

North American Operations business review

“North American Operations turned a corner in 2015, posting an underwriting profit for the first time since 2011. With portfolio remediation largely behind us, the development of an operating model to support profitable growth and “go to market” capabilities is progressing.”

David Duclos

Chief Executive Officer • North American Operations

Gross written premium US\$ million	Net earned premium US\$ million	Underwriting result US\$ million	Insurance profit US\$ million
4,961	3,666	30	93
↓ 7% from 2014	↓ 18% from 2014	↑ \$68M from 2014	↑ \$85M from 2014
		Combined operating ratio 99.2% (2014 100.8%)	Insurance profit margin 2.5% (2014 0.2%)

2015 overview

Following the sale of the Mortgage & Lender Services (M&LS) business, North American Operations has been reset as a specialist insurer and reinsurer with four key business units: Standard Lines, Specialty, Crop and Assumed Reinsurance, with the latter a component of QBE's global reinsurance business headquartered in London.

Competition has increased across all product lines (especially property) in 2015, reflecting an abundance of capacity coupled with a period of relatively low catastrophe losses (although convective and winter storms have emerged as a new “norm” for weather related losses). Premium rate increases were modest for the second consecutive year, up 0.4% on average across all business lines (excluding Crop), down from 1% in 2014.

Industry profitability remains challenged by price competition, slowing premium growth and historically low investment income, necessitating a heightened focus on cost reduction and the provision of superior service across multiple customer segments.

Operating and financial performance

Underwriting performance

North American Operations delivered an improved result in 2015, recording a combined operating ratio of 99.2% compared with 100.8% a year earlier. This result marks the first year that North American Operations has generated an underwriting profit since 2011.

The past year saw strong underwriting results in the Crop business with profit in excess of historical averages due to strong yields, favourable growing conditions and price stability in the core crops of corn and soybeans. In contrast, the prior year experienced significant commodity price declines (without

correspondingly sufficient yield increases) combined with exceptional hail claims and late claims notifications from 2013.

The improved combined operating ratio belies a material increase in the combined commission and expense ratio due to a combination of lower net earned premium (exacerbated by the additional cost of the Group's enhanced large individual risk and catastrophe aggregate reinsurance cover and the crop quote share) and the sale of the agency businesses.

The insurance profit margin improved to 2.5% from 0.2% a year earlier.

Underwriting result

FOR THE YEAR ENDED 31 DECEMBER		2015	2014	2013	2012
Gross written premium	US\$M	4,961	5,310	5,951	6,565
Gross earned premium	US\$M	4,930	5,457	6,225	6,984
Net earned premium	US\$M	3,666	4,471	5,030	5,625
Net incurred claims	US\$M	2,323	3,023	3,804	4,038
Net commission	US\$M	635	698	795	883
Expenses	US\$M	678	788	1,011	830
Underwriting result	US\$M	30	(38)	(580)	(126)
Net claims ratio	%	63.4	67.6	75.6	71.8
Net commission ratio	%	17.3	15.6	15.8	15.7
Expense ratio	%	18.5	17.6	20.1	14.7
Combined operating ratio	%	99.2	100.8	111.5	102.2
Insurance profit margin	%	2.5	0.2	(10.6)	(1.0)

Premium income

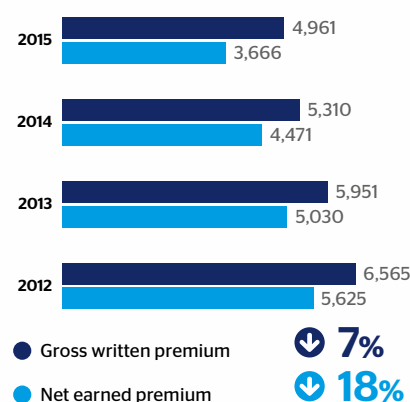
North American Operations' gross written premium declined 7% to \$4,961 million compared with \$5,310 million in 2014, partly reflecting the impact of the sale of M&LS which completed on 1 October 2015.

Excluding M&LS, gross written premium was \$4,578 million, down 4% from the prior period but in line with expectations conveyed at the half year. The reduction in premium is largely due to standard commercial lines where, in addition to an increasingly competitive premium rate environment, premium production was lower due to corrective underwriting actions including the termination of underperforming programs. Conversely, we continue to see strong growth in the consumer business within Standard Lines, which grew by 11% due to an increase in housing starts which drove revenue growth in both tenant and owner-occupied home insurance.

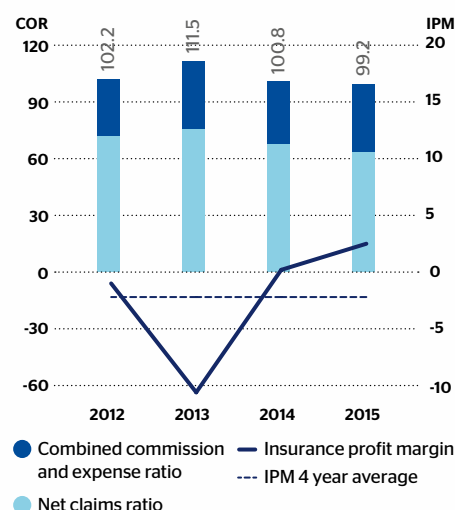
The Specialty Lines business remains focused on organic growth of existing lines and entry into targeted new lines which are expected to enhance both portfolio balance and underwriting results over time. Gross written premium increased 32%, albeit off a relatively small base. Higher retention and strong new business drove growth across management liability and professional lines, aviation, trade credit and surety. We added transactional liability and inland marine to our specialty product range during 2015, as well as QBE Rewards, a new medical stop loss experience refund product.

Net earned premium fell 18% to \$3,666 million from \$4,471 million a year earlier. In addition to the impact of the M&LS sale, retention in the Crop business fell materially as exposure to hail and MPC1 was reduced through quota share reinsurance. Moreover, premium cessions into the government reinsurance program increased as a result of the stronger underwriting performance. These factors, coupled with North American Operation's share of higher Group reinsurance costs and a change in the reporting basis for Assumed Reinsurance, resulted in a reduction in net earned premium of approximately \$500 million.

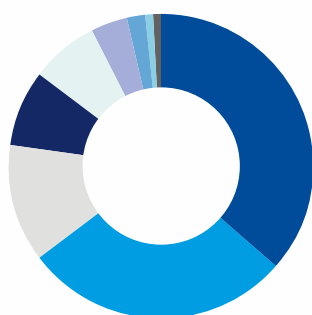
Gross written premium and net earned premium (US\$M)



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



Gross earned premium by class of business 2015



	2015 %	2014 %
Commercial & domestic property	36.5	37.7
Agriculture	28.3	28.3
Motor & motor casualty	12.5	12.3
Workers' compensation	8.1	8.5
Public/product liability	7.3	7.8
Accident & health	3.7	2.7
Professional indemnity	2.0	1.0
Marine energy & aviation	0.9	0.7
Financial & credit	0.7	0.7
Other	-	0.3

Claims expense

North American Operations reported a 2015 net claims ratio of 63.4% compared with 67.6% in 2014.

Claims experience benefited from the strong underwriting results for Crop and lower catastrophe claims, partly offset by modest increases in attritional claims, large individual risk claims and prior accident year development affecting Standard Lines.

Excluding Crop, the attritional claims ratio increased from 48.3% to 49.8%, primarily driven by Standard Lines reflecting a combination of pricing pressure and an industry-wide increase in severity trends in commercial auto lines.

Despite increased large individual risk claims, the overall cost of large individual risk and catastrophe claims decreased to 3.9% from 5.0% previously, driven by decreased catastrophe claims in Standard Lines and Assumed Reinsurance.

Adverse prior accident year claims development increased to \$85 million from \$41 million in 2014, largely driven by development on commercial auto classes in Standard Lines (broadly consistent with industry trends), coupled with development on 2014 weather events which impacted the Consumer and Agri portfolios.

Higher risk-free rates used to discount claims liabilities benefitted the result by \$20 million compared with an \$18 million charge in 2014.

Commission and expenses

The combined commission and expense ratio increased to 35.8% from 33.2% a year earlier, reflecting lower net earned premium.

The commission ratio increased to 17.3% from 15.6% in 2014. Lower commission income, following the sale of the agency and M&LS businesses, was partially offset by additional commission income from crop quota share reinsurance.

The underwriting expense ratio increased to 18.5% from 17.6% in the prior period. Despite an \$80 million reduction in controllable costs due to organisational restructuring, the underlying expense ratio increased as a result of lower net earned premium.

Notwithstanding the year-on-year increase, the expense ratio improved from 19.7% in the first half to 17.3% in the second half as benefits from first half restructuring activities and the sale of M&LS started to be realised.

In driving towards an improved expense ratio, additional expense management efforts are underway including integrating and streamlining operations, consolidating our real estate footprint and greater utilisation of the Group Shared Services Centre (GSSC) in the Philippines. Collectively, these efforts are making our expense base more variable and contributing to an operating model better positioned for growth.

Summary

Numerous initiatives are underway to further improve the North American business and ensure more predictable and better quality underwriting results. Expansion of our Specialty Lines platform continues with the addition of new lines of business. Following the recent introduction of Surety, Cyber Liability, Inland Marine and Transactional Liability, we plan to launch a number of other products to be announced later in 2016.

During 2015, a key focus has been the ongoing development of our underwriting support system including the build-out of a field operations platform in order to be responsive to the needs of the rapidly evolving marketplace. This underscores our commitment to improving producer relationships, driving profitable growth through a product-centric and customer-focused approach and providing customers with direct access to the products and services they need. Through a sharp focus on technical underwriting, we have driven strong business performance and, in turn, stability in our underwriting appetite. Additionally, the transformation of our claims practice has focused on claims capabilities, differentiation, outcomes and analytics.

Transformation initiatives continue with a focus on creating the right environment and tools to deliver sustainable profitable growth as well as high quality and predictable results. In 2015, we executed on a technology and operations roadmap to improve our systems and support scalability and new business growth. Moreover, when complete, the build-out of our data and analytics capability will further enhance both our risk selection and pricing capabilities.