Independent auditor's report

TO THE SHAREHOLDERS OF QBE INSURANCE GROUP LIMITED

pwc

Report on the audit of the Financial Report

Our opinion

In our opinion:

The accompanying Financial Report of QBE Insurance Group Limited (the company) and its controlled entities (together the Group) is in accordance with the *Corporations Act 2001*, including:

(a) giving a true and fair view of the Group's financial position as at 31 December 2018 and of its financial performance for the year then ended

(b) complying with Australian Accounting Standards and the *Corporations Regulations 2001.*

What we have audited

The Group Financial Report comprises:

- the consolidated balance sheet as at 31 December 2018
- the consolidated statement of comprehensive income for the year then ended
- the consolidated statement of changes in equity for the year then ended
- the consolidated statement of cash flows for the year then ended
- the notes to the consolidated financial statements, which include a summary of significant accounting policies
- the directors' declaration.

Basis for opinion

We conducted our audit in accordance with Australian Auditing Standards. Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the Financial Report* section of our report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We are independent of the Group in accordance with the auditor independence requirements of the *Corporations Act 2001* and the ethical requirements of the Accounting Professional and Ethical Standards Board's APES 110 *Code of Ethics for Professional Accountants* (the Code) that are relevant to our audit of the Financial Report in Australia. We have also fulfilled our other ethical responsibilities in accordance with the Code.

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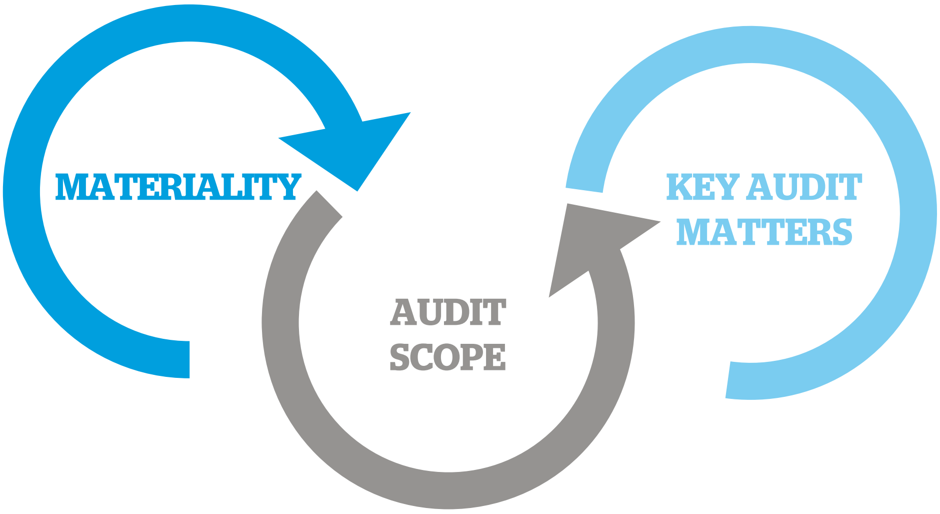
Our audit approach

An audit is designed to provide reasonable assurance about whether the Financial Report is free from material misstatement. Misstatements may arise due to fraud or error. They are considered material if individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the Financial Report.

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the Financial Report as a whole, taking into account the geographic and management structure of the Group, its accounting processes and controls and the industry in which it operates.



MATERIALITY

- For the purpose of our audit we used overall Group materiality of $58.9 million, which represents approximately 0.5% of the Group's net earned premium.
- We utilised a 0.5% threshold based on our professional judgement, noting it is within the range of commonly acceptable thresholds.
- We applied this threshold, together with qualitative considerations, to determine the scope of our audit and the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements on the Financial Report as a whole.
- We chose Group net earned premium because, in our view, it is a key financial statement metric used in assessing the performance of the Group and is not as volatile as other profit and loss measures.

AUDIT SCOPE

- Our audit focused on where the Group made subjective judgements; for example, significant accounting estimates involving assumptions and inherently uncertain future events.
- We ensured that the audit teams at both Group and operational levels possessed the appropriate skills and competencies needed for the audit of a complex global insurer. This included industry expertise in insurance, as well as IT specialists, actuarial, tax and valuation professionals.
- We conducted an audit of the most financially significant divisions being North American Operations, European Operations, Australian & New Zealand Operations and Equator Re (the divisions). In addition, we performed specified risk focused audit procedures on certain account balances for other entities within the Group.
- For the work performed by auditors within PwC Australia or from other firms operating under our instructions, we determined the level of involvement we needed to have in their audit work to be satisfied that sufficient audit evidence had been obtained for the purposes of our opinion.
- We kept in regular communication with audit teams throughout the year with conference calls, discussions and written instructions, where appropriate. Further, we visited and met with management and local audit teams in New York, London, Hong Kong and Sydney.
- We performed further audit procedures at a Group level over the remaining balances and the consolidation of the Group's reporting segments.

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Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the Financial Report for the current period. The key audit matters were addressed in the context of our audit of the Financial Report as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. Further, any commentary on the outcomes of a particular audit procedure is made in that context. We communicated the key audit matters to the Audit Committee.

KEY AUDIT MATTER	How our audit addressed the key audit matter

Valuation of net outstanding claims

(Refer to note 2.3) $14,028 million

We considered the valuation of net outstanding claims a key audit matter because of the complexity involved in the estimation process and the significant judgements that the Group makes in determining the balance. Note 2.3 to the financial statements describes the elements that make up the balance. We comment on the most judgemental aspects of these elements below.

(a) Gross discounted central estimate

(Refer to note 2.3.1) $18,421 million

The estimation of outstanding claims involves significant judgement given the size of the liability and inherent uncertainty in estimating the expected future payments for claims incurred.

The valuation of outstanding claims relies on the quality of the underlying data. It involves complex and subjective judgements about future events, both internal and external to the business, for which minor changes in assumptions can result in material impacts on the estimate. Claims estimates in respect of catastrophe events may involve additional uncertainty, particularly those occurring closer to the year end, given the materiality of amounts involved, and the inherent difficulty in initially assessing amounts until further evidence emerges.

Judgement also arises over the estimation of payments for claims that have been incurred at the reporting date but have not yet been reported to the Group as there is generally less information available in relation to these claims. Classes of business where there is a greater length of time between the initial claim event and settlement (such as workers' compensation, professional indemnity and other liability classes) tend to display greater variability between initial estimates and final settlement.

The estimate of expected future payments is discounted to present value using a risk-free rate of return in order to reflect the time value of money. Judgement is involved in estimating the period over which claims are expected to settle.

Our procedures, in conjunction with PwC actuarial experts, included:

- Assessing the design and testing the operating effectiveness of certain controls over the actuarial function.
- Testing historical claims, a key input into the actuarial estimates, by selecting a sample of claims case estimates and settlements, and agreeing the key elements to underlying documentation.
- Assessing those classes of business where claims reserve estimates present a higher risk and focusing on those which inherently involve greater levels of judgement and have shown greater year on year variation over previous estimates. In the current year these included large risk and catastrophe claims reserves related to Hurricane Michael, the California wildfires and certain longer tail liability portfolios.
- Evaluating whether the Group's actuarial methodologies were consistent with those used in the industry and with prior periods.
- Assessing key actuarial assumptions such as the claims ratios and expected frequency and severity of claims, together with our actuarial experts. We considered these assumptions by comparing them with our expectations based on the Group's experience, current trends and benchmarks, and our own industry knowledge. For some classes of business, we also performed our own independent actuarial projections and compared the results with the Group's estimates.
- Testing the discount applied, by territory and line of business, for classes of business where there is a greater length of time between the initial claim event and settlement. This included comparing the rates applied to external market data and the payment patterns to historical information.
- Considering the work and findings of external actuarial experts engaged by the Group to review the discounted central estimates.

KEY AUDIT MATTER	How our audit addressed the key audit matter
(b) Reinsurance and other recoveries (Refer to note 2.3.2) $5,551 million The valuation of reinsurance assets requires a significant level of judgement, given its inherent dependence on underlying estimates of gross outstanding claims. In addition, significant judgement may be required by the Group to ensure contractual terms are correctly accounted for (such as the Group's aggregate large risk and catastrophe reinsurance program (GLRC)).	Our procedures included: • Obtaining audit evidence in relation to the data and actuarial processes for estimating reinsurance recoveries on outstanding claims by performing the same audit procedures as those outlined above for gross claims estimates. • For the GLRC program, evaluating a sample of claims that are subject to recovery under the program. This included considering the work of the Group's actuarial experts and comparing the Group's recovery calculations to the terms of the underlying contracts with the reinsurer. • For remaining material reinsurance assets, we inspected a sample of relevant contracts to determine whether the key terms had been reflected in the financial statements in accordance with Australian Accounting Standards. We also performed procedures to assess the recoverability of those assets, including consideration of the ageing on amounts receivable and assessment of the credit ratings of relevant reinsurance counterparties.
(c) Risk margins and probability of adequacy (PoA) (Refer to note 2.3.3) $1,158 million The net outstanding claims provision includes, in addition to the central estimate of the present value of the expected future payments, a risk margin which relates to the inherent uncertainty in that estimate. In determining the risk margin, the Group must make judgements about the variability of each class of business underwritten and the extent of correlation within each division and between different geographical locations. Probability of adequacy (PoA) is a measure of the estimated overall sufficiency of reserves including a risk margin in light of that variability.	Our procedures included: • Assessing the Board's approach to setting the risk margin in accordance with the requirements of Australian Accounting Standards, with a particular focus on the assessed level of uncertainty in the net central estimate leading to a change in the margin year on year. We evaluated these factors by considering the findings from our work performed on the net central estimate. • Testing the Group's actuarial calculation of the PoA for reasonableness and consistency with previous valuations. This included developing an understanding of and testing the actuarial techniques applied by the Group, and comparing the results with industry benchmarks.

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KEY AUDIT MATTER	How our audit addressed the key audit matter

Valuation of goodwill in North American Operations
(Refer to note 7.2.1) $832 million

Goodwill has been recognised as a result of the Group's historical acquisitions and is allocated to cash generating units (CGUs) expected to benefit from synergies arising from the acquisitions giving rise to the goodwill.

An impairment assessment is performed annually by the Group, comparing the carrying value of the CGUs with their recoverable amount. The recoverable amount of each CGU is determined by calculating the fair value of the CGU.

The fair value of the CGU is contingent on future cash flows and there is a risk that goodwill will be impaired if cash flows are not in line with the Group's expectations. The projections in the Group's impairment model contain a number of significant judgements and estimates including the terminal growth rate, the forecast combined operating ratios in the projection period and investment return assumptions. Changes in these assumptions could lead to an impairment to the carrying value of goodwill.

We considered goodwill relating to the North American Operations to be a key audit matter because of the financial significance of the carrying value of the balance and previous impairment charges recorded, and because the impairment assessment is sensitive to reasonably possible changes in assumptions.

Our procedures included:

- Assessing whether the methodology used by the Group for impairment assessment purposes was in line with the requirements of Australian Accounting Standards.
- Developing an understanding of the process by which the projected future cash flow forecasts were developed and comparing the cash flows included in the impairment assessment with the three year business plan presented to the Board.
- Assessing the key assumptions used to derive the future cash flows, taking into consideration the past projections and actual performance of the North American Operations.
- Together with PwC valuation experts, evaluating the consistency of the terminal growth rate and investment returns with available external analyses, and reperforming the calculation of the discount rate applied to future cash flows, comparing key inputs (including risk-free rate, market premium, unlevered beta and company specific risk premium).
- Reperforming the Group's sensitivity analysis calculations, and considering other reasonably possible changes in key assumptions.
- Considering the work and findings of external valuation experts engaged by the Group to assess a supportable range for the valuation of the North American Operations CGU.

KEY AUDIT MATTER	How our audit addressed the key audit matter

Recoverability of deferred tax assets in the US tax group
(Refer to note 6.2.3) $370 million

The Group continues to recognise a US deferred tax asset comprised of carry forward tax losses and deductible temporary differences. Following the restructure relating to Blue Ocean in the first half of 2018 (as detailed in Note 6.2.3 to the financial statements), North American Operations' carry forward tax losses can be applied against Equator Re's profits.

The recoverability of the US deferred tax asset depends upon sustained improvement in the profitability of the North American Operations, the rate at which those profits will be taxed, the period over which tax losses will be available for recovery, and the execution of any future tax planning.

We considered this a key audit matter due to the significant judgement required by the Group to assess the recoverability of the US deferred tax asset.

Our procedures included:

- Considering the impact of the restructure of the US tax group (as detailed in note 6.2.3 to the financial statements) on the recoverability of the US deferred tax asset.
- Evaluating the progress made by the Group in improving the profitability of the North American Operations in recent periods, which included the remediation of the causes of past losses through, amongst other initiatives, business disposals and cost reduction programs.
- Comparing future taxable profits used in the deferred tax asset recoverability assessment to the current year results and three year business plan presented to the Board.
- Analysing the tax rate applied to forecast future taxable profits in light of the US tax law changes.
- Considering key assumptions adopted by the Group in relation to future tax planning strategies, as outlined in Note 4.1 to the financial statements.
- Together with PwC tax experts, considering whether the tax losses are legally available for the forecast recoupment period.

Valuation of investments
(Refer to note 3.2) $21,989 million

The Group holds investments representing 56% of the total assets.

The majority of the Group's investments are considered to be non-complex in nature as fair value is based on prices and rates that can be easily observed in the relevant markets. On this basis, the majority of the Group's investments are classified under Australian Accounting Standards as either "Level 1" (i.e. where key inputs to the valuation are based on quoted prices in the market) or "Level 2" (i.e. where key inputs to the valuation are based on observable prices in the market). We considered these Level 1 and Level 2 investments to be a key audit matter due to their financial significance to the Group.

The Group also holds a limited number of investments considered to be "Level 3" under Australian Accounting Standards (i.e. where key inputs to the valuation require additional judgement as significant inputs are not based on observable market data) primarily in respect to infrastructure debt, infrastructure assets and private equity investments. While the Group's holdings of such investments is limited relative to total investment holdings, we considered their valuation to be a key audit matter because there is more judgement involved in determining their value.

Our procedures included:

- Assessing the design and testing the operating effectiveness of selected controls over the investment function.
- Comparing the Group's calculation of fair value for a sample of investments to our own independent calculation. Together with PwC valuation experts, this included sourcing independent inputs from market data providers and using our own valuation models.
- Obtaining independent confirmations from fund managers or equivalent over the existence of investments.

Independent auditor's report

TO THE SHAREHOLDERS OF QBE INSURANCE GROUP LIMITED

KEY AUDIT MATTER	How our audit addressed the key audit matter
Operation of IT systems and controls The Group is dependent on complex IT systems for the processing and recording of significant volumes of transactions. In particular, in common with all large financial services organisations, access rights to technology are important because they are intended to ensure that changes to applications and data are appropriately authorised. Ensuring staff have appropriate access to IT systems and access is monitored, are key controls in mitigating the potential for fraud or error as a result of a change to an application or underlying data. We considered this a key audit matter because a significant number of the key financial controls we seek to rely on in our audit are related to IT systems and automated controls.	Our procedures included: • Developing an understanding of the significant business processes, IT systems and relevant controls. • Assessing the design and testing the operating effectiveness of the key controls over the relevant IT systems. This involved assessing: • Access to programs and data: the access controls designed to enforce segregation of duties or ensure that data is only changed through authorised means. • Change management: the processes and controls used to develop, test and authorise changes to the functionality and configurations within systems. • IT operations: the controls over key operations are used to ensure that any issues that arise are managed appropriately. For in-scope IT operations where technology services are provided by a third party, we considered assurance reports from the third party's auditor on the design and operating effectiveness of controls. We also carried out further independent tests over the operation of key applications to establish the accuracy of selected calculations, the correct generation of certain reports, and to assess the correct operation of selected automated controls and technology-dependent manual controls. Where we identified design and operating effectiveness issues with the access and change management controls, a combination of compensating controls and detailed testing provided sufficient evidence for our audit.

Other information

The directors are responsible for the other information. The other information comprises the information included in the Annual Report for the year ended 31 December 2018, but does not include the Financial Report and our auditor's report thereon.

Our opinion on the Financial Report does not cover the other information and accordingly we do not express any form of assurance conclusion thereon.

In connection with our audit of the Financial Report, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the Financial Report or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

If, based on the work we have performed on the other information that we obtained prior to the date of this auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of the directors for the Financial Report

The directors of the company are responsible for the preparation of the Financial Report that gives a true and fair view in accordance with Australian Accounting Standards and the *Corporations Act 2001* and for such internal control as the directors determine is necessary to enable the preparation of the Financial Report that gives a true and fair view and is free from material misstatement, whether due to fraud or error.

In preparing the Financial Report, the directors are responsible for assessing the ability of the Group to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the Financial Report

Our objectives are to obtain reasonable assurance about whether the Financial Report as a whole is free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the Australian Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the Financial Report.

A further description of our responsibilities for the audit of the Financial Report is located at the Auditing and Assurance Standards Board website at: http://www.auasb.gov.au/auditors_responsibilities/ar1.pdf.

This description forms part of our auditor's report.

Report on the Remuneration Report

Our opinion on the Remuneration Report

We have audited the Remuneration Report included in pages 60 to 82 of the Directors' Report for the year ended 31 December 2018.

In our opinion, the Remuneration Report of QBE Insurance Group Limited for the year ended 31 December 2018 complies with section 300A of the *Corporations Act 2001*.

Responsibilities

The directors of the company are responsible for the preparation and presentation of the Remuneration Report in accordance with section 300A of the *Corporations Act 2001*. Our responsibility is to express an opinion on the Remuneration Report, based on our audit conducted in accordance with Australian Auditing Standards.

PricewaterhouseCoopers

PricewaterhouseCoopers

SJ Hadfield

SJ Hadfield
Partner

Bret M. Griffin

B Griffin
Partner

Sydney
25 February 2019