Australian & New Zealand Operations business review

The positive pricing environment, combined with vigilance around cell reviews and the emerging benefits of Brilliant Basics, contributed to a 2.9%[1] improvement in the attritional claims ratio during 2018 and a cumulative 5.4%[1] improvement since 2016.

Vivek Bhatia
Chief Executive Officer • Australian & New Zealand Operations

Gross written premium (US$M)
3,992
↓ 1% from 2017[2]

Net earned premium (US$M)
3,519
↑ 1% from 2017[3]

Underwriting result (US$M)
267
↓ $16M from 2017

Insurance profit (US$M)
420
↓ $18M from 2017

Combined operating ratio[4]
91.9%
2017 92.0%

Insurance profit margin
11.9%
2017 12.6%

2018 overview

A more granular and disciplined approach to pricing again contributed to above market rate increases, with an average premium rate increase of 7.3%[5] in 2018, up from 6.1%[5] last year and 6.6%[5] in the first half. Retention remained stable at around 84%.

Vigilance around cell reviews and the ongoing implementation of Brilliant Basics, including tightened underwriting governance and risk selection, were key to the improved operating performance in 2018. This is particularly evident in commercial property where a decrease in exposure to high hazard risks resulted in a material reduction in the frequency of large individual risk claims. The underlying fundamentals of the business are especially encouraging with the reduction in exposure to high hazard risks and catastrophe accumulations being achieved in addition to strong premium rate increases.

Large individual risk claims continued to decline, falling from $169 million in 2016 to $133 million in 2017 and $107 million in 2018. Claims initiatives, including the application of data science and enhanced supply chain and vendor management, further contributed to improvement in the claims ratio and should drive additional savings in 2019.

The Australian financial services sector has been under significant scrutiny due to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry and other regulatory enquiries. QBE provided responses and support to the Commission. We welcome the findings of Commissioner Hayne and we look forward to working with the industry to increase the focus on customer outcomes.

In line with the Group's strategic focus to create a stronger and simpler QBE, a new strategic framework and transformation program was announced for Australian & New Zealand Operations. The new strategy will help us become a simpler, stronger and more customer-centred organisation, with an ambition to be the number one choice in commercial lines, build strength in personal lines and to be innovative in the small and medium-sized enterprise (SME) space.

Effective 1 January 2019, and as part of the Group simplification initiative, the Pacific Islands and India will join Australia and New Zealand to form the 'Australia Pacific' division. We will report on this basis going forward.

Operating and financial performance

Underwriting performance

Australian & New Zealand Operations reported a combined operating ratio of 91.9%[4] compared with 92.0%[4] in 2017. A material improvement in the attritional claims ratio was largely offset by a reduced level of positive prior accident year claims development and an increase in the combined commission and expense ratio.

Current accident year underwriting profitability improved due to a 2.9%[1] reduction in the attritional claims ratio. Workers' compensation, commercial property and CTP saw the most significant reduction in attritional claims costs on the back of a continued focus on risk selection. The second half saw improvement in commercial motor, largely due to premium rate strengthening which offset the first half impact of high levels of claims inflation.

The gross cost of large individual risk claims was less than the prior year largely due to lower frequency of commercial property claims, reflecting our commitment to underwriting discipline. Although lower than 2017, which was impacted by the very costly Cyclone Debbie, gross catastrophe claims were higher than expected due to significant catastrophe activity across much of Australia during December 2018 including the Sydney hailstorm.

The combined operating ratio of our LMI business increased to 55.0% from 50.7% in the prior year, driven by a higher commission ratio due to reduced ceding commissions following the non-renewal of external quota share reinsurance. The claims ratio was also adversely impacted by a lengthening of the assumed premium earning pattern to reflect a slowdown in loss emergence.

Despite some reduction in property prices, lending practices continue to improve and arrears rates are trending broadly in-line with expectations. We have taken the opportunity to purchase 30% quota share reinsurance on the 2019 underwriting year from a panel of external reinsurers on favourable terms.

1 Excluding lenders' mortgage insurance (LMI).
2 Up 2% on a constant currency basis; however, up 5% excluding the impact of premium rate reductions as a result of regulatory changes to CTP.
3 Up 4% on a constant currency basis.
4 Excludes the impact of changes in risk-free rates used to discount net outstanding claims.
5 Excludes premium rate changes relating to CTP.

Premium income

Gross written premium decreased 1% to $3,992 million but was up 2% on a constant currency basis.

Premium rate increases across most portfolios was partly offset by NSW CTP scheme reform where a 20% premium rate reduction led to significantly lower premium income. Premium income was also adversely impacted by the non-renewal of two large travel insurance credit card portfolios and subdued LMI premium volume due to macro-prudential regulatory intervention which resulted in reduced lending activity.

Excluding the CTP regulatory impact, premium income increased by around 5%, more consistent with pricing.

Pricing initiatives continued with a focus on portfolios where premium rates remain below technical levels. During 2018 we achieved an average premium rate increase of 7.3% [1], up from 6.1% [1] in the prior year, underpinned by an 18% rate increase in commercial property, 9% in workers' compensation, 10% in strata and 7% in commercial packages. New business volumes continued to grow, while we actively reduced the risk profile of the business.

Net earned premium increased 1% to $3,519 million but was up 4% on a constant currency basis, with the higher growth relative to gross written premium reflecting reduced reinsurance spend following the non-renewal of the CTP quota share with Equator Re.

Claims expense

Australian & New Zealand Operation's net claims ratio decreased to 62.1% from 62.3% in 2017, primarily reflecting an improvement in the attritional claims ratio that more than offset a reduced level of positive prior accident year claims development.

1 Excludes premium rate changes relating to CTP.

Excluding LMI, the attritional claims ratio improved to 57.7% from 60.6% in 2017 and has now improved 5.4% since 2016. Improvement was observed across most portfolios including significant reductions in commercial property, CTP and workers' compensation.

While the gross cost of large individual risk and catastrophe claims reduced relative to the prior year, the net cost increased slightly to 4.4% of net earned premium compared with 4.1% in 2017. This was due to an increase in the attachment point of our aggregate reinsurance protection in 2018.

The underwriting result benefited from positive prior accident year claims development of $112 million or 3.2% of net earned premium compared with $158 million or 4.5% in 2017.

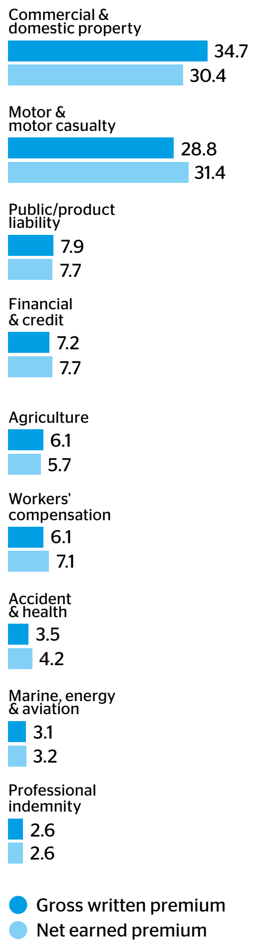
Positive development was largely attributable to benign inflationary conditions and lower frequency experience relative to reserving assumptions for NSW CTP and other long-tail classes including Queensland CTP, workers' compensation and liability portfolios.

Commission and expenses

The commission ratio increased to 15.6% from 15.1% in 2017, primarily as a result of reduced ceding commission due to the non-renewal of the CTP quota share reinsurance treaty with Equator Re.

The expense ratio increased to 14.7% from 14.5% in the prior period, primarily reflecting a reduction in fee income associated with changes to the NSW Managed Fund contract and the loss of NSW builders' warranty contract effective May 2017 and February 2018 respectively.

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



Underwriting result

FOR THE YEAR ENDED 31 DECEMBER		2018	2017	2016	2015	2014
Gross written premium	US$M	**3,992**	4,024	3,933	3,787	4,392
Gross earned premium	US$M	**3,985**	4,135	3,924	3,753	4,386
Net earned premium	US$M	**3,519**	3,480	3,410	3,282	3,834
Net incurred claims	US$M	**2,186**	2,168	2,172	2,054	2,242
Net commission	US$M	**548**	525	511	481	532
Expenses	US$M	**518**	504	477	461	562
Underwriting result	US$M	**267**	283	250	286	498
Net claims ratio	%	**62.1**	62.3	63.7	62.6	58.4
Net commission ratio	%	**15.6**	15.1	15.0	14.7	13.9
Expense ratio	%	**14.7**	14.5	14.0	14.0	14.7
Combined operating ratio	%	**92.4**	91.9	92.7	91.3	87.0
Adjusted combined operating ratio [1]	%	**91.9**	92.0	92.4	91.1	85.4
Insurance profit margin	%	**11.9**	12.6	12.3	14.2	17.7

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