European Operations business review

European Operations has produced another strong underwriting result, reflecting our underwriting discipline and improved market conditions in several underlying portfolios.

Richard Pryce
Chief Executive Officer • European Operations

Gross written premium (US$M)
4,355
↑ 8% from 2017[1]

Net earned premium (US$M)
3,505
↑ 9% from 2017[2,3]

Underwriting result (US$M)
175
↓ $38M from 2017[3]

Insurance profit (US$M)
311
↓ $24M from 2017[3]

Combined operating ratio[4]
94.8%
2017 95.2%[3]

Insurance profit margin
8.9%
2017 10.4%[3]

2018 overview

Trading conditions in our London market insurance business continued to improve in the second half of the year whilst conditions in our other insurance businesses stabilised. In contrast, and as reported at the half year, QBE Re did not experience the significant improvement in terms and conditions we anticipated.

Another year of above average catastrophe activity combined with an increase in large individual risk claims across the industry support a continued positive rating environment in 2019. This is especially the case for London Market insurance where we see some competitor repositioning largely due to the increased performance oversight actions being undertaken by Lloyd's.

European Operations recorded an average premium renewal rate increase of 4.4% compared with a reduction of 0.2%[3] in 2017. Financial lines, UK motor and international property continue to benefit from the strongest rate improvements. During the second half of the year, we experienced further improvement in most marine classes and international casualty.

Our underwriting teams continue to display leadership and discipline with focus on poorer performing portfolios such as international property and financial lines. We remain committed to achieving the pricing required to deliver an acceptable and sustainable risk-adjusted return on capital.

In response to the Brexit challenge, we now have a fully operational and well-capitalised insurance and reinsurance company located in Belgium. As a result, we have an enhanced presence across Europe and successfully renewed our existing business in continental Europe at the 1 January 2019 renewals.

We continue to invest in pricing and risk selection tools as part of the Group's Brilliant Basics program supported by our own team of data scientists. These activities will continue to add value to our business over the coming years. Our customer engagement program continues to expand across the business and the Group EQUITY program will add to this positive momentum in 2019.

Effective 1 January 2019, and as part of the Group simplification initiative, the Group's newly formed "International" division will include European Operations and Asia. We will report on this basis going forward.

Operating and financial performance

Underwriting performance

Excluding the impact of risk-free rates used to discount net outstanding claims liabilities, European Operations' combined operating ratio improved to 94.8% from 95.2% in the prior year reflecting an improved current accident year claims ratio partly offset by a lower level of positive prior accident year claims development.

European Operations' attritional claims ratio improved to 46.8% from 49.6% in the prior year. The year-on-year improvement reflects targeted underwriting actions coupled with a reduction in reinsurance spend. Furthermore, the attritional claims ratio in the prior year was adversely impacted by weakness in sterling following the EU referendum as well as the Ogden decision.

QBE Re recorded a very strong underwriting performance while the UK and European insurance businesses performed as anticipated. International Markets recorded a less satisfactory result reflecting the poorer trading conditions in London and heightened large claim severity.

European Operations continues to monitor the performance of each portfolio and each territory in detail and independently of the responsible underwriting leaders to ensure that we optimise the risk-adjusted return on allocated capital.

Insurance profit for the year was $311 million, down 7% from $335 million in the prior year, reflecting a reduced level of positive prior accident year claims development and a lower contribution from risk-free rates used to discount net outstanding claims liabilities.

1 Up 6% on a constant currency basis.
2 Up 7% on a constant currency basis.
3 Excludes the 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.

Premium income

While headline gross written premium increased by 8% to $4,355 million from $4,049 million in 2017, gross written premium was up 6% on a constant currency basis reflecting the stronger sterling and euro against the US dollar.

Gross written premium growth reflects the improved rating environment and targeted growth in profitable portfolios such as Continental European insurance, life and accident reinsurance and the improved rating environment in several London market portfolios.

Our premium retention levels remain stable and new business levels are down moderately from the previous year. We have renewed our efforts to improve the quality of the new business pipeline and are very wary of poor quality new business opportunities coming to market due to other carriers trying to improve their portfolios.

Net earned premium grew by 9% to $3,505 million from $3,212 million in the prior year but was up 7% on a constant currency basis.

Claims expense

Excluding the impact of risk-free rates used to discount net outstanding claims liabilities, the net claims ratio increased to 61.5% from 60.5% in 2017, reflecting an improved attritional claims ratio more than offset by a lower level of positive prior accident year development. On the same basis, the current accident year net claims ratio improved to 62.7% from 64.9% in the prior year.

The attritional claims ratio improved 2.8% to 46.8% from 49.6% in the prior year. This reflected underlying improvement coupled with the unwind of the previously flagged post-Brexit devaluation of sterling and the non-recurrence of one-off reinsurance expense which suppressed net earned premium in the prior year.

Positive prior accident year claims development fell to $43 million or 1.2% of net earned premium compared with $141 million or 4.4% in the prior year.

In a year where the global insurance industry experienced above average catastrophe activity and a high incidence of large individual risk claims, the net cost remained within European Operations' planned allowances.

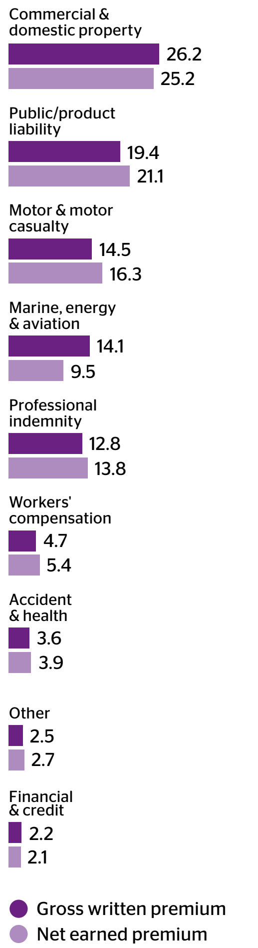
Lower risk-free rates used to discount net outstanding claims liabilities adversely impacted the underwriting result by $7 million or 0.2% of net earned premium compared with a benefit of $57 million or 1.8% in the prior year.

Commission and expenses

The net commission ratio improved to 18.3% from 19.2% reflecting reduced reinsurance spend and our underwriting teams' ongoing actions to reduce commissions particularly in the London market.

The expense ratio improved again to 15.0% from 15.5% in the prior year due to continued strict cost control as well as some efficiency and restructuring benefits.

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



Underwriting result

FOR THE YEAR ENDED 31 DECEMBER		2018	2017	2017 ADJUSTED[1]	2016	2016 ADJUSTED[2]	2015	2014 ADJUSTED[3]
Gross written premium	US$M	**4,355**	4,049	4,049	4,076	4,076	4,386	4,526
Gross earned premium	US$M	**4,302**	4,010	4,010	3,878	3,878	4,338	4,805
Net earned premium	US$M	**3,505**	3,210	3,212	2,949	3,115	3,454	3,929
Net incurred claims	US$M	**2,162**	2,024	1,885	1,658	1,826	1,844	2,362
Net commission	US$M	**641**	615	615	574	574	634	718
Expenses	US$M	**527**	499	499	516	516	599	626
Underwriting result	US$M	**175**	72	213	201	199	377	223
Net claims ratio	%	**61.7**	63.1	58.7	56.2	58.6	53.4	60.1
Net commission ratio	%	**18.3**	19.2	19.2	19.4	18.4	18.4	18.3
Expense ratio	%	**15.0**	15.5	15.5	17.5	16.6	17.3	15.9
Combined operating ratio	%	**95.0**	97.8	93.4	93.2	93.6	89.1	94.3
Adjusted combined operating ratio[4]	%	**94.8**	99.6	95.2	90.2	90.7	89.7	88.8
Insurance profit margin	%	**8.9**	6.0	10.4	10.7	10.1	13.4	8.8

1 Excludes one-off impact on the underwriting result due to the Ogden decision in the UK.
2 Excludes transactions to reinsure UK long-tail liabilities.
3 Excludes 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.