexit plans remain challenging but on track. In May 2018, we received licensing approval from the National Bank of Belgium for our new insurance and reinsurance company. The directors have been appointed and the Board has already met several times. We expect to be operational in time for January 2019 renewals.

Operating and financial performance

Underwriting performance

Excluding the beneficial impact of higher risk-free rates used to discount net outstanding claims liabilities, European Operations' combined operating ratio increased to 94.5%[4] from 91.3%[3,4] in the prior period primarily due to a reduction in the level of positive prior accident year claims development.

The current accident year performance was largely as expected and represented a significant improvement on the prior period. This was underpinned by an improvement in the attritional claims ratio coupled with a pleasing reduction in the combined commission and expense ratio.

QBE Re performed strongly assisted by especially benign global catastrophe activity during the half. The insurance division recorded a more mixed performance and we will continue to reduce exposures in underperforming areas such as direct and facultative property, Canada and Italian general liability.

Insurance profit for the period was $169 million, down 27% from $231 million[3] the prior period, reflecting a reduced level of positive prior accident year claims development.

Premium income

While headline gross written premium increased 9% to $2,614 million from $2,393 million in the prior period, gross written premium is up only 3% on a constant currency basis. New business volumes were disappointing in catastrophe loss impacted areas, particularly in QBE Re; however, both our insurance and reinsurance business in Continental Europe continued to grow, demonstrating the value of our extended distribution platform.

We continue to develop a more sophisticated approach to new business activities utilising Salesforce, a customer relationship management platform, and data analytics. This will enable our underwriting and client teams to engage more efficiently and

1 Up 3% on a constant currency basis.
2 Up 6% on a constant currency basis.
3 Excludes one-off impact on the underwriting result due to the Ogden decision in the UK.
4 Excludes the impact of changes in risk-free rates used to discount net outstanding claims.

effectively with the customers most likely to want to transact with QBE.

Our premium retention levels have increased slightly while our new business activities offset the actions to lapse poor performing business. Finding quality new business that fits our risk and profit profile remains a challenge.

Net earned premium grew 13% to $1,731 million from $1,532 million in the prior period. On a constant currency basis, net earned premium growth was 6%, reflecting the previously noted gross written premium growth coupled with non-recurring reinsurance spend in the prior period.

Claims expense

The net claims ratio increased to 60.6% from 53.3% in the prior period, reflecting a reduction in positive prior accident year claims development partly offset by a significant improvement in the attritional claims ratio.

Despite an adverse mix impact from growth in classes of business with ordinarily higher attritional claims ratios, the attritional claims ratio reduced to 47.1% from 50.3% in the prior period. This was due in part to the unwind of the previously flagged post-Brexit foreign exchange impact and the non-recurring reinsurance spend which suppressed net earned premium in the prior period. Given the more wholesale nature of European Operations' portfolio, the attritional claims ratio will remain sensitive to changes in business mix from period to period.

While catastrophe experience was benign by historical standards, catastrophe claims increased relative to an especially benign prior period. Nevertheless, the net cost of large individual risk and catastrophe claims reduced to 12.8% of net earned premium from 14.0% in the prior period due to improved large risk claim activity.

Including a benefit due to a lengthening of expected future claims payment patterns, prior accident year claims development was $39 million or 2.3% of net earned premium, down from $131 million or 8.6% of net earned premium in the prior period. Favourable claims development emerged across a number of insurance and reinsurance portfolios; however, this was more than offset by a strengthening of claims reserves primarily in our European casualty portfolio.

Higher risk-free rates used to discount net outstanding claims liabilities benefited the underwriting result by $4 million or 0.2% of net earned premium compared with a positive impact of $40 million or 2.6% in the prior period.

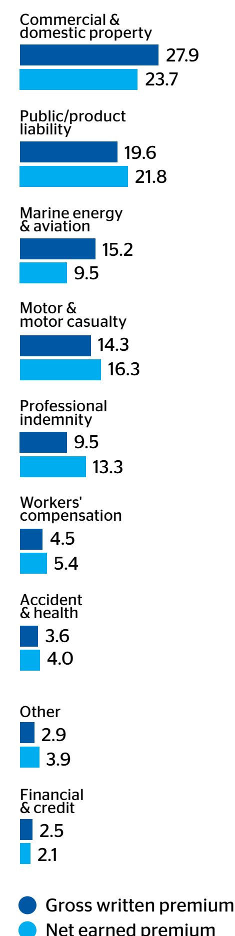
Commission and expenses

European Operations' combined commission and expense ratio improved to 33.7% from 35.4% in the prior period.

The net commission ratio reduced to 18.1% from 19.3% in the prior period due to the aforementioned reinsurance spend which suppressed net earned premium in the prior period coupled with non-recurring commission adjustments on prior underwriting years. Notwithstanding the apparent improvement, we continue to experience upward commission pressure from broker activities and the increased use of facilities.

The expense ratio also improved to 15.6% from 16.1% in the prior period reflecting ongoing strict cost control and the unwind of suppressed net earned premium as previously mentioned. Excluding the impact of foreign exchange, underwriting expenses were stable relative to the prior period while net earned premium increased 6% on a constant currency basis.

Gross written premium and net earned premium by class of business (%)



Underwriting result

FOR THE HALF YEAR ENDED 30 JUNE		2018	2017 [1] ADJUSTED	2016 [2] ADJUSTED	2015	2014 [3] ADJUSTED
Gross written premium	US$M	**2,614**	2,393	2,508	2,659	2,705
Gross earned premium	US$M	**2,134**	1,915	1,930	2,112	2,471
Net earned premium	US$M	**1,731**	1,532	1,561	1,660	2,033
Net incurred claims	US$M	**1,049**	817	990	815	1,214
Net commission	US$M	**313**	296	279	312	383
Expenses	US$M	**270**	247	270	297	319
Underwriting result	US$M	**99**	172	22	236	117
Net claims ratio	%	**60.6**	53.3	63.4	49.1	59.7
Net commission ratio	%	**18.1**	19.3	17.9	18.8	18.8
Expense ratio	%	**15.6**	16.1	17.3	17.9	15.7
Combined operating ratio	%	**94.3**	88.7	98.6	85.8	94.2
Adjusted combined operating ratio [4]	%	**94.5**	91.3	88.3	88.0	–
Insurance profit margin	%	**9.8**	15.1	5.2	16.7	8.9

1 Excludes one-off impact on the underwriting result due to the Ogden decision in the UK.
2 Adjusted for transactions to reinsure UK liabilities.
3 Adjusted for transactions to reinsure Italian and Spanish medical malpractice liabilities.
4 Excludes the impact of changes in risk-free rates used to discount net outstanding claims.

Australian & New Zealand Operations

Vivek Bhatia
Chief Executive Officer • Australian & New Zealand Operations

Gross written premium (US$M)
2,040
↑ 2% from 2017[1]

Net earned premium (US$M)
1,802
↑ 6% from 2017[2]

Underwriting result (US$M)
134
↑ 4% from 2017

Insurance profit (US$M)
213
↑ 2% from 2017

Combined operating ratio[3]
92.3%
2017 92.2%

Insurance profit margin
11.8%
2017 12.3%

2018 overview

Brilliant Basics, including investment in technical pricing, claims management and the implementation of Group Underwriting Standards, continues to improve the performance trajectory observed in 2017. The now monthly review of performance and lead indicators for our 50 business cells has allowed management to respond quickly to any changes in underlying conditions.

The rating environment remains strong. Excluding compulsory third party motor (CTP), we achieved an average premium rate increase of 6.6%, building on the 5.0% increase achieved in the prior period. Despite significant rate increases, retention has remained steady at above 80% evidencing the strength of our franchise and the great support of our broking partners and intermediaries.

Underwriting governance and risk selection were key to our improved performance. This is evident with commercial property where a reduction in exposure to high hazard risks and other inadequately priced exposures has led to a material reduction in the frequency of large claims. During the first half of 2016 and 2017, Australian & New Zealand Operations incurred large individual risk claims of A$125 million and A$116 million respectively, while only A$91 million was incurred during the first six months of 2018.

The interim result benefited from claims management initiatives including the application of data science and artificial intelligence to identify fraudulent and other inappropriate behaviour. This is in addition to benefits emerging from enhanced supply chain and vendor management.

The Australian financial services sector is currently experiencing an unprecedented level of regulatory attention and the insurance industry has not been immune. Reform of NSW CTP and the Emergency Services Levy is ongoing as is the ACCC's review of insurance affordability in Northern Australia and the Royal Commission into financial services. In committing to uphold its social licence, QBE recognises that products must fundamentally address customer needs and will hold the customer at the heart of its decision-making. This has been reinforced during 2018 with the establishment of a Customer & Product Governance Conduct risk committee (CPGC).

Operating and financial performance

Underwriting performance

Australian & New Zealand Operations reported a combined operating ratio of 92.6%, in line with the prior period. Excluding the impact of changes in risk-free rates used to discount net outstanding claims, the combined ratio was broadly stable at 92.3%.

Current accident year profitability improved appreciably underpinned by a 1.9% improvement in the attritional (excluding LMI) claims ratio. With the exception of farm that was impacted by several large attritional claims, and commercial motor which continues to be impacted by high levels of claims inflation, the performance of all portfolios improved. Nevertheless, workers' compensation, commercial property, commercial motor and strata underwriting results remain unacceptable and further remediation was undertaken during the half to drive returns in these portfolios to more acceptable levels.

The underwriting result benefited from $62 million of prior accident year claims development or 3.4% of net earned premium, down from $78 million or 4.6% in the prior period. Consistent with the change in underwriting appetite, there has been a notable reduction in large individual risk claim frequency and catastrophe experience was also benign relative to previous periods. Although the gross cost of large individual risk and catastrophe claims was well below the prior period, the net cost was broadly unchanged reflecting the Group's aggregate reinsurance.

As expected, the combined operating ratio of our lenders' mortgage insurance (LMI) business increased to 50.6%, from 44.8% in the prior period, to be in line with the underlying 2017 full year combined operating ratio. This reflected the increased propensity for mortgages in arrears, primarily in mining towns in Western Australia and Queensland, to generate claims, and reduced ceding commissions following a change in reinsurance strategy.

1 Down 1% on a constant currency basis; however, up 3% excluding the impact of premium rate reductions as a result of regulatory changes to CTP.
2 Up 3% on a constant currency basis.
3 Excludes the impact of changes in risk-free rates used to discount net outstanding claims.

Premium income

Gross written premium during the half was $2,040 million, up 2% from $2,007 million in the prior period, with the slightly stronger Australian dollar providing a modest tailwind. On a constant currency basis, gross written premium was down 1%, primarily reflecting NSW CTP scheme reform where a 20% premium rate reduction has led to significantly reduced premium income. Gross written premium was also adversely impacted by the non-renewal of two large but unprofitable travel insurance credit card portfolios and subdued LMI premium volumes due to macro-prudential regulatory intervention resulting in reduced lending activity. Excluding the above impacts, a reduction in premium volumes attributable to reduced levels of exposure has essentially been offset by premium rate increases.

We continue to drive pricing initiatives across all our portfolios with higher rate increases targeted on those portfolios for which premium levels are substantially below required levels. Excluding CTP, we achieved an average premium rate increase of 6.6% during the half, up from 5.0% in the prior period, underpinned by an 18% rate increase in commercial property, 9% in workers' compensation, 9% in strata and 6% in commercial packages.

Reflecting tightened underwriting discipline and improved risk selection, new business volumes were below the prior period primarily in short-tail personal and commercial lines.

Net earned premium increased 6% to $1,802 million from $1,705 million in the prior period, reflecting gross written premium growth coupled with reduced reinsurance spend due to the non-renewal of a quota share with Equator Re. Net earned premium was up 3% on a constant currency basis.

Claims expense

The net claims ratio decreased to 63.0% from 63.6% in the prior period, primarily reflecting an improvement in the attritional claims ratio to 57.3% from 58.7% in the prior period. Excluding LMI, the attritional claims ratio fell 1.9% with improvement observed across most of our portfolios including significant reductions in commercial packages, CTP and workers' compensation.

The gross cost of large individual risk and catastrophe claims fell materially relative to the prior period. However, the net cost is largely unchanged at 5.2% of net earned premium compared with 5.4% in the prior period reflecting the mitigating impact of the Group's "in-the-money" aggregate reinsurance protection.

The underwriting result included positive prior accident year claims development of $62 million or 3.4% of net earned premium compared with $78 million or 4.6% in the prior period. Approximately half of the reserve releases during the recent period were attributable to the NSW CTP portfolio while benign wage inflation has resulted in smaller releases across other long-tail portfolios including Queensland CTP, workers' compensation and liability.

Risk-free rates used to discount net outstanding claims liabilities decreased slightly during the period resulting in a $5 million or 0.3% adverse underwriting impact, in line with the prior period.

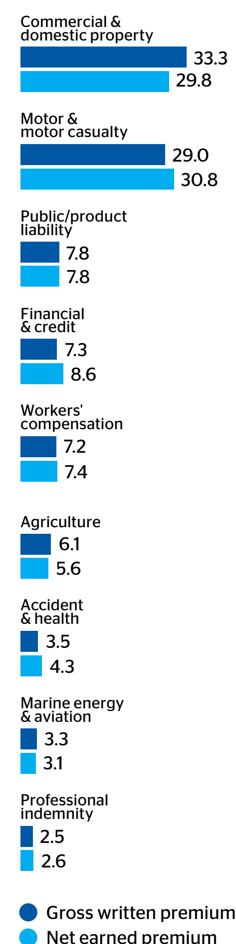
Commission and expenses

Australian & New Zealand Operations' combined commission and expense ratio increased to 29.6% from 28.9% in the prior period.

The commission ratio increased to 15.6% from 15.0% in the prior period, primarily due to non-renewal of a quota share arrangement with Equator Re which resulted in reduced exchange commissions.

The headline expense ratio increased slightly to 14.0% from 13.9% in the prior period. Excluding the Fire and Emergency Services Levy, the underlying expense ratio increased to 12.7% from 12.1% in the prior period, with cost savings more than offset by a reduction in fee income associated with changes to the NSW Managed Fund contract and the loss of the NSW builders' warranty contract that began impacting the expense ratio from May 2017 and February 2018 respectively.

Gross written premium and net earned premium by class of business (%)



Underwriting result

FOR THE HALF YEAR ENDED 30 JUNE		2018	2017	2016	2015	2014
Gross written premium	US$M	**2,040**	2,007	1,861	1,928	2,275
Gross earned premium	US$M	**2,035**	2,024	1,871	1,913	2,192
Net earned premium	US$M	**1,802**	1,705	1,654	1,668	1,916
Net incurred claims	US$M	**1,136**	1,084	1,120	1,050	1,134
Net commission	US$M	**280**	255	250	235	267
Expenses	US$M	**252**	237	217	230	274
Underwriting result	US$M	**134**	129	67	153	241
Net claims ratio	%	**63.0**	63.6	67.7	62.9	59.2
Net commission ratio	%	**15.6**	15.0	15.1	14.1	13.9
Expense ratio	%	**14.0**	13.9	13.1	13.8	14.3
Combined operating ratio	%	**92.6**	92.5	95.9	90.8	87.4
Adjusted combined operating ratio [1]	%	**92.3**	92.2	93.9	90.7	–
Insurance profit margin	%	**11.8**	12.3	8.9	14.8	17.2

1 Excludes the impact of changes in risk-free rates used to discount net outstanding claims.

Asia Pacific Operations

Jason Brown
Chief Executive Officer • Asia Pacific Operations

Gross written premium (US$M)
350
↓ 14% from 2017 [1]

Net earned premium (US$M)
282 [2]
↓ 11% from 2017 [3]

Underwriting result (US$M)
(22) [2]
↑ 24% from 2017

Insurance profit (US$M)
(18) [2]
↑ 28% from 2017

Combined operating ratio [4]
108.5% [2]
2017 109.1%

Insurance profit margin
(6.4)% [2]
2017 (7.9)%

2018 overview

Following deterioration in Asia Pacific Operations' 2017 underwriting performance, we have taken aggressive and swift remediation actions. Brilliant Basics initiatives have been implemented including greater use of technical pricing models to drive premium rate increases as well as an in-depth analysis of our underwriting exposures to materially reduce our exposure to catastrophe prone territories and high hazard industries. We have exited Thailand, Hong Kong construction workers' compensation and Indonesian marine hull – which together contributed $49 million of the $100 million underwriting loss in 2017.

In March 2018, we reinsured potentially volatile claims liabilities and all ongoing exposure to our Hong Kong construction workers' compensation portfolio. A clean exit from this business materially reduces our risk profile while significantly improving earnings certainty. Moreover, in May 2018 we completed the divestment of our business in Thailand that contributed a $2 million underwriting loss in the half.

While Asia remains competitive, across the entirety of Asia Pacific Operations we have seen a modest improvement in premium pricing conditions with an average rate increase of 0.3% achieved during the half compared with an average premium rate reduction of 3.9% in the prior period.

The Cell Performance Review process is fully implemented and has added a robust layer of oversight to our remediation actions.

The 2018 adjusted result in the table overleaf excludes the one-off transaction to reinsure Hong Kong construction workers' compensation liabilities which reduced net earned premium by $190 million and net claims expense by $166 million while adversely impacting commission and underwriting expenses by $1 million and $2 million respectively. The transaction is one-off in nature and impacts half-on-half comparison of net earned premium and underwriting ratios, depressing the net claims ratio and inflating the combined commission and expense ratio.

The commentary following refers to Asia Pacific's result on the basis described above.

Operating and financial performance

Underwriting performance

Asia Pacific Operations reported a combined operating ratio of 108.5% [2,4], a modest improvement from 109.1% [4] in the prior period. Given the significant performance deterioration during the second half of 2017, the result is more appropriately compared with the 2017 full year combined operating ratio of 115.5% [4], against which there has been significant improvement.

Not surprisingly, gross written premium fell materially due to remediation initiatives including the complete exiting of businesses as described above and the widespread re-underwriting of poorly selected and/or poorly priced risks in accordance with a reduced risk appetite. These initiatives are having a noticeable impact on business performance metrics including improved premium pricing, reduced catastrophe exposure and a further material improvement in portfolio quality as evidenced by an ongoing reduction in property hazard grades.

Although the attritional claims ratio was broadly unchanged from the prior period, we have seen significant improvement relative to the second half of 2017. The underwriting result also included adverse prior accident year claims development equating to 5.3% of net earned premium, primarily relating to late claim notifications in property, engineering, marine and motor portfolios. This was identified during the first quarter of 2018 as part of a significant overhaul of our claims management processes.

Although delivering an improved result and achieving material price increases relative to the prior period, our two largest territories, Hong Kong and Singapore, both reported underwriting losses primarily due to adverse prior accident year claims development and a heightened frequency of large individual risk claims in marine, engineering and property. Malaysia and Vietnam continue to report underwriting profits while the Pacific Islands achieved a combined operating ratio of 84.9% compared with 88.3% in the prior period.

1 Down 17% on a constant currency basis.
2 Excludes transaction to reinsure Hong Kong construction workers' compensation liabilities.
3 Down 13% on a constant currency basis.
4 Excludes the impact of changes in risk-free rates used to discount net outstanding claims.

Premium income

Gross written premium was down 14% to $350 million from $409 million in the prior period or down 17% on a constant currency basis.

Reflecting the remediation undertaken, premium income contracted across most countries and portfolios with the lapsing of unprofitable accounts resulting in a renewal retention ratio of 67% compared with 81% in the prior period. Significant premium contraction was experienced in marine, property and workers' compensation, accounting for over 75% of the total reduction. By territory, Hong Kong, Singapore and Indonesia, as well as the sale of our business in Thailand, were the key drivers of top-line reduction.

Portfolios subject to remediation experienced a 24% reduction in gross written premium while the better performing portfolios reported 9% growth relative to the prior period – evidence of the success of our targeted approach.

Pleasingly, we achieved an average premium rate increase of 0.3% on renewed business compared with an average premium rate reduction of 3.9% in the prior period, including material premium rate increases across workers' compensation, marine and group medical.

Net earned premium fell by 11% to $282 million or 13% on a constant currency basis, more than the reduction in gross written premium due to the unwind of prior period unearned premium which more than offset the impact of higher reinsurance spend.

Claims expense

Asia Pacific Operations' net claims ratio improved to 63.8% from 65.3% in the prior period, primarily due to a risk margin release of $7 million or 2.5% of net earned premium compared with a $3 million or 0.9% charge in the prior year. This was due to the reduction in net outstanding claims volatility following the Hong Kong construction workers' compensation reinsurance transaction, with the probability of adequacy of claims liabilities unchanged from 31 December 2017.

The attritional claims ratio was broadly stable at 54.6% compared with 54.3% in the prior period but improved appreciably relative to the 2017 second half and full year attritional claims ratios of 57.7% and 56.0% respectively, principally as a result of significant portfolio reshaping.

While catastrophe experience was particularly benign, a number of large individual risk claims in property, engineering and marine (the largest of which was in our since exited business in Thailand) saw the net cost of large individual risk and catastrophe claims increase to 4.0% of net earned premium from 2.8% in the prior period.

The underwriting result included $15 million of adverse prior accident year claims development due to late claim notifications in short-tail property portfolios, including fire and engineering in Singapore and Hong Kong motor. This compared with $12 million of adverse development in the prior period pertaining to our now exited Hong Kong construction workers' compensation business.

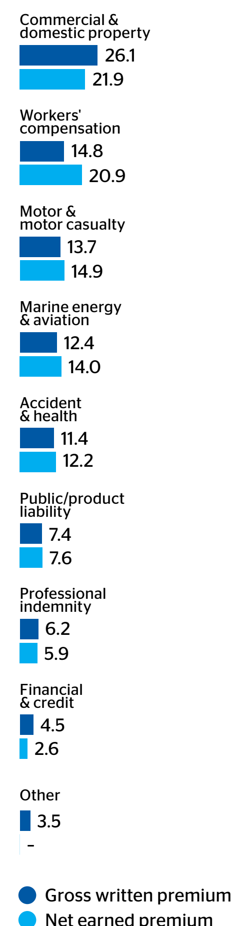
Commission and expenses

Asia Pacific Operations' combined commission and expense ratio was broadly stable at 44.0%.

The commission ratio improved to 21.3% from 21.7% in the prior period, primarily due to additional exchange commissions associated with revised reinsurance arrangements partially offset by growth in higher commission paying personal lines distributed through agency and affinity channels.

Despite cost reduction initiatives, the expense ratio increased to 22.7% from 22.1% in the prior period due to the material reduction in net earned premium. An operating model review in 2017 and an ongoing drive for operational efficiency and organisational agility has led to a leaner corporate office, a simplified distribution model and fewer management layers, resulting in a $6 million reduction in expenses compared with the prior period. Further right-sizing of the business relative to premium income is planned across the remainder of 2018.

Gross written premium and net earned premium by class of business (%)



Underwriting result

FOR THE HALF YEAR ENDED 30 JUNE		2018	2018 [1] ADJUSTED	2017	2016	2015	2014
Gross written premium	US$M	**350**	**350**	409	419	424	394
Gross earned premium	US$M	**365**	**365**	378	366	368	346
Net earned premium	US$M	**92**	**282**	317	298	304	285
Net incurred claims	US$M	**14**	**180**	207	153	159	147
Net commission	US$M	**61**	**60**	69	64	65	58
Expenses	US$M	**66**	**64**	70	66	64	59
Underwriting result	US$M	**(49)**	**(22)**	(29)	15	16	21
Net claims ratio	%	**15.2**	**63.8**	65.3	51.3	52.3	51.6
Net commission ratio	%	**66.4**	**21.3**	21.7	21.6	21.3	20.3
Expense ratio	%	**71.7**	**22.7**	22.1	22.1	21.1	20.7
Combined operating ratio	%	**153.3**	**107.8**	109.1	95.0	94.7	92.6
Adjusted combined operating ratio [2]	%	**155.5**	**108.5**	109.1	95.0	94.7	92.6
Insurance profit margin	%	**(48.9)**	**(6.4)**	(7.9)	6.0	6.3	8.1

1 Excludes transaction to reinsure Hong Kong construction workers' compensation liabilities.
2 Excludes the impact of changes in risk-free rates used to discount net outstanding claims.

Equator Re

Jim Fiore
Group Chief Reinsurance Officer & President • Equator Re

Gross written premium (US$M)
1,250
↓ 9% from 2017

Net earned premium (US$M)
314
↓ 25% from 2017

Underwriting result (US$M)
25
↓ 69% from 2017

Insurance profit (US$M)
42
↓ 54% from 2017

Combined operating ratio[1]
91.7%
2017 79.9%

Insurance profit margin
13.4%
2017 21.7%

2018 overview

Like many of our peers in the Bermudian captive market, Equator Re's business model was reassessed in response to the Base Erosion Anti-Abuse Tax (BEAT) that was introduced as part of the US Tax Reform Act signed into law on 22 December 2017. This act introduced a tax of 10% on payments made from US tax paying entities to non-US affiliated companies, which for Bermudian domiciled captive reinsurers, like Equator Re, introduces a 10% tax on all premium ceded from US based cedants.

In response, QBE created a new Bermudian domiciled captive, Blue Ocean Re, which now owns Equator Re. Blue Ocean Re in turn is owned by North American Operations and will be taxed as a US domestic taxpayer. This corporate restructure required no additional capital to be deployed and mitigated the impact of BEAT, with taxable profits of Blue Ocean Re and Equator Re now effectively taxed at the US corporate rate of 21%. The US taxable income of Blue Ocean Re and Equator Re are able to be offset against existing tax losses in North American Operations.

2017 was the costliest year on record for insured natural catastrophes[2]. Due to the global reinsurance market maintaining very strong levels of capital across all geographies and lines of business, the average premium rate increase achieved on renewal of divisional catastrophe excess of loss books during 2018 was limited to 5%. More pronounced increases were levied on divisions with loss-affected reinsurance layers, with loss-free treaties/layers renewing largely flat on a risk-adjusted basis. On non-catastrophe business, the same capital surplus ensured that recent downward pricing pressure on renewal rates remained, with price increases only achieved on loss-affected portfolios in most instances.

The reinsurance marketplace is expected to remain extremely well capitalised and we anticipate continued downward pressure on rates in the near future: any significant and sustained increase in reinsurance pricing will likely require a market loss well beyond that experienced by the industry to date.

Operating and financial performance

Underwriting performance

The first half of 2018 was characterised by benign global catastrophe experience. For a catastrophe exposed reinsurance captive such as Equator Re, this would ordinarily result in a strong underwriting performance; however, the benefit of benign catastrophe experience was negated by the Group's large individual risk and catastrophe aggregate reinsurance program.

While this program insulates Equator Re from significant downside risk associated with both frequency and severity of large individual risk and/or catastrophe claims, the "in-the-money" aggregate treaty attachment point typically negates the benefit to the company of benign catastrophe experience. Accordingly, Equator Re's cumulative net cost of large individual risk and catastrophe claims during the half remains as per plan and at the program attachment point.

Equator Re reported a combined operating ratio of 92.0%, up from 80.6% in the prior period. Excluding the impact of movements in risk-free rates used to discount net outstanding claims, the combined operating ratio increased to 91.7% from 79.9% in the prior period.

Net premium volumes are down significantly due to the non-renewal of two large divisional quota shares that magnified the impact of the retained large individual risk and catastrophe claims on the net claims ratio. Adverse prior accident year claims development during the half increased relative to the prior period and contributed even more significantly to the combined operating ratio in the current half due to the reduced premium volume. These headwinds were partially offset by a reduction in the attritional claims ratio and the commission expense ratio reflecting the reduced proportional income.

Given the significant headroom that remains available in the aggregate cover, Equator Re is well positioned heading into the second half northern hemisphere wind season.

1 Excludes the impact of changes in risk-free rates used to discount net outstanding claims.
2 Swiss Re, sigma No 1/2018.

Premium income

Gross written premium reduced 9% to $1,250 million from $1,375 million in the prior period due to the non-renewal of two proportional contracts written during 2017. Increased confidence in the earnings trajectory of the North American Specialty book prompted a switch from quota share support by Equator Re to an excess of loss program effective 1 January 2018. While this revised strategy materially reduced premium income to Equator Re, the new program continues to provide North American Operations with an appropriate level of reinsurance protection. At the same time, Australian & New Zealand Operations elected not to renew a quota share treaty with Equator Re reflecting a change in that division's appetite for reinsurance spend following significant remediation over the past 18 months.

Net earned premium fell 25% to $314 million from $419 million in the prior corresponding period. The $105 million reduction in net earned premium during the half entirely reflects the drop in gross earned premium, with reinsurance costs remaining consistent half on half.

External reinsurance purchased primarily protects against large individual risk and catastrophe claims. The non-renewed quota share treaties with North American and Australian & New Zealand Operations had minimal large individual risk and catastrophe exposure and therefore their non-renewal did not overly impact the cost or extent of external reinsurance cover purchased by Equator Re.

Claims expense

Equator Re's net claims ratio increased materially to 80.9% from 68.7% in the prior period with adverse experience across both the current and prior accident years.

The net cost of large individual risk and catastrophe claims was broadly in line with the prior period and reflects the net retention under the Group's aggregate program. However, as a proportion of net earned premium, large individual risk and catastrophe claims increased to 37.6% from 30.3% in the prior period due to reduced net earned premium.

The attritional claims ratio fell to 22.9% from 28.7% in the prior period reflecting both the reduction in proportional premium and an improved performance on the retained proportional book.

The interim result included $80 million of adverse prior accident year claims development or 25.5% of net earned premium compared with $49 million and 11.8% respectively in the prior period. The exaggerated impact on the net claims ratio during the current half reflects the significantly reduced premium income.

Prior accident year development during the current half related to reduced recoveries projected on older year aggregate treaties and a net increase in 2017 catastrophe losses due to late reporting, primarily with respect to the Mexican earthquakes. Exhaustion of the Group's large individual risk and catastrophe aggregate program in 2017 meant that this development was largely retained by Equator Re.

Commission and expenses

The combined commission and expense ratio improved to 11.1% from 11.9% in the prior period. This was largely due to the reduction in proportional business underwritten which typically attracts a far higher exchange commission relative to excess of loss business, due to the need to reimburse the cedant's acquisition costs. The current half also benefited from a one-off reversal of costs accrued during the prior period.

Underwriting result

FOR THE HALF YEAR ENDED 30 JUNE		2018	2017	2016	2015	2014
Gross written premium	US$M	**1,250**	1,375	1,125	976	607
Gross earned premium	US$M	**691**	798	583	485	404
Net earned premium	US$M	**314**	419	197	182	280
Net incurred claims	US$M	**254**	288	116	106	267
Net commission	US$M	**28**	41	18	13	5
Expenses	US$M	**7**	9	4	6	4
Underwriting result	US$M	**25**	81	59	57	4
Net claims ratio	%	**80.9**	68.7	58.9	58.2	95.4
Net commission ratio	%	**8.9**	9.8	9.1	7.1	1.8
Expense ratio	%	**2.2**	2.1	2.0	3.3	1.4
Combined operating ratio	%	**92.0**	80.6	70.1	68.6	98.6
Adjusted combined operating ratio [1]	%	**91.7**	79.9	63.5	70.8	–
Insurance profit margin	%	**13.4**	21.7	37.6	47.8	9.0

1 Excludes the impact of changes in risk-free rates used to discount net outstanding claims.

Directors' Report

FOR THE HALF YEAR ENDED 30 JUNE 2018

Your directors present their report on QBE Insurance Group Limited and the entities it controlled at the end of, or during, the half year ended 30 June 2018.

Directors

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

Marty Becker (Chairman)
Stephen Fitzgerald
John M Green (Deputy Chairman)
Kathryn Lisson
Sir Brian Pomeroy
Patrick Regan
Jann Skinner
Rolf Tolle
Michael Wilkins AO

Consolidated results

FOR THE HALF YEAR ENDED	30 JUNE 2018 US$M	30 JUNE 2017 US$M
Gross written premium	**7,887**	7,590
Gross earned premium revenue	**6,697**	6,547
Net earned premium	**5,647**	5,696
Net claims expense	**(3,564)**	(3,727)
Net commission	**(947)**	(936)
Underwriting and other expenses	**(876)**	(848)
Underwriting result	**260**	185
Net investment income on policyholders' funds	**190**	232
Insurance profit	**450**	417
Net investment income on shareholders' funds	**97**	192
Financing and other costs	**(135)**	(164)
Gain on sale of entities	**2**	2
Share of net profits of associates	**–**	1
Amortisation and impairment of intangibles	**(20)**	(20)
Profit before income tax	**394**	428
Income tax expense	**(29)**	(74)
Profit after income tax from continuing operations	**365**	354
Loss after income tax from discontinued operations	**(12)**	(10)
Profit after income tax	**353**	344
Net loss attributable to non-controlling interests	**5**	1
Net profit after income tax	**358**	345

Result

Net profit after income tax for the period to 30 June 2018 was $358 million, up from a profit of $345 million for the same period last year.

The Group's Latin American Operations is considered held for sale and is separately presented as a discontinued operation in these financial statements, with comparative results restated accordingly as required by accounting standards. The results from continuing operations are discussed below. Details of the results of our discontinued operations are provided in note 5.2 to the financial statements.

Net earned premium of $5,647 million was down 1% compared with the same period last year, principally reflecting increased reinsurance expense in the current half year due to a $190 million cost to reinsure Hong Kong workers' compensation liabilities.

The Group's underwriting result was a profit of $260 million compared with a profit of $185 million for the same period last year, reflecting a combined operating ratio of 95.4% compared with a prior period 96.8%. The result benefited from a stronger underwriting performance in both North American and European Operations, partly offset by increased claims activity in Equator Re. The current period underwriting result includes a net cost in relation to reinsurance of Hong Kong workers' compensation liabilities ($27 million) whilst the prior period underwriting result was negatively impacted by the Ogden decision in the UK ($156 million).

The net claims ratio was 63.1% (or 63.9% adjusting for the one-time reinsurance cost mentioned above) compared with 65.4% (or 62.7% excluding the Ogden impact) for the same period last year. Favourable prior accident year claims development was $193 million, including a benefit of $142 million from the reinsurance of Hong Kong construction workers' compensation liabilities. Excluding this, favourable prior accident year claims development was $51 million, down from $147 million for the same period last year. The combined commission and expense ratio was up compared with the same period last year (32.3% compared with 31.4%) but was down slightly when adjusted for the distorting effect of the reinsurance protection mentioned above (31.2%).

QBE's 2018 full year combined operating ratio guidance to the market in February 2018 specifically excluded the impact of discount rate movements (consistent with our usual practice). Adjusting the reported statutory underwriting result for discount rate movements, the combined operating ratio was 96.1% which is at the mid-point of our target range of 95.0%–97.5%.

Net investment income was $287 million compared with $424 million in the same period last year. The fixed income book was impacted by mark-to-market losses as risk-free rates for US Treasury Bonds and UK Gilts increased combined with more modest returns on our growth assets after an especially strong performance in the prior period.

The effective tax rate for our continuing operations was 7% of net profit, down from 17%, reflecting the mix of corporate tax rates in the jurisdictions in which QBE operates as well as the recognition of deferred tax assets and utilisation of tax losses in the US tax group.

Dividends

The directors are pleased to announce an interim dividend of 22 Australian cents per share for the period ended 30 June 2018 in line with the 2017 interim dividend. The interim dividend will be 30% franked (2017 30%). The total interim dividend payout is A$297 million (2017 A$302 million) or 59% of cash profit.

Our objective is to deliver a stable and growing dividend to our shareholders. Our current dividend policy sets the full year dividend payout ratio at up to 65% of cash profit.

Operating and financial review

Information on the Group's results, operations, business strategies, prospects and financial position is set out on pages 4 to 33 of this Half Year Report.

Outstanding claims liability

The net central estimate of outstanding claims is determined by the Group Chief Actuary after consultation with internal actuaries at 30 June and both internal and external actuaries at the 31 December balance date. The assessment takes into account the statistical analysis of past claims, allowance for claims incurred but not reported, reinsurance and other recoveries and future interest and inflation factors.

As in previous years, the directors consider that substantial risk margins are required to mitigate inherent uncertainty in the actuarial central estimate. The probability of adequacy of the outstanding claims liability at 30 June 2018 was 90.2%, broadly unchanged from 90.0% at 31 December 2017. APRA prudential standards provide a capital credit for outstanding claims in excess of a probability of adequacy of 75%.

Material business risks

As an international insurance and reinsurance business, QBE is subject to a substantial variety of business risks. The Board believes that effective management of these risks is critical to delivering value for QBE's stakeholders. 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 QBE's governance structure, broader business processes and, most importantly, culture.

Some of the material business risks that QBE faces include strategic, insurance, credit, market, liquidity, operational and group risks. Explanations of these risks and their mitigations are set out in more detail in note 4 to the Group's financial statements for the year ended 31 December 2017, which we recommend you read. Further details of how QBE manages risk are set out in the Chief Risk Officer's Report and the section of the Corporate Governance Statement addressing the ASX Corporate Governance Council's Principle 7: Recognise and Manage Risk, both of which are included in the 2017 Annual Report.

QBE's 2017 Annual Report and Corporate Governance Statement are available on the QBE website at www.qbe.com.

QBE has committed to provide climate risk reporting under the Task Force for Climate-related Financial Disclosures (TCFD) guidelines for the first time in our 2018 Annual Report. We recognise the importance of these disclosures and see this as part of a three to five-year journey to full disclosure. Our planned approach is set out on pages 8 and 9 of this Half Year Report.

Commentary on significant judgements and estimates impacting the half year result and balance sheet, with particular emphasis on the limited headroom in relation to goodwill in our North American Operations, is included in note 1.2 to the financial statements for the half year ended 30 June 2018.

Events after balance date

Operations in Argentina and Brazil were disposed of on 2 July 2018 for aggregate consideration of $244 million, giving rise to an estimated pre-tax gain of $125 million which remains subject to closing adjustments and is before the reclassification of foreign currency translation reserve. After the reclassification of foreign currency translation reserve from equity to retained earnings through profit or loss, the estimated pre-tax loss on disposal is $91 million.

We expect to complete the disposal of remaining operations in Colombia, Ecuador and Mexico during the second half of 2018 for aggregate consideration of $141 million, subject to regulatory approvals and closing adjustments. The disposals are estimated to result in no gain or loss before the reclassification of foreign currency translation reserve. After the reclassification of foreign currency translation reserve from equity to retained earnings through profit or loss, the estimated pre-tax loss on disposal is $24 million.

We have also entered into an agreement to dispose of our Australian travel insurance business for consideration of $18 million, subject to adjustment based on the business' performance. Our business in Puerto Rico remains held for sale, and sale activity is underway in relation to the personal lines business in North America.

Other than these and the declaration of the interim dividend, no matter or circumstance has arisen since 30 June 2018 that, in the opinion of the directors, has significantly affected or may significantly affect the Group's operations, the results of those operations or the Group's state of affairs in future financial periods.

Auditor's independence declaration

A copy of the auditor's independence declaration as required under section 307C of the Corporations Act 2001 is set out on page 37.

Rounding of amounts

The company is of a kind referred to in the *ASIC Corporations (Rounding in Financial/Directors' Reports) Instrument 2016/191*. Amounts have been rounded off in the Directors' Report in accordance with that instrument.

Signed in SYDNEY on 15 August 2018 in accordance with a resolution of the directors.

WM Becker
Director

Patrick Regan
Director

Auditor's independence declaration

FOR THE HALF YEAR ENDED 30 JUNE 2018

As lead auditor for the review of QBE Insurance Group Limited for the half year ended 30 June 2018, 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 review; and

(b) no contraventions of any applicable code of professional conduct in relation to the review.

This declaration is in respect of QBE Insurance Group Limited and the entities it controlled during the period.

SJ Hadfield
Partner, PricewaterhouseCoopers

Sydney
15 August 2018

Liability limited by a scheme approved under Professional Standards Legislation.

Consolidated statement of comprehensive income

FOR THE HALF YEAR ENDED 30 JUNE 2018

	NOTE	30 JUNE 2018 US$M	30 JUNE 2017 US$M
Gross written premium		**7,887**	7,590
Unearned premium movement		**(1,190)**	(1,043)
Gross earned premium revenue	2.1	**6,697**	6,547
Outward reinsurance premium		**(1,318)**	(1,677)
Deferred reinsurance premium movement		**268**	826
Outward reinsurance premium expense		**(1,050)**	(851)
Net earned premium (a)		**5,647**	5,696
Gross claims expense	2.2	**(4,084)**	(4,801)
Reinsurance and other recoveries revenue	2.1	**520**	1,074
Net claims expense (b)	2.2	**(3,564)**	(3,727)
Gross commission expense		**(1,077)**	(1,093)
Reinsurance commission revenue	2.1	**130**	157
Net commission (c)		**(947)**	(936)
Underwriting and other expenses (d)		**(876)**	(848)
Underwriting result (a)+(b)+(c)+(d)		**260**	185
Investment and other income – policyholders' funds	3.1	**196**	239
Investment expenses – policyholders' funds	3.1	**(6)**	(7)
Insurance profit		**450**	417
Investment and other income – shareholders' funds	3.1	**100**	196
Investment expenses – shareholders' funds	3.1	**(3)**	(4)
Financing and other costs		**(135)**	(164)
Gain on sale of entities	5.1	**2**	2
Share of net profits of associates		**–**	1
Amortisation and impairment of intangibles		**(20)**	(20)
Profit before income tax		**394**	428
Income tax expense		**(29)**	(74)
Profit after income tax from continuing operations		**365**	354
Loss after income tax from discontinued operations	5.2.1	**(12)**	(10)
Profit after income tax		**353**	344
Other comprehensive income (loss)			
Items that may be reclassified to profit or loss			
Net movement in foreign currency translation reserve		**107**	(62)
Net movement in cash flow hedges		**–**	(1)
Income tax relating to these components of other comprehensive income		**39**	(14)
Other comprehensive loss from discontinued operations after income tax		**(54)**	(28)
Items that will not be reclassified to profit or loss			
Gains on remeasurement of defined benefit superannuation plans		**19**	5
Income tax relating to these components of other comprehensive income		**(3)**	(1)
Other comprehensive income (loss) after income tax		**108**	(101)
Total comprehensive income after income tax		**461**	243
Profit (loss) after income tax from continuing operations attributable to:			
Ordinary equity holders of the company		**370**	355
Non-controlling interests		**(5)**	(1)
		365	354
Profit (loss) after income tax attributable to:			
Ordinary equity holders of the company		**358**	345
Non-controlling interests		**(5)**	(1)
		353	344
Total comprehensive income (loss) after income tax attributable to:			
Ordinary equity holders of the company		**466**	244
Non-controlling interests		**(5)**	(1)
		461	243

EARNINGS PER SHARE FOR PROFIT AFTER INCOME TAX ATTRIBUTABLE TO ORDINARY EQUITY HOLDERS OF THE COMPANY	NOTE	30 JUNE 2018 US CENTS	30 JUNE 2017 US CENTS
For profit after income tax from continuing operations			
Basic earnings per share	4.5	**27.3**	25.8
Diluted earnings per share	4.5	**27.2**	25.7
For profit after income tax			
Basic earnings per share	4.5	**26.4**	25.1
Diluted earnings per share	4.5	**26.3**	25.0

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

Consolidated balance sheet

AS AT 30 JUNE 2018

	NOTE	30 JUNE 2018 US$M	31 DECEMBER 2017 US$M
Assets			
Cash and cash equivalents		**511**	572
Investments	3.2	**22,756**	25,554
Derivative financial instruments	4.2	**106**	223
Trade and other receivables		**5,780**	4,906
Current tax assets		**81**	22
Deferred insurance costs		**2,437**	2,257
Reinsurance and other recoveries on outstanding claims	2.3	**6,001**	6,311
Other assets		**9**	7
Assets held for sale	5.3	**963**	63
Defined benefit plan surpluses		**44**	33
Property, plant and equipment		**229**	276
Deferred tax assets		**525**	514
Investment properties		**13**	15
Investment in associates		**29**	30
Intangible assets		**2,933**	3,079
Total assets		**42,417**	43,862
Liabilities			
Derivative financial instruments	4.2	**152**	144
Trade and other payables		**1,738**	2,327
Current tax liabilities		**50**	160
Liabilities held for sale	5.3	**863**	28
Unearned premium		**7,546**	6,887
Outstanding claims	2.3	**19,938**	21,579
Provisions		**96**	104
Defined benefit plan deficits		**49**	60
Deferred tax liabilities		**55**	56
Borrowings	4.1	**3,205**	3,616
Total liabilities		**33,692**	34,961
Net assets		**8,725**	8,901
Equity			
Share capital	4.3	**8,344**	8,931
Treasury shares held in trust		**(3)**	(50)
Reserves		**(1,741)**	(1,785)
Retained profits		**2,095**	1,763
Shareholders' funds		**8,695**	8,859
Non-controlling interests		**30**	42
Total equity		**8,725**	8,901

The consolidated balance sheet above should be read in conjunction with the accompanying notes.

Consolidated statement of changes in equity

FOR THE HALF YEAR ENDED 30 JUNE 2018

2018	SHARE CAPITAL US$M	TREASURY SHARES HELD IN TRUST US$M	RESERVES US$M	RETAINED PROFITS US$M	SHARE-HOLDERS' FUNDS US$M	NON-CONTROLLING INTERESTS US$M	TOTAL EQUITY US$M
As at 1 January	**8,931**	**(50)**	**(1,785)**	**1,763**	**8,859**	**42**	**8,901**
Profit (loss) after income tax	**–**	**–**	**–**	**358**	**358**	**(5)**	**353**
Other comprehensive income	**–**	**–**	**92**	**16**	**108**	**–**	**108**
Total comprehensive income (loss)	**–**	**–**	**92**	**374**	**466**	**(5)**	**461**
Transactions with owners in their capacity as owners							
Shares bought back on-market and cancelled	**(75)**	**–**	**–**	**–**	**(75)**	**–**	**(75)**
Shares acquired and held in trust	**–**	**(11)**	**–**	**–**	**(11)**	**–**	**(11)**
Share-based payment expense	**–**	**–**	**17**	**–**	**17**	**–**	**17**
Shares vested and/or released	**–**	**57**	**(54)**	**–**	**3**	**–**	**3**
Net changes in non-controlling interests	**–**	**–**	**(1)**	**–**	**(1)**	**(5)**	**(6)**
Dividends paid on ordinary shares	**–**	**–**	**–**	**(43)**	**(43)**	**(2)**	**(45)**
Dividend reinvestment under Bonus Share Plan	**–**	**–**	**–**	**1**	**1**	**–**	**1**
Foreign exchange movement	**(512)**	**1**	**(10)**	**–**	**(521)**	**–**	**(521)**
As at 30 June	**8,344**	**(3)**	**(1,741)**	**2,095**	**8,695**	**30**	**8,725**

2017	SHARE CAPITAL US$M	TREASURY SHARES HELD IN TRUST US$M	RESERVES US$M	RETAINED PROFITS US$M	SHARE-HOLDERS' FUNDS US$M	NON-CONTROLLING INTERESTS US$M	TOTAL EQUITY US$M
As at 1 January	8,350	–	(1,654)	3,588	10,284	50	10,334
Profit (loss) after income tax	–	–	–	345	345	(1)	344
Other comprehensive (loss) income	–	–	(105)	4	(101)	–	(101)
Total comprehensive (loss) income	–	–	(105)	349	244	(1)	243
Transactions with owners in their capacity as owners							
Shares acquired and held in trust	–	(122)	–	–	(122)	–	(122)
Share-based payment expense	–	–	33	–	33	–	33
Shares vested and/or released	–	73	(73)	–	–	–	–
Contributions of equity, net of transaction costs and tax	1	–	–	–	1	–	1
Net changes in non-controlling interests	–	–	1	–	1	(1)	–
Dividends paid on ordinary shares	–	–	–	(342)	(342)	–	(342)
Dividend reinvestment under Bonus Share Plan	–	–	–	4	4	–	4
Foreign exchange movement	552	(1)	14	–	565	–	565
As at 30 June	8,903	(50)	(1,784)	3,599	10,668	48	10,716

The consolidated statement of changes in equity above should be read in conjunction with the accompanying notes.

Consolidated statement of cash flows

FOR THE HALF YEAR ENDED 30 JUNE 2018

	NOTE	30 JUNE 2018 US$M	30 JUNE 2017 US$M
Operating activities			
Premium received		**6,576**	6,257
Reinsurance and other recoveries received		**475**	774
Outward reinsurance premium paid		**(1,732)**	(1,315)
Claims paid		**(4,403)**	(4,010)
Acquisition and other underwriting costs paid		**(2,055)**	(2,153)
Interest received		**260**	235
Dividends received		**80**	36
Other operating income		**–**	14
Other operating payments		**(77)**	(67)
Interest paid		**(100)**	(113)
Income taxes paid		**(198)**	(60)
Net cash flows from operating activities		**(1,174)**	(402)
Investing activities			
Proceeds on sale of growth assets		**715**	2,136
Payments for purchase of growth assets		**(780)**	(1,431)
Net proceeds on foreign exchange transactions		**28**	72
Net proceeds on purchase and sale of interest bearing financial assets		**1,785**	54
Payments for purchase of intangible assets		**(34)**	(36)
Payments for purchase of property, plant and equipment		**(15)**	(19)
Proceeds on disposal of entities (net of cash disposed)		**18**	16
Net cash flows from investing activities		**1,717**	792
Financing activities			
Payments for shares bought on market and cancelled		**(75)**	–
Purchase of treasury shares		**(11)**	(122)
Proceeds from settlement of staff share loans		**–**	1
Proceeds from borrowings		**2**	306
Repayment of borrowings		**(390)**	(320)
Dividends paid		**(41)**	(319)
Net cash flows from financing activities		**(515)**	(454)
Net movement in cash and cash equivalents		**28**	(64)
Cash and cash equivalents at 1 January		**572**	847
Effect of exchange rate changes		**(76)**	19
Cash transferred to assets held for sale		**(13)**	–
Cash and cash equivalents at 30 June		**511**	802

The consolidated statement of cash flows above should be read in conjunction with the accompanying notes.

Notes to the financial statements

FOR THE HALF YEAR ENDED 30 JUNE 2018

1. OVERVIEW

1.1 Basis of preparation

This general purpose consolidated financial report for the half year ended 30 June 2018 (Half Year Financial Report) has been prepared in accordance with AASB 134 *Interim Financial Reporting* as issued by the Australian Accounting Standards Board, IAS 34 *Interim Financial Reporting* as issued by the International Accounting Standards Board and the *Corporations Act 2001*.

The Half Year Financial Report does not include all the notes normally included in an annual financial report. Accordingly, it is recommended that this report be read in conjunction with QBE's Annual Report for the financial year ended 31 December 2017 and any public announcements made by QBE Insurance Group Limited and its controlled entities (QBE or the Group).

The accounting policies adopted are consistent with those of the previous financial year and corresponding interim reporting period, except as set out below.

New and amended accounting standards adopted by the Group

The Group adopted the following new or revised accounting standards which became effective for the annual reporting period commencing on 1 January 2018.

TITLE	
AASB 15	Revenue from Contracts with Customers
AASB 2016–5	Classification and Measurement of Share-based Payment Transactions
AASB 2016–6 [1]	Applying AASB 9 Financial Instruments with AASB 4 Insurance Contracts
AASB 2017–1	Transfers of Investment Property, Annual Improvements 2014–2016 Cycle and Other Amendments
AASB 2017–3	Clarifications to AASB 4 Insurance Contracts
AASB Interpretation 22	Foreign Currency Transactions and Advance Consideration

1 Having met the criteria introduced by this amendment, the application of AASB 9 *Financial Instruments* has been deferred to 1 January 2021 at the latest.

The adoption of these new or revised standards did not materially change the Group's accounting policies or Half Year Financial Report.

1.2 Critical accounting judgements and estimates

The Group makes judgements and estimates in respect of the reported amounts of certain assets and liabilities. Noted below are the most material judgements and estimates that should be considered when reviewing the financial statements for the half year ended 30 June 2018.

1.2.1 Outstanding claims liability

The determination of the amounts that the Group will ultimately pay for claims arising under insurance and inward 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 can elapse before a claim is paid in full;
- the existence of complex underlying exposures;
- the incidence of catastrophic events close to the balance date;
- changes in the legal environment, including the interpretation of liability laws and the quantum of damages; and
- changing social, political and economic trends, for example price and wage inflation.

The potential impact of changes in key assumptions used in the determination of the central estimate and the probability of adequacy of the outstanding claims liability on the Group's profit or loss are summarised in note 2.3.7 to the consolidated financial statements for the year ended 31 December 2017.

1.2.2 Intangible assets

QBE monitors goodwill and identifiable intangible assets for indicators of impairment at each reporting date in accordance with the Group's policy, which is set out in note 7.2 to the consolidated financial statements for the year ended 31 December 2017.

At 30 June 2018, QBE has reviewed all material intangible assets for indicators of impairment and has completed detailed impairment tests where indicators of impairment were identified. No impairment charge resulted from the analysis undertaken.

A detailed impairment test was completed in respect of goodwill in QBE's North American Operations. The headroom (being the excess of recoverable value over carrying value) at the balance date increased to $75 million compared with nil at 31 December 2017. The valuation continues to be highly sensitive to a range of assumptions, in particular, to increases in the forecast combined operating ratio used in the terminal value calculation and changes in discount rate and long-term investment return assumptions. The impact of changes in key assumptions is shown in the table below and each change has been calculated in isolation from other changes. In practice, this is considered unlikely to occur due to interrelationships between assumptions.

KEY ASSUMPTION	VALUE [1]	SENSITIVITY	IMPACT OF SENSITIVITY
Terminal value combined operating ratio	95.8%	+1%	Impairment of $328 million
		-1%	Increase headroom to $478 million
Terminal value long-term investment return	4.30%	+1%	Increase headroom to $514 million
		-1%	Impairment of $364 million
Post-tax discount rate	9.47%	+1%	Impairment of $361 million
		-1%	Increase headroom to $657 million

1 Terminal value long-term investment return assumption was 4.25% at 31 December 2017. Other assumptions are unchanged.

1.2.3 Recoverability of future tax losses

A deferred tax asset (DTA) of $370 million (2017 $325 million) has been recognised in relation to the entities included in our US tax group. Uncertainty continues to exist in relation to the utilisation of this DTA and QBE has made a judgement that enities in the US tax group will be able to generate sufficient taxable profits to utilise the DTA balance over the foreseeable future, based on future business plans. Losses expire over the next 20 years, with the majority expiring between 2030 and 2034. The uncertainty around the recognition of the DTA will be resolved in future years assuming that sufficient taxable profits are generated.

Recovery of the DTA remains sensitive to changes in the forecast combined operating ratio, premium growth and investment yield assumptions as these items are the key drivers of future taxable income.

1.2.4 Liability adequacy test

At each balance date, the adequacy of the unearned premium liability is assessed on a net of reinsurance basis against the present value of the expected future claims cash flows in respect of the relevant insurance contracts, plus an additional risk margin to reflect the inherent uncertainty of the central estimate. The assessment is carried out at the operating segment level, being a portfolio of contracts subject to broadly similar risks and which are managed together as a single portfolio.

The application of the liability adequacy test at 30 June 2018 did not identifiy a deficiency (2017 $10 million deficiency in Asia Pacific Operations).

Notes to the financial statements CONTINUED

FOR THE HALF YEAR ENDED 30 JUNE 2018

1.3 Segment information

QBE provides segment information by operating division to assist an understanding of the Group's performance. The Group's operating segments are consistent with the basis on which information is provided to the Group Executive for measuring performance and determining the allocation of capital, being the basis upon which the Group's underwriting products and services are managed within the various markets in which QBE operates.

This note presents the results of continuing operations only. Latin American Operations is classified as a discontinued operation and is therefore excluded from this note. The results of discontinued operations are presented in note 5.2.

Corporate & Other includes non-operating holding companies that do not form part of the Group's insurance operations; gains or losses on disposals except those relating to discontinued operations (refer note 5.2); and financing costs and amortisation of any intangibles which are not allocated to a specific operating segment. It also includes consolidation adjustments and internal reinsurance eliminations. Following the disposal of the Group's operations in Thailand, the results of Thailand for the current period are also presented in Corporate & Other.

30 JUNE 2018	NORTH AMERICAN OPERATIONS US$M	EUROPEAN OPERATIONS US$M	AUSTRALIAN & NEW ZEALAND OPERATIONS US$M	ASIA PACIFIC OPERATIONS US$M	EQUATOR RE US$M	TOTAL REPORTABLE SEGMENTS US$M	CORPORATE & OTHER US$M	TOTAL US$M
Gross written premium	2,896	2,614	2,040	350	1,250	9,150	(1,263)	7,887
Gross earned premium revenue – external	2,162	2,113	2,032	365	5	6,677	20	6,697
Gross earned premium revenue – internal	–	21	3	–	686	710	(710)	–
Outward reinsurance premium expense	(484)	(403)	(233)	(273)	(377)	(1,770)	720	(1,050)
Net earned premium	1,678	1,731	1,802	92	314	5,617	30	5,647
Net claims expense	(1,066)	(1,049)	(1,136)	(14)	(254)	(3,519)	(45)	(3,564)
Net commission	(268)	(313)	(280)	(61)	(28)	(950)	3	(947)
Underwriting and other expenses	(266)	(270)	(252)	(66)	(7)	(861)	(15)	(876)
Underwriting result	78	99	134	(49)	25	287	(27)	260
Net investment income on policyholders' funds	54	70	79	4	17	224	(34)	190
Insurance profit (loss)	132	169	213	(45)	42	511	(61)	450
Net investment income on shareholders' funds	35	25	45	3	17	125	(28)	97
Financing and other costs	–	–	–	–	–	–	(135)	(135)
Gain on sale of entities	–	–	–	–	–	–	2	2
Amortisation and impairment of intangibles	–	–	(6)	–	–	(6)	(14)	(20)
Profit (loss) before income tax from continuing operations	167	194	252	(42)	59	630	(236)	394
Income tax (expense) credit	(35)	(33)	(74)	6	(12)	(148)	119	(29)
Profit (loss) after income tax from continuing operations	132	161	178	(36)	47	482	(117)	365
Net loss from continuing operations attributable to non-controlling interests	–	–	–	–	–	–	5	5
Net profit (loss) after income tax from continuing operations	132	161	178	(36)	47	482	(112)	370

30 JUNE 2017	NORTH AMERICAN OPERATIONS US$M	EUROPEAN OPERATIONS US$M	AUSTRALIAN & NEW ZEALAND OPERATIONS US$M	ASIA PACIFIC OPERATIONS US$M	EQUATOR RE US$M	TOTAL REPORTABLE SEGMENTS US$M	CORPORATE & OTHER US$M	TOTAL US$M
Gross written premium	2,803	2,393	2,007	409	1,375	8,987	(1,397)	7,590
Gross earned premium revenue – external	2,187	1,894	2,023	378	–	6,482	65	6,547
Gross earned premium revenue – internal	–	21	1	–	798	820	(820)	–
Outward reinsurance premium expense	(475)	(385)	(319)	(61)	(379)	(1,619)	768	(851)
Net earned premium	1,712	1,530	1,705	317	419	5,683	13	5,696
Net claims expense	(1,144)	(971)	(1,084)	(207)	(288)	(3,694)	(33)	(3,727)
Net commission	(266)	(296)	(255)	(69)	(41)	(927)	(9)	(936)
Underwriting and other expenses	(274)	(247)	(237)	(70)	(9)	(837)	(11)	(848)
Underwriting result	28	16	129	(29)	81	225	(40)	185
Net investment income on policyholders' funds	43	59	80	4	10	196	36	232
Insurance profit (loss)	71	75	209	(25)	91	421	(4)	417
Net investment income on shareholders' funds	29	22	39	3	16	109	83	192
Financing and other costs	–	–	–	–	–	–	(164)	(164)
Losses on sale of entities	–	–	–	–	–	–	2	2
Share of net profits of associates	–	–	–	–	–	–	1	1
Amortisation and impairment of intangibles	–	–	(7)	–	–	(7)	(13)	(20)
Profit (loss) before income tax from continuing operations	100	97	241	(22)	107	523	(95)	428
Income tax (expense) credit	(28)	(17)	(71)	3	(15)	(128)	54	(74)
Profit (loss) after income tax from continuing operations	72	80	170	(19)	92	395	(41)	354
Net loss from continuing operations attributable to non-controlling interests	–	–	–	–	–	–	1	1
Net profit (loss) after income tax from continuing operations	72	80	170	(19)	92	395	(40)	355

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2. UNDERWRITING ACTIVITIES

2.1 Revenue

	NOTE	30 JUNE 2018 US$M	30 JUNE 2017 US$M
Gross earned premium revenue			
Direct and facultative		**6,182**	6,062
Inward reinsurance		**515**	485
		6,697	6,547
Other revenue			
Reinsurance and other recoveries revenue	2.2	**520**	1,074
Reinsurance commission revenue		**130**	157
		7,347	7,778

2.2 Net claims expense

	NOTE	30 JUNE 2018 US$M	30 JUNE 2017 US$M
Gross claims and related expenses		**4,084**	4,801
Reinsurance and other recoveries revenue	2.1	**(520)**	(1,074)
Net claims expense		**3,564**	3,727

2.2.1 Prior accident year claims development

Net claims expense for the half year ended 30 June 2018 includes undiscounted prior accident year central estimate releases of $193 million, including a recovery of $142 million from the reinsurance of Hong Kong construction workers' compensation liabilities. Excluding this recovery, the net undiscounted central estimate release is $51 million comprising positive development in our North American and Australian & New Zealand Operations, partly offset by aggregate adverse development in the remaining segments.

This compares with $147 million of positive prior accident year claims development in the prior period (excluding discontinued operations and the $154 million cost of the Ogden decision in the UK).

2.3 Net outstanding claims liability

	NOTE	30 JUNE 2018 US$M	31 DECEMBER 2017 US$M
Gross discounted central estimate	2.3.1	**18,777**	20,340
Risk margin	2.3.3	**1,161**	1,239
Gross outstanding claims liability		**19,938**	21,579
Reinsurance and other recoveries on outstanding claims	2.3.2	**(6,001)**	(6,311)
Net outstanding claims liability		**13,937**	15,268

2.3.1 Gross discounted central estimate

	NOTE	30 JUNE 2018 US$M	31 DECEMBER 2017 US$M
Gross undiscounted central estimate excluding claims settlement costs		**19,860**	21,278
Claims settlement costs		**357**	372
Gross undiscounted central estimate		**20,217**	21,650
Discount to present value		**(1,440)**	(1,310)
Gross discounted central estimate	2.3	**18,777**	20,340

2.3.2 Reinsurance and other recoveries on outstanding claims

	NOTE	30 JUNE 2018 US$M	31 DECEMBER 2017 US$M
Reinsurance and other recoveries on outstanding claims – undiscounted [1]		**6,521**	6,692
Discount to present value		**(520)**	(381)
Reinsurance and other recoveries on outstanding claims	2.3	**6,001**	6,311

1 Net of a provision for impairment of $38 million (2017 $37 million).

2.3.3 Risk margin

The risk margin included in the net outstanding claims liability is 9.1% (2017 8.8%) of the net discounted central estimate. The probability of adequacy at 30 June 2018 is 90.2% (2017 90.0%) which is well above APRA's 75% benchmark. Net profit after tax would have increased by $6 million if the probability of adequacy was maintained at 90.0%.

3. INVESTMENT ACTIVITIES

3.1 Investment income

	30 JUNE 2018 US$M	30 JUNE 2017 US$M
Income on growth assets	**124**	188
Income on fixed interest securities, short-term money and cash	**137**	271
Gross investment income [1]	**261**	459
Investment expenses	**(9)**	(11)
Net investment income	**252**	448
Foreign exchange gain (loss)	**8**	(22)
Other income	**27**	2
Other expenses	**–**	(4)
Total investment income	**287**	424
Investment and other income – policyholders' funds	**196**	239
Investment expenses – policyholders' funds	**(6)**	(7)
Investment and other income – shareholders' funds	**100**	196
Investment expenses – shareholders' funds	**(3)**	(4)
Total investment income	**287**	424

1 Includes net fair value losses of $60 million (2017 gains of $158 million), interest income of $244 million (2017 $243 million) and dividend income of $77 million (2017 $58 million).

3.2 Investment assets

	30 JUNE 2018 US$M	31 DECEMBER 2017 US$M
Fixed income		
Short-term money	**2,525**	3,462
Government bonds	**4,261**	5,576
Corporate bonds	**12,686**	13,243
Infrastructure debt	**552**	562
Unit trusts	**–**	29
	20,024	22,872
Growth assets		
Developed market equity	**381**	520
Emerging market equity	**232**	110
Emerging market debt	**110**	–
Unlisted property trusts	**991**	1,082
Infrastructure assets	**907**	894
Private equity	**111**	76
	2,732	2,682
Total investments	**22,756**	25,554

Notes to the financial statements CONTINUED

FOR THE HALF YEAR ENDED 30 JUNE 2018

3.3 Fair value hierarchy

The Group's investment assets are disclosed in the table below using a fair value hierarchy which reflects the significance of inputs into the determination of their fair value.

	30 JUNE 2018				31 DECEMBER 2017			
	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
Fixed income								
Short-term money	**1,050**	**1,475**	**–**	**2,525**	1,066	2,396	–	3,462
Government bonds	**2,886**	**1,374**	**1**	**4,261**	3,337	2,238	1	5,576
Corporate bonds	**–**	**12,683**	**3**	**12,686**	–	13,221	22	13,243
Infrastructure debt	**–**	**140**	**412**	**552**	–	147	415	562
Unit trusts	**–**	**–**	**–**	**–**	–	29	–	29
	3,936	**15,672**	**416**	**20,024**	4,403	18,031	438	22,872
Growth assets								
Developed market equity	**380**	**–**	**1**	**381**	518	–	2	520
Emerging market equity	**232**	**–**	**–**	**232**	–	110	–	110
Emerging market debt	**110**	**–**	**–**	**110**	–	–	–	–
Unlisted property trusts	**–**	**991**	**–**	**991**	–	1,082	–	1,082
Infrastructure assets	**–**	**–**	**907**	**907**	–	–	894	894
Private equity	**–**	**–**	**111**	**111**	–	–	76	76
	722	**991**	**1,019**	**2,732**	518	1,192	972	2,682
Total investments	**4,658**	**16,663**	**1,435**	**22,756**	4,921	19,223	1,410	25,554

The Group's approach to measuring the fair value of investments is described below:

Short-term money

Term deposits are valued at par plus accrued interest and are categorised as level 1 fair value measurements. Other short-term money (bank bills, certificates of deposit, treasury bills and other short-term instruments) is priced using interest rates and yield curves observable at commonly quoted intervals.

Government bonds and corporate bonds

Bonds which are traded in active markets and have quoted prices from external data providers are categorised as level 1 fair value measurements. Bonds which are not traded in active markets are priced using broker quotes, comparable prices for similar instruments or pricing techniques set by local regulators or exchanges.

Infrastructure debt

Infrastructure debt prices are sourced from the investment manager who may use a combination of observable market prices or comparable market prices where available and other valuation techniques.

Developed market equity

Listed equities traded in active markets are valued by reference to quoted bid prices. Unlisted equities are priced using QBE's share of the net assets of the entity.

Emerging market equity, emerging market debt, unlisted property trusts, infrastructure assets and unit trusts

These assets are valued using quoted bid prices in active markets or current unit prices as advised by the responsible entity, trustee or equivalent of the investment management scheme.

Private equity

These assets comprise fund of funds vehicles. Fair value is based on the net asset value of the vehicle, and responsibility for the valuation of the underlying securities lies with the external manager. In most cases, an independent administrator will be utilised by the external fund manager for pricing and valuation. A combination of observable market prices or comparable market prices (where available) and other valuation techniques may be used in the determination of fair value.

Movements in level 3 investments

The following table provides an analysis of investment assets valued with reference to level 3 inputs.

LEVEL 3	30 JUNE 2018 US$M	30 JUNE 2017 US$M
At 1 January	**1,410**	572
Purchases	**75**	526
Disposals	**(15)**	(27)
Reclassifications to level 2 [1]	**(19)**	–
Fair value gains recognised in profit or loss	**18**	7
Foreign exchange	**(34)**	23
At 30 June	**1,435**	1,101

1 Corporate bonds were transferred from level 3 to level 2 due to the use of a more observable external price source.

4. CAPITAL STRUCTURE

4.1 Borrowings

The Group's borrowings are initially measured at fair value net of transaction costs directly attributable to the transaction and are subsequently remeasured at amortised cost.

FINAL MATURITY DATE	PRINCIPAL AMOUNT	30 JUNE 2018 US$M	31 DECEMBER 2017 US$M
Bank loans			
27 September 2018 (2017 21 March 2018)	$10 million facility	**–** [1]	7
		–	7
Senior debt			
21 October 2022	$200 million (2017 $300 million)	**199**	299
25 May 2023	$9 million (2017 $300 million)	**9**	297
		208	596
Subordinated debt			
29 September 2040	A$200 million	**147**	156
24 May 2041	$167 million	**167**	167
24 May 2041	£24 million	**33**	33
24 May 2042	£327 million	**395**	402
24 November 2043	$400 million	**400**	400
2 December 2044	$700 million	**696**	696
12 November 2045	$300 million	**300**	300
17 June 2046	$524 million	**460**	460
		2,598	2,614
Additional Tier 1 instruments			
No fixed date	$400 million	**399**	399
		399	399
Total borrowings		**3,205**	3,616

1 $9 million is included in liabilities held for sale.

Senior notes due 2022

On 21 April 2017, the company issued $300 million of senior notes maturing on 21 October 2022. The notes were issued under the QBE Green Bond Framework, details of which can be found on QBE's website. During 2018, the Group repurchased $100 million of these notes for cash.

Senior notes due 2023

On 21 September 2017, the company issued $300 million of senior notes maturing on 25 May 2023. During 2018, the Group repurchased $291 million of these notes for cash.

4.1.1 Fair value of borrowings

	30 JUNE 2018 US$M	31 DECEMBER 2017 US$M
Bank loans	**–**	7
Senior debt	**201**	589
Subordinated debt	**2,798**	3,056
Additional Tier 1 instruments	**360**	407
Total fair value of borrowings	**3,359**	4,059

The fair value of the Group's borrowings are categorised as level 2 fair value measurements. Fixed and floating rate securities are priced using broker quotes and comparable prices for similar instruments in active markets.

Notes to the financial statements CONTINUED

FOR THE HALF YEAR ENDED 30 JUNE 2018

4.2 Derivatives

Forward foreign exchange contracts are used as a tool to manage the Group's foreign exchange exposure and interest rate swaps are used to hedge exposure to interest rate movements in relation to some of the Group's borrowings.

	30 JUNE 2018			31 DECEMBER 2017		
	EXPOSURE US$M	FAIR VALUE ASSET US$M	FAIR VALUE LIABILITY US$M	EXPOSURE US$M	FAIR VALUE ASSET US$M	FAIR VALUE LIABILITY US$M
Forward foreign exchange contracts	**694**	**106**	**152**	3,386	223	144
Interest rate swaps	**147**	**–**	**–**	156	–	–

Forward foreign exchange contracts and interest rate swaps are categorised as level 2 in the fair value hierarchy. Their fair value is determined using present value techniques utilising observable market data including foreign exchange rates, forward rates and yield curves.

4.3 Share capital

	30 JUNE 2018		30 JUNE 2017	
	NUMBER OF SHARES MILLIONS	US$M	NUMBER OF SHARES MILLIONS	US$M
Issued ordinary shares, fully paid at 1 January	**1,358**	**8,931**	1,370	8,350
Shares issued under the Employee Share and Option Plan	**–**	**–**	–	1
Shares issued under the Bonus Share Plan	**–**	**–**	1	–
Shares bought back on-market and cancelled	**(10)**	**(75)**	–	–
Foreign exchange	**–**	**(512)**	–	552
Issued ordinary shares, fully paid at 30 June	**1,348**	**8,344**	1,371	8,903
Shares notified to the Australian Securities Exchange	**1,349**	**8,349**	1,372	8,909
Less: Plan shares subject to non-recourse loans, derecognised under IFRS	**(1)**	**(5)**	(1)	(6)
Issued ordinary shares, fully paid at 30 June	**1,348**	**8,344**	1,371	8,903

4.4 Dividends

	2017		2016
	FINAL	INTERIM	FINAL
Dividend per share (Australian cents)	4	22	33
Franking percentage	30%	30%	50%
Franked amount per share (Australian cents)	1.2	6.6	16.5
Dividend payout (A$M)	54	302	453
Payment date	20 April 2018	29 September 2017	13 April 17

On 15 August 2018, the directors declared a 30% franked interim dividend of 22 Australian cents per share, payable on 5 October 2018. The interim dividend payout is A$297 million (2017 A$302 million). The record date is 24 August 2018.

The unfranked part of the dividend is declared to be conduit foreign income. For shareholders not resident in Australia, the dividend will not be subject to Australian withholding tax.

4.5 Earnings per share

	30 JUNE 2018 US CENTS	30 JUNE 2017 US CENTS
For profit after income tax from continuing operations		
Basic earnings per share	**27.3**	25.8
Diluted earnings per share	**27.2**	25.7
For profit after income tax		
Basic earnings per share	**26.4**	25.1
Diluted earnings per share	**26.3**	25.0

Earnings used in calculating basic and diluted earnings per share relating to continuing operations is $370 million (2017 $355 million), being the net profit after income tax from continuing operations attributable to ordinary equity holders of the company.

Earnings used in calculating basic and diluted earnings per share for profit after income tax is $358 million (2017 $345 million), being the total net profit after income tax attributable to ordinary equity holders of the company.

Information relating to earnings per share from discontinued operations is provided in note 5.2.

4.5.1 Reconciliation of weighted average number of ordinary shares used for all earnings per share measures

	30 JUNE 2018 NUMBER OF SHARES MILLIONS	30 JUNE 2017 NUMBER OF SHARES MILLIONS
Weighted average number of ordinary shares on issue	**1,354**	1,371
Weighted average number of non-recourse loan shares issued under the Employee Share and Option Plan (the Plan)	**(1)**	(1)
Weighted average number of ordinary shares used as the denominator in calculating basic earnings per share	**1,353**	1,370
Weighted average number of dilutive potential ordinary shares relating to shares issued under the Plan	**9**	9
Weighted average number of ordinary shares used as the denominator in calculating diluted earnings per share	**1,362**	1,379

The weighted and diluted average numbers of ordinary shares shown above is used for calculating all earnings per share measures, including those for profit after tax, profit after tax from continuing operations and profit after tax from discontinued operations.

Notes to the financial statements CONTINUED

FOR THE HALF YEAR ENDED 30 JUNE 2018

5. GROUP STRUCTURE

5.1 Disposals

QBE Insurance (Thailand) Public Company Limited was disposed of during the period giving rise to a gain of $2 million. The gain is presented as part of continuing operations in the statement of comprehensive income.

5.2 Discontinued operations

The Group's Latin American Operations constitutes a discontinued operation, representing a major geographical area held for sale. Disclosures in the Half Year Report have therefore been prepared in accordance with Australian Accounting Standards which require:

- information relating to the profit or loss from discontinued operations to be disclosed separately from that relating to continuing operations, with corresponding restatements and disclosures for all prior period profit or loss information in the statement of comprehensive income and in corresponding notes, as if Latin American Operations had been classified as a discontinued operation from the beginning of that period; and
- summarised cash flow information from discontinued operations to be disclosed separately, including comparative information.

5.2.1 Profit or loss from discontinued operations

	30 JUNE 2018 US$M	30 JUNE 2017 US$M
Gross earned premium revenue	**391**	426
Outward reinsurance expense	**(79)**	(79)
Net earned premium	**312**	347
Net claims expense	**(192)**	(217)
Net commission	**(73)**	(89)
Underwriting and other expenses	**(86)**	(72)
Underwriting result	**(39)**	(31)
Net investment income on policyholders' funds	**27**	20
Insurance loss	**(12)**	(11)
Net investment income on shareholders' funds	**10**	13
Financing and other costs	**(2)**	(1)
Amortisation and impairment of intangibles	**(1)**	(2)
Loss before income tax from discontinued operations	**(5)**	(1)
Income tax expense	**(7)**	(4)
Loss after income tax from discontinued operations	**(12)**	(5)
Net loss on disposals	**–**	(5)
Net loss after income tax from discontinued operations	**(12)**	(10)
Net loss after income tax from discontinued operations attributable to:		
Ordinary equity holders of the company	**(12)**	(10)
Non-controlling interests	**–**	–

LOSS PER SHARE FROM DISCONTINUED OPERATIONS ATTRIBUTABLE TO ORDINARY EQUITY HOLDERS OF THE COMPANY	30 JUNE 2018 US$M	30 JUNE 2017 US$M
Basic loss per share	**(0.9)**	(0.7)
Diluted loss per share	**(0.9)**	(0.7)

5.2.2 Cash flows from discontinued operations

	30 JUNE 2018 US$M	30 JUNE 2017 US$M
Net cash flows from operating activities	**(6)**	26
Net cash flows from investing activities	**16**	21
Net cash flows from financing activities	**2**	(3)
Net movement in cash and cash equivalents from discontinued operations	**12**	44

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5.3 Assets and liabilities held for sale

Assets and liabilities held for sale at 30 June 2018 relate mainly to Latin American Operations. Other balances held for sale are not material.

	30 JUNE 2018 US$M
Assets held for sale	
Cash and cash equivalents	**13**
Investments and other financial assets	**703**
Insurance assets	**139**
Current and deferred tax assets	**42**
Property, plant and equipment	**35**
Intangible assets	**29**
Other assets	**2**
Total assets held for sale	**963**
Liabilities held for sale	
Financial liabilities	**76**
Insurance liabilities	**742**
Current and deferred tax liabilities	**25**
Other liabilities	**20**
Total liabilities held for sale	**863**
Net assets held for sale	**100**

5.4 Disposals and classifications as held for sale after the balance date

Operations in Argentina and Brazil were disposed of on 2 July 2018 for aggregate consideration of $244 million, giving rise to an estimated pre-tax gain of $125 million which remains subject to closing adjustments and is before the reclassification of foreign currency translation reserve. After the reclassification of foreign currency translation reserve from equity to retained earnings through profit or loss, the estimated pre-tax loss on disposal is $91 million.

Disposal of remaining operations in Colombia, Ecuador and Mexico is expected to complete during the second half of 2018 for aggregate consideration of $141 million, subject to regulatory approvals and closing adjustments. The disposals are estimated to result in no gain or loss before the reclassification of foreign currency translation reserve. After the reclassification of foreign currency translation reserve from equity to retained earnings through profit or loss, the estimated pre-tax loss on disposal is $24 million.

The Group has also entered into an agreement to dispose of its Australian travel insurance business for consideration of $18 million, subject to adjustment based on the business' performance. The Group's business in Puerto Rico remains held for sale, and sale activity is underway in relation to the personal lines business in North America.

6. OTHER

6.1 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. If the expected settlement of the liability is considered probable and can be reliably estimated, a provision is recognised.

As set out in note 7.2 to the consolidated financial statements for the year ended 31 December 2017, the Group continues to be exposed to contingent liabilities in the ordinary course of business in relation to claims litigation and regulatory examinations arising out of its insurance and reinsurance activities, as well as in relation to the Group's support of the underwriting activities of controlled entities which are corporate members at Lloyd's of London. The Group may also be exposed to the possibility of contingent liabilities in relation to non-insurance litigation, taxation and compliance matters. 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.

Directors' declaration

In the directors' opinion:

(a) the financial statements and notes set out on pages 38 to 53 are in accordance with the *Corporations Act 2001*, including:

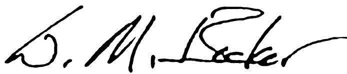
(i) complying with accounting standards, the *Corporations Regulations 2001* and other mandatory professional reporting requirements; and

(ii) giving a true and fair view of the Group's financial position as at 30 June 2018 and of its performance for the half 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.

The directors have been given the declarations by the Group Chief Executive Officer and Group Chief Financial Officer recommended under the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations.

Signed in SYDNEY on 15 August 2018 in accordance with a resolution of the directors.



WM Becker
Director

Patrick Regan
Director

Independent auditor's review report

TO THE SHAREHOLDERS OF QBE INSURANCE GROUP LIMITED

Report on the Half Year Financial Report

We have reviewed the accompanying Half Year Financial Report of QBE Insurance Group Limited (the Company), which comprises the consolidated balance sheet as at 30 June 2018, the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the half year ended on that date, basis of preparation, other explanatory notes and the directors' declaration for QBE Insurance Group Limited (the Group). The Group comprises the Company and the entities it controlled during that half year.

Directors' responsibility for the Half Year Financial Report

The directors of the Company are responsible for the preparation of the Half Year 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 Half Year Financial Report that is free from material misstatement whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express a conclusion on the Half Year Financial Report based on our review. We conducted our review in accordance with Australian Auditing Standard on Review Engagements ASRE 2410 *Review of a Financial Report Performed by the Independent Auditor of the Entity*, in order to state whether, on the basis of the procedures described, we have become aware of any matter that makes us believe that the Half Year Financial Report is not in accordance with the *Corporations Act 2001* including giving a true and fair view of the Group's financial position as at 30 June 2018 and its performance for the half year ended on that date; and complying with Accounting Standard AASB 134 *Interim Financial Reporting* and the *Corporations Regulations 2001*. As the auditor of QBE Insurance Group Limited, ASRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial report.

A review of a Half Year Financial Report consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Australian Auditing Standards and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Independence

In conducting our review, we have complied with the independence requirements of the *Corporations Act 2001*.

Conclusion

Based on our review, which is not an audit, we have not become aware of any matter that makes us believe that the Half Year Financial Report of QBE Insurance Group Limited is not in accordance with the *Corporations Act 2001* including:

(a) giving a true and fair view of the Group's financial position as at 30 June 2018 and of its performance for the half year ended on that date;

(b) complying with Accounting Standard AASB 134 *Interim Financial Reporting* and the *Corporations Regulations 2001*.

PricewaterhouseCoopers

SJ Hadfield
Partner

B Griffin
Partner

Sydney
15 August 2018

Historical review

FOR THE HALF YEAR ENDED 30 JUNE 2018

		HALF YEAR ENDED 30 JUNE						YEAR ENDED 31 DECEMBER				
		2018 [1]	2017 [1]	2017 [2]	2016 [2]	2015 [2]	2014 [2]	2017 [2]	2016 [2]	2015 [2]	2014 [2]	2013 [2]
Profit or loss information:												
Gross written premium	US$M	**7,887**	7,590	8,038	8,107	8,692	8,491	14,191	14,395	15,092	16,332	17,975
Gross earned premium	US$M	**6,697**	6,547	6,973	6,876	7,293	7,819	14,446	14,276	14,922	16,521	17,889
Net earned premium	US$M	**5,647**	5,696	6,043	5,615	6,229	6,947	12,041	11,066	12,314	14,084	15,396
Claims ratio	%	**63.1**	65.4	65.3	64.8	59.8	63.1	70.9	58.2	60.4	63.2	64.5
Commission ratio	%	**16.8**	16.5	17.0	17.7	17.3	17.1	17.6	18.4	17.2	16.8	16.8
Expense ratio	%	**15.5**	14.9	15.2	16.5	18.2	16.3	16.3	17.4	17.3	16.1	16.5
Combined operating ratio	%	**95.4**	96.8	97.5	99.0	95.3	96.5	104.8	94.0	94.9	96.1	97.8
Investment income												
before fair value gains/losses	US$M	**323**	269	282	291	262	338	589	641	541	676	691
after fair value gains/losses	US$M	**287**	424	457	437	386	429	812	746	665	814	772
Insurance profit (loss)	US$M	**450**	417	406	326	536	530	(98)	1,075	1,031	1,074	841
Insurance profit (loss) to net earned premium	%	**8.0**	7.3	6.7	5.8	8.6	7.6	(0.8)	9.7	8.4	7.6	5.5
Financing and other costs	US$M	**135**	164	165	125	127	150	305	294	244	297	345
Operating profit (loss)												
before income tax	US$M	**394**	428	422	347	679	487	(825)	1,072	953	931	(448)
after income tax and non-controlling interest	US$M	**370**	355	345	265	488	392	(1,249)	844	687	742	(254)
Balance sheet and share information:												
Number of shares on issue [3]	millions	**1,348**		1,371	1,370	1,363	1,276	1,358	1,370	1,370	1,363	1,247
Shareholders' funds	US$M	**8,695**		10,668	10,325	10,949	11,228	8,859	10,284	10,505	11,030	10,356
Total assets	US$M	**42,417**		45,993	43,273	46,101	48,990	43,862	41,583	42,176	45,000	47,271
Net tangible assets per share [3]	US$	**4.30**		5.09	4.96	5.31	5.29	4.29	4.90	5.07	5.32	4.75
Borrowings to shareholders' funds	%	**36.9**		32.8	33.7	32.8	38.4	40.8	33.8	33.6	32.5	44.1
Basic earnings (loss) per share [3]	US cents	**26.4**		25.1	19.3	35.8	31.3	(91.5)	61.6	50.3	57.4	(22.8)
Basic earnings (loss) per share – cash basis [4]	US cents	**28.5**		27.2	20.9	34.5	33.2	(18.9)	65.5	65.3	63.5	62.9
Diluted earnings (loss) per share	US cents	**26.3**		25.0	19.2	35.5	30.5	(91.5)	60.8	49.8	55.8	(22.8)
Return on average shareholders' funds	%	**8.2**		6.6	5.1	8.9	7.3	(13.0)	8.1	6.4	6.9	(2.3)
Dividend per share	Australian cents	**22**		22	21	20	15	26	54	50	37	32
Dividend payout	A$M	**297**		302	288	274	192	356	741	685	492	394
Total investments and cash [5]	US$M	**23,280**		25,665	25,741	27,903	31,359	26,141	25,235	26,708	28,583	30,619

1 Profit or loss information for the current period has been prepared on a continuing basis and excludes discontinued operations. For comparability, restated profit or loss information for the half year to 30 June 2017 has also been included above. Balance sheet and share information for both periods continues to reflect the consolidated Group unless otherwise specified.

2 As originally reported for each period.

3 Reflects shares on an accounting basis.

4 Calculated with reference to cash profit, being profit after tax adjusted for amortisation and impairment of intangibles and other non-cash items net of tax.

5 Includes financial assets at fair value through profit or loss, cash and cash equivalents and investment properties; excludes any balances held for sale.

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