

# European Operations business review

“European Operations delivered a strong financial performance in 2015 despite market conditions continuing to deteriorate. The combined operating ratio was 89.1% and the insurance profit was \$464 million. Gross written premium increased 5% on a constant currency basis.”

## Richard Pryce

Chief Executive Officer • European Operations

Gross written premium US\$ million	Net earned premium US\$ million	Underwriting result US\$ million	Insurance profit US\$ million
<b>4,386</b>	<b>3,454</b>	<b>377</b>	<b>464</b>
↓ 3% from 1 2014	↓ 12% from 2 2014	↑ \$154M from 2014	↑ \$119M from 2014
		Combined operating ratio <b>89.1%</b> (2014 94.3%)	Insurance profit margin <b>13.4%</b> (2014 8.8%)

## 2015 overview

The last 12 months have been characterised by intense competition, especially in the London market.

The pricing environment deteriorated in the second half of the year and, as a consequence, rates were marginally worse than our planning assumptions. Notwithstanding the competitive landscape, our strong market position combined with increased focus on cross class client engagement helped us improve our retention ratio and selectively grow gross written premium.

To support further selective growth we made several strategic hires across the business, most notably in the last quarter when we recruited extensively to expand our real estate business.

The operational environment improved during the year and our major IT infrastructure upgrade project is on schedule to be completed early in 2016. Further positive progress has been made in the data analytics arena, especially in claims management.

The year ended on a positive note with the Prudential Regulation Authority (PRA) approving our Solvency II internal capital model application.

*Note: All comparative 2014 performance figures exclude the one-off impact of the medical malpractice reinsurance transaction.*

1 Up 5% on a constant currency basis.

2 Down 5% on a constant currency basis (excluding the one-off impact of the medical malpractice reinsurance transaction).

## Operating and financial performance

### Underwriting performance

European Operations recorded a strong underwriting performance across the business. All three business units performed well and exceeded our planning expectation. This contributed to a materially improved combined operating ratio of 89.1% compared with 94.3% in the prior corresponding period.

European Operations reported an insurance profit margin of 13.4%, up materially from 8.8% in 2014, with lower investment returns more than offset by the significant improvement in underwriting profitability.

### Underwriting result

FOR THE YEAR ENDED 31 DECEMBER

		2015	2014 EX MED MAL	2014	2013
Gross written premium	US\$M	4,386	4,526	4,526	5,236
Gross earned premium	US\$M	4,338	4,805	4,805	5,146
Net earned premium	US\$M	3,454	3,929	3,567	4,160
Net claims expense	US\$M	1,844	2,362	2,000	2,486
Net commission	US\$M	634	718	718	768
Expenses	US\$M	599	626	626	646
Underwriting result	US\$M	377	223	223	260
Net claims ratio	%	53.4	60.1	56.1	59.7
Net commission ratio	%	18.4	18.3	20.1	18.5
Expense ratio	%	17.3	15.9	17.6	15.5
Combined operating ratio	%	89.1	94.3	93.8	93.7
Insurance profit margin	%	13.4	8.8	9.7	9.0

### Premium income

Given competitive market headwinds and the impact of the dramatic fall in commodity prices, particularly crude oil, it was encouraging to record gross written premium growth of 5% on a constant currency basis.

The fall in the price of commodities and crude oil particularly impacted our International Markets business where we have seen a reduction in insured values and a significant downturn in project activity.

Premium growth was underpinned by an improved performance in retention and new business activity as well as the successful execution of various strategic initiatives. As expected, higher percentage growth was achieved from our extended distribution such as in Continental Europe and Canada. The slight improvement in the European economies also contributed to this growth.

Renewal premium rates continued to deteriorate in most products and territories and resulted in a 3.2% reduction on average across the portfolio for the full year. Pricing pressure moderated most in QBE Re.

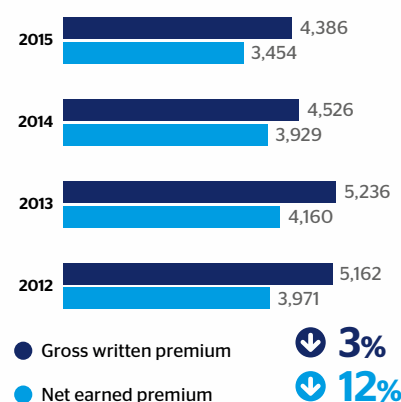
Notwithstanding the aforementioned gross written premium growth, net earned premium declined 5% on a constant currency basis due to significantly increased Group and local reinsurance costs.

Reinsurance spend increased in 2015 due to European Operations' share of the increased costs associated with the Group's enhanced large individual risk and catastrophe aggregate reinsurance program and an increase in reinstatement costs following the spate of large individual energy risk claims during the first half of the year.

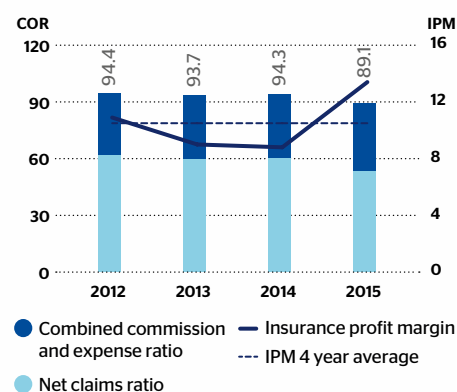
### Claims expense

The claims ratio benefitted from continued favourable prior accident year reserve development of \$253 million, up from \$158 million in 2014, in part driven by improved claims management practices.

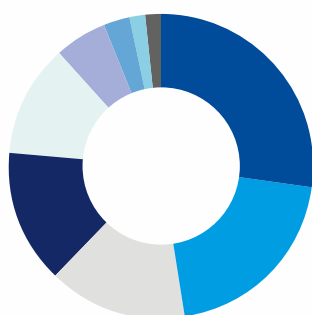
### Gross written premium and net earned premium (US\$M)



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



**Gross earned premium  
by class of business 2015**



	2015 %	2014 %
Commercial & domestic property	27.3	28.0
Public/product liability	20.3	21.7
Marine energy & aviation	14.8	15.8
Professional indemnity	14.1	11.9
Motor & motor casualty	11.9	11.3
Workers' compensation	5.7	6.0
Other	2.8	1.8
Financial & credit	1.6	1.6
Accident & health	1.5	1.4
Agriculture	-	0.5

The attritional claims ratio was adversely impacted by lower net earned premium due to additional reinsurance costs associated with the Group's enhanced large individual risk and catastrophe aggregate reinsurance program. Absent this impact, the current accident year attritional claims ratio was better than the prior year and benefited from the ongoing improvement in our claims analytics capabilities for fraud protection and indemnity management as well as the portfolio changes undertaken in 2013 and 2014. Claims inflation remains under control across most of the business.

The combined cost of large individual risk and catastrophe claims was 13.5% of net earned premium compared with 12.5% in the prior year. Catastrophe activity was relatively benign across the business until the extensive flooding in the UK which occurred throughout December. Large individual risk claims included several large energy claims during the first half of the year and a number of European property losses in the second half.

Having enjoyed a \$36 million benefit from higher risk free rates used to discount claims liabilities during the first half of 2015, risk-free rates in GBP, EUR and AUD fell during the second half resulting in a reduced full year discount rate benefit of only \$21 million. This compares with a charge of \$217 million incurred in 2014.

Risk margins as a percentage of the net undiscounted central estimate increased slightly during the year as did the reserving probability of adequacy.

### Commission and expenses

The increase in the commission ratio reflects a combination of increased broker demands as well as a reduction in our net earned premium. As previously highlighted, one of our biggest challenges is broker demand for increased commissions (both on individual risks and facilities) fuelled by the significant over supply of capacity.

Our expense ratio has also been adversely impacted by the reduction in net earned premium together with significant one-off project costs involving Solvency II, real estate consolidation and refurbishment, as well as the IT infrastructure upgrade. Underlying operating expenses will continue to reduce as these short term project and restructuring costs are eliminated.

Robust management of all costs including headcount will remain a priority in 2016 and beyond.

### Summary

Notwithstanding the operating landscape, this has been a very positive year for European Operations.

Across the business we have delivered our financial, operational and strategic objectives and, as a consequence, we move into 2016 with positive momentum.

There is, however, much more to be accomplished to build the quality business to which we aspire. In particular, further developments in client engagement, getting more value from our extended distribution, data analytics and improved operational efficiency remain our priorities.

Our biggest challenge continues to be the extremely competitive pricing and commission landscape which shows little sign of abating. Our focus on underwriting discipline remains paramount and, combined with our position as a market leader, we are well placed to respond appropriately.

Once again the European Operations' team has performed very well. Individually and collectively they have displayed skill and commitment and the result is testimony to their efforts.