Asia Pacific Operations
business review

Remediation of Asia Pacific Operations is largely complete with the business returning to an underwriting profit in the second half of 2018 following a $22 million loss in the first half and a $100 million loss in 2017.

Jason Brown
Chief Executive Officer • Asia Pacific Operations

Gross written premium (US$M)

633

↓ **14%** from 2017 [1]

Net earned premium (US$M) [2]

538

↓ **18%** from 2017 [3]

Underwriting result (US$M) [2]

(20)

↑ **$80M** from 2017

Insurance profit (US$M) [2]

(12)

↑ **$81M** from 2017

Combined operating ratio [4]

104.2% [2]

2017 115.5%

Insurance loss margin

(2.2)% [2]

2017 (14.2)%

2018 overview

Asia Pacific Operations finished 2018 strongly with a combined operating ratio of 104.2% [2,4] compared with 115.5% [4] in the prior year and 108.5% [2,4] in the first half of 2018. Performance improvement gathered momentum as the year progressed culminating in a return to underwriting profitability in the second half with a 99.5% [2,4] combined operating ratio (98.3% [2,4] excluding the now sold Philippines and Indonesian operations).

Relentless execution of the cell review process contributed to a significant improvement in the attritional claims ratio, with decisive action to restore underwriting margins driving the reduction in premium income.

While key insurance markets remain competitive, Asia Pacific Operations achieved an average premium rate increase of 1.0% compared with a premium rate reduction of 2.3% in 2017. Premium rate momentum increased as the year progressed and remediation initiatives gained traction.

Consistent with the Group-wide agenda, Asia Pacific has pursued a simplification strategy that has included a loss portfolio transfer (LPT) of our Hong Kong construction workers' compensation business as well as the sale of our operations in Thailand and, more recently, the Philippines and Indonesia where we had subscale operations with significant natural catastrophe exposures.

An operational efficiency program enacted in late 2017 resulted in a much leaner operating structure and contributed to a significant reduction in underwriting and administration expenses. Redeployment of human resources enabled underwriting and pricing capabilities to be strengthened with a renewed focus on customer experience through technology in claims notification and natural disaster response.

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 $6 million and $5 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 commentary following refers to Asia Pacific Operations' results on the adjusted basis described above.

As part of the Group's simplification agenda and as announced on 31 October 2018, effective from 1 January 2019 we will no longer separately identify Asia Pacific Operations as a standalone division; Asia will form part of QBE's International division and the Pacific Islands and India will form part of the Australia Pacific division.

Operating and financial performance

Underwriting performance

The significant improvement in Asia Pacific Operations' underwriting performance was underpinned by a significant improvement in the attritional claims ratio, a reduced level of adverse prior accident year claims development and a material reduction in costs.

During 2018 we aggressively remediated poorly performing portfolios, reduced our exposure to high hazard property business, rebalanced the portfolio towards more profitable segments and revised our reinsurance protection. Additional de-risking initiatives included exiting Hong Kong construction workers' compensation and Indonesian marine hull as well as significantly reducing natural catastrophe exposure in Fiji, the Philippines and Vanuatu.

Underwriting profits were generated in Singapore, Malaysia, Vietnam and the Pacific Islands in the second half of 2018 with an aggregate combined operating ratio of 91.1% in the period. Our Hong Kong business generated an underwriting loss primarily due to Super Typhoon Mangkhut and adverse claims experience in the marine and motor portfolios. Notwithstanding these factors, the Hong Kong attritional claims ratio improved by around 2% relative to the prior year.

Having experienced adverse prior accident year claims development in 2017 and then again during the first half of 2018, it was pleasing to see a small amount of positive claims development emerge in the second half.

1 Down 15% on a constant currency basis. Down 12% excluding the divested Thailand operation.
2 Excludes transaction to reinsure Hong Kong construction workers' compensation liabilities.
3 Down 18% on a constant currency basis.
4 Excludes the impact of changes in risk-free rates used to discount net outstanding claims.

Premium income

On a constant currency basis, gross written premium fell 15% (12% excluding the divested Thailand operation) to $633 million from $740 million in 2017 reflecting decisive action to restore underwriting margins with property, marine and workers' compensation accounting for the majority of the premium contraction.

Portfolios subject to remediation saw cumulative premium contraction of around 25% while portfolios targeted for growth grew by 8% as we continued to enhance our proposition with affinity, banking and agency channels. By territory, Hong Kong, Singapore, Indonesia and Malaysia were the key drivers of premium reduction offset by continued profitable growth in Vietnam.

We achieved an average premium rate increase of 1.0% in 2018 compared with a premium rate reduction of 2.3% in the prior year. Pricing in key portfolios including workers' compensation, marine and group medical accounted for much of the premium rate turnaround. Pricing momentum accelerated across the year with an average premium rate increase of 2.0% achieved in the second half compared with an increase of only 0.3% in the first half.

On a constant currency basis, net earned premium fell 18% to $538 million from $653 million in the prior year, reflecting top-line contraction coupled with increased reinsurance spend.

Claims expense

Asia Pacific Operations' net claims ratio improved to 58.0% from 67.2% in the prior year reflecting an improvement in the attritional claims ratio and a reduced level of adverse prior accident year claims development. Improvement was particularly pronounced in the second half of 2018 with the net claims ratio falling to 51.6% from 63.8% in the first half driven by strong improvement in all major markets.

The attritional claims ratio improved to 51.0% from 56.0% in the prior year due to the exiting of poor performing portfolios coupled with premium rate increases and continuous portfolio reshaping across the division. Demonstrating strong underlying momentum, the attritional claims ratio improved to 47.3% in the second half of 2018 from 54.6% in the first half and 57.7% in the second half of 2017.

The net cost of large individual risk and catastrophe claims was broadly unchanged. While catastrophe experience improved slightly, the net cost of large individual risk claims increased due to revised reinsurance with Equator Re. Gross of internal reinsurance, the cost of individual risk claims fell 13% reflecting a reduction in claims frequency driven by significantly tightened underwriting discipline.

Prior accident year claims development stabilised, improving from $35 million adverse in 2017 to only $10 million adverse in 2018, including $5 million of net positive development in the second half.

As part of the Brilliant Basics agenda, we have strengthened our claims management practices including enhanced claims monitoring through data analytics dashboards. The LPT of our Hong Kong construction workers' compensation portfolio led to a significant reduction in average caseloads that has enabled a more proactive approach to claims management with positive implications for claims settlements.

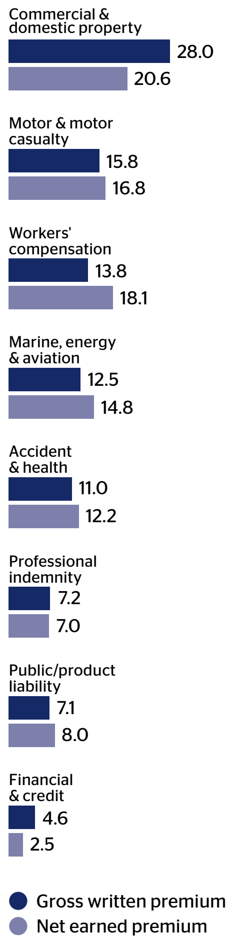
Commission and expenses

Asia Pacific Operations' combined commission and expense ratio improved to 45.7% from 48.1% in the prior year.

The net commission ratio increased slightly to 22.5% from 22.2% in the prior corresponding period, primarily reflecting targeted growth in higher commission paying agency and affinity channels where underwriting profitability remains sound.

Despite materially lower premium income, the expense ratio improved to 23.2% from 25.9% in the prior year reflecting the full year benefit of the operational efficiency program coupled with the sale of the business in Thailand. Underwriting and administration costs fell by $44 million or 26% relative to the prior year.

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



Underwriting result

FOR THE YEAR ENDED 31 DECEMBER		2018	2018 ADJUSTED[1]	2017	2016	2015	2014
Gross written premium	US$M	**633**	633	740	765	759	785
Gross earned premium	US$M	**708**	708	779	748	737	720
Net earned premium	US$M	**348**	538	653	615	599	593
Net incurred claims	US$M	**146**	312	439	321	298	306
Net commission	US$M	**127**	121	145	132	130	122
Expenses	US$M	**130**	125	169	135	130	127
Underwriting result	US$M	**(55)**	(20)	(100)	27	41	38
Net claims ratio	%	**42.0**	58.0	67.2	52.2	49.8	51.6
Net commission ratio	%	**36.4**	22.5	22.2	21.4	21.7	20.5
Expense ratio	%	**37.4**	23.2	25.9	22.0	21.7	21.4
Combined operating ratio	%	**115.8**	103.7	115.3	95.6	93.2	93.5
Adjusted combined operating ratio[2]	%	**116.5**	104.2	115.5	95.6	93.2	93.5
Insurance profit margin	%	**(13.5)**	(2.2)	(14.2)	5.5	8.0	7.1

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.