EQUATOR REINSURANCES LIMITED

2018 ANNUAL REPORT

ONE Smile Committee

The ONE Smile Committee was established in 2016 with the primary objectives of promoting employee engagement through charitable activities within the community, employee wellness promotion and professional development.

In conjunction with the QBE Foundation, ONE Smile identified local charities whose mandates mirror QBE's twofold purpose of helping people achieve their ambitions and striving beyond what is seen as possible. In 2018, the two charities supported were Teen Services Teen Haven and Centre Against Abuse. Both have been active within the Bermuda support network for over 30 years and the company is proud to partner with them. The committee also gathered together with the employees to participate in Relay for Life and was formally recognised for its fundraising efforts.

In addition to its charitable contributions, employees have donated their time to support local fundraising events, by participating in mentor programs, picking-up debris around local beaches, and hosting lunches twice a year for the needy.

ONE Smile also presents a series of Lunch and Learn seminars to assist employees with their professional development by giving employees exposure to all aspects of Equator Re's business outside their main responsibilities and rising topics in the industry.

In an effort to promote further employee engagement, ONE Smile also organizes regular social activities.

Annual financial report

31 DECEMBER 2018

EQUATOR REINSURANCES LIMITED

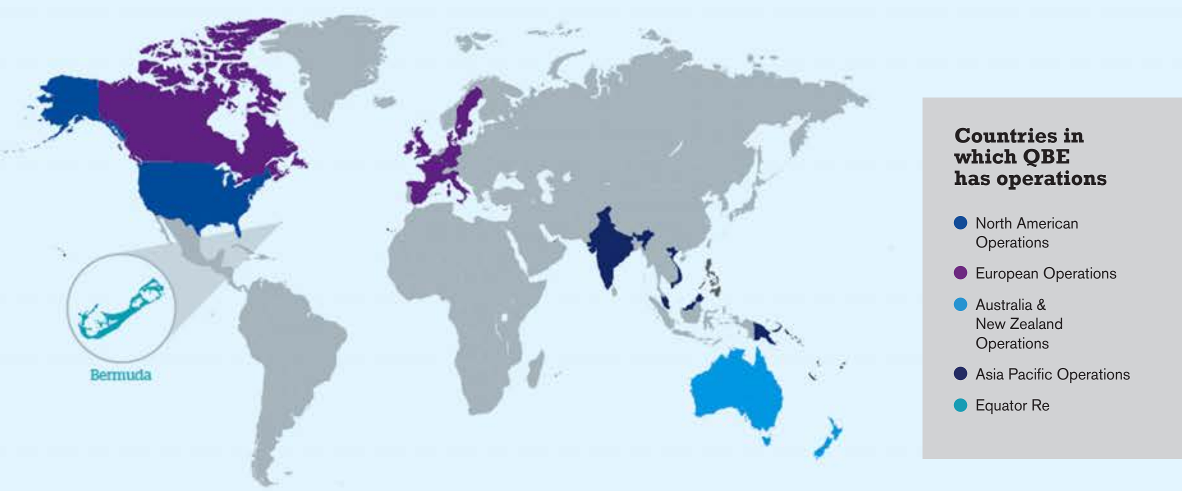
The financial report is presented in United States dollars.

Equator Reinsurances Limited is a company limited by shares, incorporated and domiciled in Bermuda. Its registered office is located at:

19 Par-La-Ville Road, 4th Floor,
Hamilton HM11, Bermuda.

A description of the nature of the Company's operations and its principal activities is included in the Directors' report on pages 2 to 7 which is not part of this financial report.

The financial report was authorised for issue by the directors on the 25th day of April 2019.



Directors' report

FOR THE YEAR ENDED 31 DECEMBER 2018

The directors of Equator Reinsurances Limited ("Equator Re" or the "Company") present their report on the financial statements for the year ended 31 December 2018.

Directors

The following directors held office during the whole of the financial year and up to the date of this report:

M. Angelina
D. Duclos
J. Fiore
N. Jones
A. Sodergren

A. Burton held office during the whole of the financial year and up to 1 April 2019.

B. Carlino was appointed to the Board on 26 September 2018.

R. Stone was appointed to the Board on 1 April 2019.

Michael (Mike) Angelina — Independent non-executive director

Mike was appointed as an independent non-executive director of the Company in July 2014 and is Chairman of the Risk and Capital Committee and a member of the Audit Committee. He is an insurance professional, with over 30 years practicing experience. Mike is a qualified actuary, former Chief Risk Officer, and insurance professional with consulting, executive, and directorship roles throughout his career. He currently serves as the Executive Director of the Academy of Risk Management and Insurance within the Erivan K. Haub School of Business of Saint Joseph's University, where he leads the Risk Management and Insurance undergraduate program.

Alana Burton — Chief Financial Officer (resigned 1 April 2019)

Alana was appointed as an executive director and Chief Financial Officer in January 2016. Alana was a member of the Risk and Capital and Sanctions Committees through until her resignation in April 2019, due to her relocation to Australia. She has over 19 years' experience in the insurance and reinsurance industry and has held various roles within the QBE Group over this period. Alana was awarded the University Medal upon graduation from her Bachelor of Commerce (1st Class honors) in Accounting at the University of New South Wales.

David (Dave) Duclos — Chairman, Non-independent non-executive director

David was appointed non-executive director of the Company in July 2016. He serves on the audit committee and became Chair of the Board in January 2018. David retired in June 2016 after 38 years of insurance and reinsurance experience in a number of technical and executive level roles with CIGNA, XL and QBE. He also serves on the board of RLI Corporation and on the advisory board of AAIS within the insurance industry.

James (Jim) Fiore — President, Equator Re; Group Chief Reinsurance Officer

Jim has had management responsibility of the Company since 2012 and is a member of the Company's Risk & Capital Committee. He also sits on the Group Underwriting Committee and the Group Security Committee. In his role as President of the Company, he oversees the day to day operations of QBE's reinsurance captive. In addition, he continues to work as the Group Chief Reinsurance Officer, which he was promoted to in 2012. In this capacity, he is responsible for QBE's global ceded reinsurance strategy and purchasing, as well as the management and oversight of the Company's exposures and accumulations. Jim began his career with QBE in 1992 and has over 30 years of industry experience.

Amanda Sodergren — Independent non-executive director

Amanda was appointed as an independent non-executive director of the Company in May 2018 and is Chairwoman of the Audit and Sanctions Committees and a member of the Risk & Capital Committee. Amanda also serves on the Boards of Hellenic Mutual War Risks Association (Bermuda) Limited, The UK P&I Club and a number of the Validus AlphaCat funds. Amanda was Chief Legal Counsel and Chief Ethics Officer of PartnerRe Ltd until December 2012 and has over thirty years' experience in the insurance, reinsurance and banking industries.

Directors' report CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2018

Neil Jones — Group Head of Underwriting Operations, Executive director

Neil was appointed as a non-independent executive director of the Company in December 2017 and is a member of the Company's Sanctions Committee. He also sits on the Group Underwriting Committee and is Chair of the Group Technical Committee. Neil has over 26 years' experience in the reinsurance industry, 23 years with the QBE Group.

Bruce Carlino — Chief Claims Officer

Bruce was appointed to the Equator Re Board in September 2018. He has been involved in reinsurance and insurance claims for almost 40 years. In 2015 he returned to the QBE Group and has served as the Chief Claims Officer for QBE Blue Ocean Re Limited and the Company. In that capacity he is responsible for the claims management process. Prior to re-joining QBE, Bruce was the Head of Claims for HCC Insurance responsible for their Specialty portfolios. Bruce also was Head of Claims for QBE Re and QBE Specialty from 2002-2012. Bruce is a qualified US attorney and holds the Associate in Reinsurance, the Chartered Property Casualty Underwriters (CPCU) and Chartered Insurance Operational Professional designations..

Rob Stone — Chief Financial Officer

Rob accepted the role as Chief Financial Officer of the Company on 1 April 2019 and was appointed to the Board as an executive director on 25 April 2019. Over the last 11 years, Rob has held various senior management roles within the finance function of QBE Group's European division. Rob is a Chartered Accountant and fellow of the Institute of Chartered Accountants in England and Wales (FCA). Prior to joining QBE, Rob spent 12 years within professional services. Following his appointment to the Board, Rob will also be a member of the Risk and Capital Committee.

Financial results highlights

	STATUTORY RESULT	
	2018 $M	2017 $M
Gross written premium	1,166	3,324
Gross earned premium revenue	1,520	3,408
Net earned premium	935	2,228
Net claims expense	(478)	(2,000)
Net commission	(213)	(698)
Underwriting and other expenses	(10)	(16)
Underwriting result	234	(486)
Net investment income on policyholder funds	27	132
Insurance profit / (loss)	261	(354)
Net investment income / (loss) on shareholder funds	22	(87)
Profit / (loss) before income tax	283	(441)
Income tax expense	(15)	(17)
Net profit / (loss) after income tax	268	(458)

About the Company

The Company is a Company limited by shares, incorporated and domiciled in Bermuda. The parent entity is QBE Blue Ocean Re Limited and the ultimate parent is QBE Insurance Group Limited ("QBE Group"). The parent entity is incorporated and domiciled in Bermuda with its registered office at 19 Par-La-Ville Road, Hamilton HM11, Bermuda. The ultimate parent is incorporated and domiciled in Australia with its registered office at Level 27, 8 Chifley Square, Sydney 2000, NSW Australia.

The Company is the wholly owned internal reinsurer for the QBE Group. The Company provides reinsurance protections to the QBE Group's operations around the world to assist in management of QBE Group's capital, balance sheet and net exposure to large individual risk and catastrophe claims. Business written and retained by the Company is within the risk appetite of the QBE Group and is designed to support the management of aggregate exposures to large individual risk and catastrophe claim and to optimise the levels of capital held within the QBE Group.

Result

Gross written premium of $1.2 billion decreased 64% or $2.1 billion from $3.3 billion last year. This decrease was due to:

- all risks ceded from QBE's North American Operations being written by the newly established QBE Blue Ocean Re Ltd (Blue Ocean) in 2018. Blue Ocean is also a Bermudan domiciled wholly owned captive of the QBE Insurance Group. These exposures were underwritten by the Company in 2017;

- a loss portfolio transfer in 2017 generating one-off premium income of $336 million;
- the cancelation and commutation of contracts with QBE's Latin American operating entities following their sale to a third party during 2018;
- the cancelation and commutation of a large quota share with QBE's European Operations during 2018, which generated a significant return of unearned premium at the date of transactions, which is accounted for as a reduction in gross written premium (GWP);
- the non-renewal of a large quota shares from QBE's Australia & New Zealand Operations following a revision to that divisions risk appetite and reinsurance spend, partly offset by a new quota share (LMI);
- partly offset by new quota share arrangements with QBE's Asia Pacific Operations and growth in some existing proportional contracts

Net earned premium (NEP) of $935 million was down by 58% compared with $2,228 million last year. The decrease in NEP is largely reflective of the top line decrease. Gross premium refunds in some cases generated a decline in written premium but nil impact on an earned basis and contribute to the higher GWP relative to NEP.

The Company's underwriting result was a profit of $234 million which generated a combined operating ratio of 75.0% compared with a loss of $486 million and combined operating ratio of 121.8% last year.

Net claims cost 51.1% of net earned premium compared to 89.8% last year. The 38.7% improvement was due primarily to the 2017 result being impacted by a lower level of catastrophe losses.

The closing risk margin balance of $230 million generates a probability of adequacy ("PoA") of 88.7%. This compares to risk margins of $441 million and a PoA of 90.0% at 31 December 2017. The commutations and novation of some risks to Blue Ocean significantly reduced the outstanding claims balance which allowed for a proportionate reduction in risk margins whilst maintaining a PoA well within the Boards target range.

The combined commission and expense ratio of 23.9% improved by 8.1% from 32.0% last year. This was primarily due to the cancelation and non-renewal of quota shares which run at high commission ratios.

Net investment income of $49 million compared to $45 million last year. Included in net investment income is a $25 million loss (2017 $107 million loss) on another financial asset, purchased during the first half of 2016, which is managed outside of the core investment portfolio. Absent the gain / loss on this asset, the investment income during 2018 would have been $79 million lower than the prior year at $73 million (2017 $152 million). The decrease was largely driven by lower returns on our fixed interest securities, short-term money and cash, which generated income of $16 million compared with $86 million in 2017.

Net profit after tax for the 12 months ended 31 December 2018 was $268 million, compared to a net loss of $458 million last year. The current year benefited from benign catastrophe activity and release of profits related to the commutation of some historic quota share arrangements. The prior year net loss was largely due to significant insured catastrophe losses in the second half of 2017 including hurricanes Harvey, Irma and Maria and Cyclone Debbie

Net profit before tax was $283 million compared to net loss before tax of $441 million last year. Whilst income tax is not levied on the Company in Bermuda, it is payable to the Australian tax office in relation to premiums ceded from QBE's Australian domiciled operating entities.

Dividends & Capital

There were no dividends paid during 2018 (2017 $290 million). Profits were retained to bolster the Company's capital position following an increase in the target level of capital under a revision to the capital strategy during the year.

During the second half of 2017, the company issued an additional $100 million of share capital and drew down on a contingent capital facility which was in place with a related QBE company. This capital injection was in response to the significant impact of the catastrophe losses incurred by the Company and ensured that target capital levels remained in line with the Board approved capital strategy. The contingent capital draw down is recognised as a loan on the balance sheet but is permissible as Tier 2 capital for regulatory reporting and remains on the balance sheet in full, plus accrued interest as at the balance sheet date.

Shareholders' funds

Shareholders' funds increased to $1,072 million at 31 December 2018 from $936 million at 31 December 2017, due to the current year net profit partly offset by adverse movement in the foreign currency translation reserve.

Presentation currency

The Company has presented the Annual Report in United States dollars because a significant proportion of its underwriting activity is denominated in United States dollars. The United States dollar is also the currency that is widely understood by the global reinsurance industry, international investors and analysts.

Directors' report CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2018

Outstanding claims liability

The net central estimate of outstanding claims is determined by the VP, Actuarial Reserving and Capital, after consultation with internal and external actuaries. The assessment takes into account, amongst other things, a statistical analysis of past claims, allowance for claims incurred but not reported, reinsurance and other recoveries and future interest and inflation factors. The VP, Actuarial Reserving and Capital provides an annual opinion on the adequacy of the outstanding claims liability as approved by the Board.

As in previous years, the directors consider that a risk margin is required, above the actuarial central estimate, to mitigate the inherent uncertainty in the central estimate. The probability of adequacy of the outstanding claims liability at 31 December 2018 was 88.7%, which is broadly consistent with 90.0% last year and well within the Board approved range.

Indemnification and insurance

During the year, a related company paid a premium in respect of a contract insuring directors and officers of the Company. In accordance with normal commercial practice, disclosure of the total amount of premium payable under, and the nature of liabilities covered by, the insurance contract is prohibited by a confidentiality clause in the contract.

No such insurance cover has been provided for the benefit of the auditor of the Company.

Significant changes

During 2018 the Company was sold by its parent to a newly created Bermuda domiciled entity, QBE Blue Ocean Re Limited. Blue Ocean is also a wholly owned subsidiary of the QBE Group.

The Company's opening unearned premium liabilities, and a portion of its outstanding claims liabilities, on contracts with QBE's North American Operations were novated to Blue Ocean during 2018. From 1 January 2018, all premium from QBE North America that were once ceded to the Company, were ceded to Blue Ocean. The Company will continue to run-off the remaining North American reserves on its balance sheet, in the ordinary course of business.

There were no significant changes in the Company's state of affairs during the financial year other than as disclosed in this Annual Report.

Likely developments and expected results

Information on likely developments in the Company's operations in future financial years and the expected results of those operations have not been included in this report because disclosure of the information would be likely to result in unreasonable prejudice to the Company.

Events after balance sheet date

The directors are not aware of any matter or circumstance that has arisen since the end of the year that has significantly affected, or may significantly affect, the Company's operations, the results of those operations and the Company's state of affairs in future financial years.

Material business risks

As a global reinsurance business, the Company is subject to a variety of business risks. The Board believes that effective management of these risks is critical to delivering value for its stakeholders. It is the Company's policy to adopt a rigorous approach to managing risk; risk management is a continuous process and an integral part of the Company's governance structure, its broader business processes and, most importantly, its culture.

Some of the material business risks that the Company faces include strategic, insurance, credit, market, liquidity and operational risks. Explanations of these risks and their mitigations are set out in more detail in note 4 to the financial statements.

The directors are committed to high standards of Corporate Governance. The Company adopts a proactive governance framework consistent with the requirements of the Insurance Code of Conduct issued by the Bermuda Monetary Authority and the governance and risk management requirements and best practice standards of the QBE Group.

The Company makes judgements and estimates in respect of the reported amounts of certain assets and liabilities, the most significant of which are in relation to the determination of the outstanding claims liability and the application of the liability adequacy test. More detail of each of these is included in notes 2.3 and 2.5.1 respectively.

Board selection criteria and terms of reference

Directors are selected to achieve a broad range of skills, experience and expertise complementary to the Company's activities. The Board currently comprises seven directors including four executive and three non-executive directors, two of which are independent. The Board has determined that a non-executive director's relationship with the Company as a professional adviser, consultant, supplier, customer or otherwise is not material unless amounts paid under that relationship exceed $250,000.

In accordance with its charter, the Board's functions include:

- establishing financial and strategic objectives;
- evaluating, approving and monitoring strategic, business and financial plans;
- establishing and monitoring an appropriate governance and operational structure of the Company for the purpose of ensuring the sound and prudent management of the Company;
- approving and monitoring the Company's risk management and internal control framework to enable key business risks to be appropriately identified and managed;
- approving and monitoring adherence to policies, including code of conduct, fitness and probity and outsourcing;
- monitoring the Company's operations against legal, regulatory and financial responsibilities;
- reviewing and ensuring the adequacy of human resources, information technology and other resources; and
- appointment and, where appropriate, removal of the external auditor.

The Board ensures it has the information it requires to be effective including, where necessary, professional advice.

Company Secretary

The Company's appointed Company Secretary is Compass Administration Services Ltd, a firm registered in Bermuda.

Directors' interests and benefits

Director fees

The Company paid directors fees of $150,000 during the financial year (2017 $150,000) to independent non-executive directors external to the QBE Group, being M. Angelina and A. Sodergren. Executive directors of the Company and non-independent non-executive directors are remunerated for their contribution to the board as part of their overall remuneration package, paid either by the Company or another entity within the QBE Group.

Ordinary share capital

At no time during the year did any director have a beneficial interest in the shares of the Company.

Loans to directors and executives

The Company does not provide loans to directors or executives.

Other governance matters

The Company has adopted a code of conduct which outlines a set of general business ethics that apply to all Directors and employees when conducting any activity on behalf of the Company. The code of conduct requires employees to carry out business in an open and honest manner with customers, shareholders, employees, regulatory bodies, outside suppliers, intermediaries and the community. The code provides guidelines in respect of other requirements including whistle-blowing, confidentiality, disclosure of information, conflicts of interest and fraud.

Environmental regulation

The Company is not currently required to report upon any significant environmental regulations under Bermuda legislation.

Auditor

PricewaterhouseCoopers Ltd., Chartered Professional Accountants, Bermuda, continue in office in accordance with section 327B of the *Corporations Act 2001* of the Commonwealth of Australia.

Directors' report CONTINUED

FOR THE YEAR ENDED 31 DECEMBER 2018

Non-audit services

During the year, PricewaterhouseCoopers did not perform other services in addition to its statutory duties however a process remains in place by which any planned or actual activities are assessed.

A copy of the auditor's independence declaration required under section 307C of the *Corporations Act 2001* of the Commonwealth of Australia is set out on page 8.

Details of amounts paid or payable to PricewaterhouseCoopers is provided in note 7.5 to the financial statements.

Rounding of amounts

The Company is of a kind referred to in the *ASIC Corporations (Rounding in Financial/Directors' Reports) Instrument 2016/191.* Amounts have been rounded off in the Directors' Report to the nearest million dollars or, in certain cases, to the nearest thousand dollars in accordance with that instrument.

Registered office and principal place of business

The Company's registered office and principal place of business is at the 4th Floor, 19 Par-La-Ville Road, Hamilton HM11, Bermuda.

Signed in HAMILTON, Bermuda 26th day of April 2019 in accordance with a resolution of the directors.

J. Fiore
Director

R. Stone
Director

pwc

Auditor's independence declaration for the year ended December 31, 2018

As lead auditor of Equator Reinsurances Limited for the year ended December 31, 2018, I declare that, to the best of my knowledge and belief, there have been:

1. No contraventions of the auditor independence requirements of the *Corporations Act 2001* of the Commonwealth of Australia in relation to the audit; and
2. No contraventions of any applicable code of professional conduct in relation to the audit.

This declaration is in respect of Equator Reinsurances Limited.

PricewaterhouseCoopers Ltd.

David C. Gibbons
Partner

Hamilton, Bermuda
April 26, 2019

PricewaterhouseCoopers Ltd., Chartered Professional Accountants, P.O. Box HM 1171, Hamilton HM EX, Bermuda
T: +1 (441) 295 2000, F:+1 (441) 295 1242, www.pwc.com/bermuda

Financial Statements

FOR THE YEAR ENDED 31 DECEMBER 2018

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Directors' declaration

All amounts in are presented in United States dollars unless otherwise stated.

The Company is a Company limited by shares, incorporated and domiciled in Bermuda. Its registered office is located at:

4th Floor, 19 Par-La-Ville Road,

Hamilton HM11, Bermuda.

The parent entity is QBE Blue Ocean Re Limited and the ultimate parent is QBE Insurance Group Limited (the QBE Group). The parent entity is incorporated and domiciled in Bermuda. The ultimate parent is incorporated and domiciled in Australia with their registered office at Level 27, 8 Chifley Square, Sydney 2000, NSW Australia.

The Company is a wholly owned internal reinsurer for the QBE Group.

The Financial Report was authorised for issue by the directors on 25 April 2019. The directors have the power to amend and reissue the financial statements.

Statement of comprehensive income

FOR THE YEAR ENDED 31 DECEMBER 2018

	NOTE	2018 $M	2017 $M
Gross written premium		**1,166**	3,324
Unearned premium movement		**354**	84
Gross earned premium revenue	2.1	**1,520**	3,408
Outward reinsurance premium		**(196)**	(1,587)
Deferred reinsurance premium movement		**(389)**	407
Outward reinsurance premium expense		**(585)**	(1,180)
Net earned premium (a)		**935**	2,228
Gross claims expense	2.2	**(966)**	(3,782)
Reinsurance and other recoveries revenue	2.2	**488**	1,782
Net claims expense (b)	2.2	**(478)**	(2,000)
Gross commission expense		**(235)**	(753)
Reinsurance commission revenue	2.1	**22**	55
Net commission (c)		**(213)**	(698)
Underwriting and other expenses (d)		**(10)**	(16)
Underwriting result (a)+(b)+(c)+(d)		**234**	(486)
Investment and other income – policyholders' funds	3.1	**29**	135
Investment expenses – policyholders' funds	3.1	**(2)**	(3)
Insurance profit (loss)		**261**	(354)
Investment and other income (loss) – shareholder funds	3.1	**29**	(82)
Investment expenses – shareholder funds	3.1	**(1)**	-
Financing and other costs	3.1	**(6)**	(5)
Profit (loss) before income tax		**283**	(441)
Income tax expense	6.1	**(15)**	(17)
Profit (loss) after income tax		**268**	(458)
Other comprehensive income			
Items that may be reclassified to profit or loss			
Net movement in foreign currency translation reserve	5.2.2	**(77)**	101
Total comprehensive income (loss) after income tax		**191**	(357)
Profit (loss) after income tax attributable to:			
Ordinary equity holder of the Company		**268**	(458)
Total comprehensive income (loss) after income tax attributable to:			
Ordinary equity holder of the Company		**191**	(357)

EARNINGS PER SHARE FOR PROFIT AFTER INCOME TAX ATTRIBUTABLE TO THE EQUITY HOLDER OF THE COMPANY	NOTE	2018 $	2017 $
Basic earnings per share	5.4	**5.45**	(11.44)

The statement of comprehensive income should be read in conjunction with the accompanying notes.

Balance sheet

AS AT 31 DECEMBER 2018

	NOTE	2018 $M	2017 $M
Assets			
Cash and cash equivalents	5.1	**37**	37
Investments	3.2	**2,119**	3,713
Derivative financial instruments	5.5	**15**	24
Trade and other receivables	2.6	**1,391**	2,332
Deferred insurance costs	2.5	**126**	723
Reinsurance and other recoveries on outstanding claims	2.3	**2,650**	3,205
Property plant and equipment		**1**	-
Total assets		**6,339**	10,034
Liabilities			
Derivative financial instruments	5.5	**23**	28
Trade and other payables	2.7	**713**	1,492
Unearned premium	2.5	**355**	1,117
Outstanding claims	2.3	**4,176**	6,461
Total liabilities		**5,267**	9,098
Net assets		**1,072**	936
Equity			
Share capital	5.2.1	**380**	421
Share premium reserves	5.2.2	**126**	140
Foreign currency translation reserve	5.2.2	**(246)**	(169)
Retained profits		**812**	544
Total equity		**1,072**	936

The balance sheet should be read in conjunction with the accompanying notes.

Statement of changes in equity

FOR THE YEAR ENDED 31 DECEMBER 2018

2018	SHARE CAPITAL $M	SHARE PREMIUM RESERVES $M	FOREIGN CURRENCY TRANSLATION RESERVE $M	RETAINED PROFITS $M	TOTAL EQUITY $M
As at 1 January	**421**	**140**	**(169)**	**544**	**936**
Profit after income tax	**-**	**-**	**-**	**268**	**268**
Other comprehensive income	**-**	**-**	**(77)**	**-**	**(77)**
Total comprehensive income	**421**	**140**	**(246)**	**812**	**1,127**
Transactions with owners in their capacity as owners					
Foreign exchange movement	**(41)**	**(14)**	**-**	**-**	**(55)**
As at 31 December	**380**	**126**	**(246)**	**812**	**1,072**

2017	SHARE CAPITAL $M	SHARE PREMIUM RESERVES $M	FOREIGN CURRENCY TRANSLATION RESERVE $M	RETAINED PROFITS $M	TOTAL EQUITY $M
As at 1 January	307	134	(270)	1,301	1,472
Loss after income tax	-	-	-	(458)	(458)
Other comprehensive income	-	-	101	-	101
Total comprehensive income	-	-	101	(458)	(357)
Transactions with owners in their capacity as owners					
Shares issued	100	-	-	-	100
Dividends paid on ordinary shares	-	-	-	(290)	(290)
Foreign exchange movement	14	6	-	(9)	11
As at 31 December	421	140	(169)	544	936

The statement of changes in equity should be read in conjunction with the accompanying notes.

Statement of cash flows

FOR THE YEAR ENDED 31 DECEMBER 2018

	NOTE	2018 $M	2017 $M
Operating activities			
Premium received		**2,024**	3,030
Reinsurance and other recoveries received		**420**	121
Outward reinsurance paid		**(898)**	(1,168)
Claims paid		**(2,094)**	(1,414)
Acquisition and other underwriting costs paid		**(318)**	(511)
Novation and commutation transactions paid		**(439)**	-
Interest received		**85**	78
Dividends received		**52**	17
Interest paid		**(6)**	(5)
Income taxes paid		**(15)**	(13)
Net cash flows from operating activities	7.3	**(1,189)**	135
Investing activities			
Proceeds on sale of growth assets		**418**	736
Payment for purchase of growth assets		**(307)**	(624)
Payments for foreign exchange transactions		**(50)**	(20)
Net proceeds (payments) on sale (purchase) of interest-bearing financial assets		**1,465**	(523)
Net cash flows from investing activities		**1,526**	(431)
Financing activities			
Proceeds from issue of shares		**-**	100
Dividends paid		**-**	(290)
Payments to (proceeds from) loan from related entity		**(432)**	350
Proceeds from (payments to) related entities		**458**	(130)
Net cash flows from financing activities		**26**	30
Net movement in cash and cash equivalents		**363**	(266)
Cash and cash equivalents at the beginning of the year		**37**	37
Effect of exchange rate changes		**(363)**	266
Cash and cash equivalents at the end of the year	5.1	**37**	37

The statement of cash flows should be read in conjunction with the accompanying notes.

Notes to the financial statements

FOR THE YEAR ENDED 31 DECEMBER 2018

1 OVERVIEW

1.1 About the Company

About our ultimate parent, the QBE Insurance Group

QBE is one of the world's largest insurance and reinsurance companies, with operations in all the major insurance markets. Formed in Australia in 1886, QBE employs over 12,000 people in 31 countries, with significant operations in Australia, Europe, North America and Asia Pacific.

QBE is listed on the Australian Securities Exchange and is a for-profit entity.

About our history and activities

The Company is a wholly owned internal reinsurer of the QBE Group. Based in Bermuda, the Company provides reinsurance protections to the QBE Group's operations around the world to assist in management of QBE's capital, balance sheet and net exposure to large individual risk and catastrophe claims. Business written and retained by the Company is within the risk appetite of the Company and QBE Group.

About insurance

In simple terms, insurance and reinsurance companies help their customers (consumers, businesses and other insurance companies) to manage risk. More broadly put, an insurance company creates value by pooling and redistributing risk. This is done by collecting premium from those that it insures (i.e. policyholders), and then paying the claims of the few that call upon their insurance protection. The company may also choose to reduce some of its own accumulated risk through the use of outward reinsurance, which is insurance for insurance companies. As not all policyholders will actually experience a claims event, the effective pooling and redistribution of risk lowers the total cost of risk management, thereby making insurance protection more cost effective for all.

The operating model of insurance companies relies on profits being generated:

- by appropriately pricing risk and charging adequate premium to cover the expected pay-outs that will be incurred over the life of the insurance policy (both claims and operating expenses); and
- by earning a return on the collected premium and funds withheld to pay future claims through the adoption of an appropriate investment strategy.

Insurance therefore serves a critical function of providing customers with the confidence to achieve their business and personal goals through cost-effective risk management. This is achieved within a highly regulated environment, designed to ensure that insurance companies maintain adequate capital to protect the interests of policyholders. The Company is regulated by the Bermuda Monetary Authority, who also liaises with other global regulators including the QBE Group regulator, Australian Prudential Regulatory Authority.

1.2 About this report

This Financial Report includes the financial statements for Equator Reinsurances Limited.

The Financial Report includes the four primary statements, namely the statement of comprehensive income (which comprises profit or loss and other comprehensive income), balance sheet, statement of changes in equity and statement of cash flows as well as associated notes as required by Australian Accounting Standards. Disclosures have been grouped into the following categories in order to assist users in their understanding of our financial statements:

1. **Overview** contains information that impacts the Financial Report as a whole, as well as an overview of the reporting segments of the Company.
2. **Underwriting activities** brings together results and balance sheet disclosures relevant to the Company's reinsurance activities.
3. **Investment activities** include the results and balance sheet disclosures relevant to the Company's investment activities.
4. **Risk management** provides commentary on the Company's exposure to various financial and capital risks, explaining the potential impact on the results and balance sheet and how the Company manages these risks.
5. **Capital structure** provides information about the Company's capital.
6. **Tax** includes required disclosures in relation to the Company's tax balances.
7. **Other** includes additional disclosures required in order to comply with Australian Accounting Standards.

Where applicable within each note, disclosures are further analysed as follows:

- **Overview** provides some context to assist users in understanding the disclosures.
- **Disclosures** (both numbers and commentary) provides analysis of balances as required by Australian Accounting Standards.
- **How we account for the numbers** summarises the accounting policies relevant to an understanding of the numbers.
- **Critical accounting judgements and estimates** explains the key estimates and judgements applied by management in determining the numbers.

Notes to the financial statements

FOR THE YEAR ENDED 31 DECEMBER 2018

1 OVERVIEW CONTINUED

The notes include information which the directors believe is required to understand the financial statements and is material and relevant to the operations, balance sheet and results of the Company. Information is considered material and relevant if:

- the amount in question is significant because of its size or nature; and
- it is important to assist an understanding the results of the Company.

1.2.1 Basis of preparation

This Financial Report is a general purpose financial report which:

- has been prepared in accordance with Australian Accounting Standards and Interpretations as issued by the Australian Accounting Standards Board (AASB), International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board and the *Corporations Act 2001* of the Commonwealth of Australia;
- has been prepared on a historical cost basis as modified by certain exceptions, the most significant of which are the measurement of investments and derivatives at fair value and the measurement of the net outstanding claims liability at present value;
- is presented in US dollars; and
- is presented with values rounded to the nearest million dollars or, in certain cases, to the nearest thousand dollars in accordance with *ASIC[1] Corporations (Rounding in Financial/Directors' Reports) Instrument 2016/191*.

New and amended Accounting Standards and Interpretations issued by the AASB that are now effective are detailed in note 7.1.

The Company has not adopted any Accounting Standards and Interpretations that have been issued or amended but are not yet effective.

1.2.2 Critical accounting judgements and estimates

The preparation of the Company's financial statements requires management to make judgements and estimates that affect amounts reported in the profit or loss and balance sheet. The key areas in which critical estimates and judgements are applied are as follows:

- net outstanding claims liability (note 2.3);
- liability adequacy test (note 2.5.1).

1.2.3 Foreign currency

Translation of foreign currency transactions and balances

Foreign currency transactions are translated into functional currencies at the spot rates of exchange applicable at the dates of the transactions. At the balance sheet date, monetary assets and liabilities denominated in foreign currencies are retranslated at the rates of exchange prevailing at that date. Resulting exchange gains and losses are included in profit or loss.

Translation of foreign currency ledgers

The Company accounts for transactions in three separate currency ledgers, each reflecting the functional currency of one of the QBE Group's operating divisions and the underlying nature of premium and risks ceded to the Company from each QBE division. Results and balance sheets of these foreign currency ledgers are translated into US dollars as follows:

- income, expenses and other current period movements in comprehensive income are translated at average rates of exchange; and
- balance sheet items are translated at the closing balance date rates of exchange.

On consolidation of these ledgers, exchange differences arising from the translation of net assets are taken to shareholders' equity and recognized in other comprehensive income.

Derivatives and hedging transactions

Derivatives which meet the specified criteria in AASB 139 *Financial Instruments: Recognition and Measurement* are accounted for as fair value hedges.

Exchange rates

The principal exchange rates used in the preparation of the financial statements were:

	2018		2017	
	PROFIT OR LOSS	BALANCE SHEET	PROFIT OR LOSS	BALANCE SHEET
A$/US$	**0.747**	**0.704**	0.766	0.780
£/US$	**1.334**	**1.275**	1.288	1.350

[1] The Australian Securities and Investments Commission

Notes to the financial statements

FOR THE YEAR ENDED 31 DECEMBER 2018

1 OVERVIEW CONTINUED

1.3 Segment information

Overview

The segment note provides information by segment to assist the understanding of the Company's activities.

Operating segments

The Company's operating segments are as follows:

- North American Operations represents the reinsurance of business written on 2017 and prior years by the QBE division of the same name, which writes general insurance and reinsurance business in the United States of America.
- European Operations represents the reinsurance of business written by the QBE division of the same name, which writes general insurance business principally in the United Kingdom, in Canada and throughout mainland Europe, both general insurance and reinsurance business through Lloyd's of London and worldwide reinsurance business through offices in the UK, Ireland, Bermuda and mainland Europe.
- Australian & New Zealand Operations represents the reinsurance of business written by the QBE division of the same name, which primarily underwrites general insurance risks throughout Australia and New Zealand, providing all major lines of insurance for personal and commercial risks.
- Latin American Operations represents the reinsurance of business written by the former QBE division of the same name, which wrote general insurance business in North, Central and South America.
- Asia Pacific Operations represents the reinsurance of business written by the QBE division of the same name, which provides personal, commercial and specialist general insurance covers throughout the Asia Pacific region.

For future reporting periods, consistent with the way the information will be reported by the QBE Group from 1 January 2019:

- the QBE Group's entities in Asia will be combined with European Operations to form a new International operating segment; and
- the QBE Group's entities in the Pacific will be combined with Australia and New Zealand Operations to form a new Australia Pacific operating segment.

The information presented below relates tonsurance activities only, as investments are managed at the Company level and therefore segmental reporting by division is deemed relevant or meaningful.

2018	NORTH AMERICA $M	EUROPE $M	AUSTRALIA & NEW ZEALAND $M	LATIN AMERICA $M	ASIA PACIFIC $M	TOTAL $M
Gross written premium	**(80)**	**462**	**537**	**35**	**212**	**1,166**
Gross earned premium	**16**	**739**	**482**	**64**	**219**	**1,520**
Outward reinsurance premium expense	**(4)**	**(298)**	**(217)**	**(24)**	**(42)**	**(585)**
Net earned premium	**12**	**441**	**265**	**40**	**177**	**935**
Net claims expense	**(25)**	**(184)**	**(94)**	**(55)**	**(120)**	**(478)**
Net commission	**(7)**	**(117)**	**(31)**	**(14)**	**(44)**	**(213)**
Underwriting and other expenses	**-**	**(5)**	**(4)**	**-**	**(1)**	**(10)**
Underwriting result	**(20)**	**135**	**136**	**(29)**	**12**	**234**

2017	NORTH AMERICA $M	EUROPE $M	AUSTRALIA & NEW ZEALAND $M	LATIN AMERICA $M	ASIA PACIFIC $M	TOTAL $M
Gross written premium	1,534	969	503	75	243	3,324
Gross earned premium	1,546	912	653	90	207	3,408
Outward reinsurance premium expense	(588)	(304)	(211)	(31)	(46)	(1,180)
Net earned premium	958	608	442	59	161	2,228
Net claims expense	(804)	(514)	(310)	(267)	(105)	(2,000)
Net commission	(436)	(165)	(47)	(16)	(34)	(698)
Underwriting and other expenses	(5)	(5)	(5)	-	(1)	(16)
Underwriting result	(287)	(76)	80	(224)	21	(486)

1 OVERVIEW CONTINUED

Geographical analysis

All operating segments are defined by reference to the geographical locations of each operating segment and, as such, satisfy the requirements of a geographical analysis as well as an operating segment analysis.

Product analysis

The Company and the QBE Group do not collect revenue information by product as the cost to develop this information would be excessive. Gross earned premium revenue by class of business is disclosed in note 4.2.

2 UNDERWRITING ACTIVITIES

Overview

This section provides analysis and commentary on the Company's underwriting activities. Underwriting, in simple terms, is the agreement by the reinsurer to assume reinsurance risk in return for a premium paid by the reinsured. The underwriter assesses the quality of the risk and prices it accordingly.

2.1 Revenue

Overview

Revenue comprises premiums charged for providing reinsurance coverage. Inwards reinsurance business assumed is largely from related entities on either a quota share or excess of loss basis. During 2018 and 2017, the Company underwrote a very small amount of business providing reinsurance to unrelated third parties in Latin America and also underwrote an insignificant amount of facultative reinsurance. Materially all outwards reinsurance business is placed with third parties. Other sources of revenue include amounts recovered from reinsurers under the terms of reinsurance contracts and commission income from reinsurers.

	NOTE	2018 $M	2017 $M
Gross earned premium revenue			
Reinsurance business written		**1,520**	3,408
Other revenue			
Reinsurance and other recoveries revenue received	2.2	**488**	1,782
Reinsurance commission revenue		**22**	55
		510	1,837

How we account for the numbers

Premium revenue

Premium written comprises inwards reinsurance amounts charged to the reinsured, excluding taxes collected on behalf of other parties. Premium is recognised as revenue in profit or loss based on the incidence of the pattern of risk associated with the reinsurance policy. The earned portion of premium on unclosed business, being business that is written at the balance date, but for which detailed policy information is not yet booked, is also included in premium revenue.

Reinsurance and other recoveries

Reinsurance and other recoveries on paid claims, reported claims not yet paid, claims incurred but not reported (IBNR), and claims incurred but not enough reported (IBNER) are recognised as revenue. Recoveries are measured as the present value of the expected future receipts.

Notes to the financial statements

FOR THE YEAR ENDED 31 DECEMBER 2018

2 UNDERWRITING ACTIVITIES CONTINUED

2.2 Net claims expense

Overview

The largest expense for the Company is net claims expense, which is the difference between the net outstanding claims liability (as described in note 2.3 below) at the beginning and the end of the financial year, plus any claims incurred and settled during the financial year.

	NOTE	2018 $M	2017 $M
Gross claims and related expenses			
Reinsurance business written		**966**	3,782
Reinsurance and other recoveries revenue			
Reinsurance recoveries		**(488)**	(1,782)
Net claims expense		**478**	2,000
Analysed as follows:			
Movement in net discounted central estimate		**552**	1,923
Movement in risk margin	2.4.1	**(74)**	77
Net claims expense		**478**	2,000

2.3 Net outstanding claims liability

Overview

The net outstanding claims liability comprises the elements described below.

- The gross central estimate (note 2.3.1). This is the provision for expected future claims payments and includes claims reported but not yet paid, claims incurred but which have not yet been reported (IBNR), claims incurred but not enough reported (IBNER) and estimated claims handling costs.
- Less reinsurance and other recoveries (note 2.3.2). The Company purchases reinsurance to manage its exposure to any one claim or series of claims. When it incurs a claim as a result of an insured loss, it may be able to recover some of that claim from reinsurance. It includes an allowance for IBNR on these reinsurances to the extent that IBNR on gross claims would trigger a recovery.
- Less an amount to reflect the discount to present value using risk-free rates of return. The net central estimate (gross central estimate less reinsurance and other recoveries) is discounted to present value recognising that the claim and/or recovery may not be settled for some time. The weighted average risk-free rate for each operating segment is summarised in note 2.3.4.
- Plus, a risk margin (note 2.3.3). A risk margin is added to reflect the inherent uncertainty in the net discounted central estimate of outstanding claims.

Notes to the financial statements

FOR THE YEAR ENDED 31 DECEMBER 2018

2 UNDERWRITING ACTIVITIES CONTINUED

	NOTE	2018 $M	2017 $M
Gross discounted central estimate		**3,946**	6,020
Risk margin	2.3.3	**230**	441
Gross outstanding claims liability	2.3.1	**4,176**	6,461
Reinsurance and other recoveries on outstanding claims	2.3.2	**(2,650)**	(3,205)
Net outstanding claims liability		**1,526**	3,256

The table below analyses the movement in the net outstanding claims liability, showing separately the movement in gross claims liability and the impact of reinsurance.

	2018			2017		
	GROSS $M	REINSURANCE $M	NET $M	GROSS $M	REINSURANCE $M	NET $M
At 1 January	**6,461**	**(3,205)**	**3,256**	4,379	(1,581)	2,798
Current accident year development in net discounted central estimate (note 2.4.2)	**785**	**(483)**	**302**	3,727	(1,391)	2,336
Prior accident year development in net discounted central estimate (note 2.4.2)	**181**	**(5)**	**176**	55	(391)	(336)
Incurred claims recognised in profit or loss (note 2.2)	**966**	**(488)**	**478**	3,782	(1,782)	2,000
Commutations and novation	**(1,026)**	**-**	**(1,026)**	-	-	-
Claims payments	**(1,966)**	**1,035**	**(931)**	(1,820)	163	(1,657)
Foreign exchange	**(259)**	**8**	**(251)**	120	(5)	115
At 31 December	**4,176**	**(2,650)**	**1,526**	6,461	(3,205)	3,256

2.3.1 Gross outstanding claims liability

	NOTE	2018 $M	2017 $M
Gross undiscounted central estimate excluding claims settlement costs[1]		**4,461**	6,811
Claims settlement costs		**1**	1
Gross undiscounted central estimate		**4,462**	6,812
Discount to present value		**(286)**	(351)
Gross outstanding claims liability	2.3	**4,176**	6,461
Payable within 12 months		**1,120**	2,309
Payable in greater than 12 months		**3,056**	4,152
Gross outstanding claims liability	2.3	**4,176**	6,461

1 At the year end the Company had issued, in its own name and through QBE Group, letters of credit of $1,120 million for the benefit of various ceding entities (2017 $797 million).

2 UNDERWRITING ACTIVITIES CONTINUED

Critical accounting judgements and estimates

The gross discounted central estimate is the present value of the expected future payments for claims incurred and includes reported but unpaid claims, IBNR, IBNER and claims handling costs. The central estimate is determined by the VP, Actuarial Reserving & Capital, supported by a team of actuaries and with input from peers in other QBE divisions and QBE Group head office. The valuation process is performed quarterly and includes extensive consultation with claims and underwriting staff as well as senior management. The central estimate of outstanding claims is subject to a comprehensive independent review at least annually. The risk management procedures related to the actuarial function are explained further in note 4.2.

The determination of the amounts that the Company will ultimately pay for claims arising under inward reinsurance contracts involves a number of critical assumptions. Some of the uncertainties impacting these assumptions are as follows:

- changes in patterns of claims incidence, reporting and payment;
- volatility in the estimation of future costs for long tail insurance classes due to the longer period of time that can elapse before a claim is paid in full;
- the existence of complex underlying exposures;
- the incidence of catastrophic events close to the balance date;
- changes in the legal environment, including the interpretation of liability laws and the quantum of damages; and
- changing social, political and economic trends for example price and wage inflation.

The estimation of IBNR and IBNER is generally subject to a greater degree of uncertainty than the estimation of the cost of settling claims already reported to the Company but not yet paid, for which more information about the claims is generally available. The notification and settlement of claims relating to liability and other long tail classes of business may not happen for many years after the event giving rise to the claim. As a consequence, liability and other long tail classes typically display greater variability between initial estimates and final settlement due to delays in reporting claims and uncertainty in respect of court awards and future claims inflation. Claims in respect of property and other short tail classes are typically reported and settled soon after the claim event, giving rise to more certainty.

Central estimates for each class of business are determined using a variety of estimation techniques, generally based on an analysis of historical experience and with reference to external benchmarks where relevant. The gross central estimate is discounted to present value using the appropriate risk-free rate.

Central estimates are calculated gross of any reinsurance and other recoveries. A separate estimate is made of the amounts recoverable from reinsurers based on the gross central estimate (note 2.3.2).

2.3.2 Reinsurance and other recoveries on outstanding claims

	NOTE	2018 $M	2017 $M
Reinsurance and other recoveries on outstanding claims - undiscounted [1]		**2,830**	3,347
Discount to present value		**(180)**	(142)
Reinsurance and other recoveries on outstanding claims	2.3	**2,650**	3,205
Receivable within 12 months		**613**	1,025
Receivable in greater than 12 months		**2,037**	2,180
Reinsurance and other recoveries on outstanding claims	2.3	**2,650**	3,205

1 Net of a provision for impairment of $2.9 million (2017 $3.5 million)

How we account for the numbers

The recoverability of amounts due from reinsurers is assessed at each balance date to ensure that the balances properly reflect the amounts that are ultimately expected to be received, taking into account counterparty credit risk and the contractual terms of the reinsurance contract. Counterparty credit risk in relation to reinsurance assets is considered in note 4.3. Recoveries are discounted to present value using the appropriate risk-free rate.

2 UNDERWRITING ACTIVITIES CONTINUED

2.3.3 Risk margin

Overview

A risk margin is determined by the Company's Board to account for the inherent uncertainty in the net discounted central estimate.

The risk margin and the net discounted central estimate are key inputs in the determination of the probability of adequacy, which is a statistical measure of the relative adequacy of the outstanding claims liability to ultimately be able to pay claims. For example, a 90% probability of adequacy indicates that the net discounted central estimate is expected to be adequate nine years in ten.

		2018	2017
Risk margin	$M	**230**	441
Risk margin as a percentage of the net discounted central estimate	%	**17.7**	15.7
Probability of adequacy	%	**88.7**	90.0

Management has chosen to decrease risk margins by $211 million to $230 million as a result of the decrease in the volatility of the portfolio and a decrease in the net central estimate of reserves. The resulting probability of adequacy is 88.7% compared with 90.0% last year.

How we account for the numbers

AASB 1023 *General Insurance Contracts* requires an entity to adopt an appropriate risk margin. The resulting probability of adequacy is not of itself an accounting policy as defined by AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*. The appropriate level of risk margin is not determined by reference to a fixed probability of adequacy.

The Company reviews a number of factors when determining the appropriate risk margin, including any changes in the level of uncertainty in the net discounted central estimate, the resulting probability of adequacy and the risk margin as a percentage of the net discounted central estimate.

2 UNDERWRITING ACTIVITIES CONTINUED

Critical accounting judgements and estimates

The risk margin is determined by the Board and is held to mitigate the potential for uncertainty in the net discounted central estimate. The determination of the appropriate level of risk margin takes into account similar factors to those used to determine the central estimate, such as:

- mix of business, in particular the mix of short tail and long tail business and the overall weighted average term to settlement; and
- the level of uncertainty in the central estimate due to estimation error, data quality, variability of key inflation assumptions and possible economic and legislative changes.

The variability by class of business is measured using techniques that determine a range of possible outcomes of ultimate payments and assign a likelihood to outcomes at different levels. These techniques generally use standard statistical distributions, and the measure of variability is referred to as the coefficient of variation.

At a fixed probability of adequacy, the appropriate risk margin for two or more classes of business or for two or more geographic locations combined is likely to be less than the sum of the risk margins for the individual classes. This reflects the benefit of diversification in reinsurance. The statistical measure used to determine diversification is called the correlation. The higher the correlation between two classes of business, the more likely it is that a negative outcome in one class will correspond to a negative outcome in the other class. For example, high correlation exists between classes of business affected by court cases involving bodily injury claims such as motor third party liability, workers' compensation and public liability, particularly in the same jurisdiction.

The probability of adequacy for the Company is determined by analysing the variability of each class of business and the correlation between classes of business and geographic locations. Correlations are determined for aggregations of classes of business, where appropriate. The correlations adopted by the Company are generally derived from industry analysis, the Company's (and QBE Group trends as appropriate) historical experience and the judgement of experienced and qualified actuaries.

2.3.4 Discount rate used to determine the outstanding claims liability

Overview

Claims in relation to long tail classes of business (e.g. professional indemnity and workers' compensation) typically may not settle for many years. As such, the liability is discounted to reflect the time value of money. The table below summarises the weighted average discount rates utilised for each operating segment.

	2018 %	2017 %
North American Operations	**(0.08) - 2.67**	2.35
European Operations	**(0.22) - 2.70**	1.37-2.31
Australian & New Zealand Operations	**0.49 - 2.63**	0.38-2.24
Latin American Operations	**2.65 - 4.93**	1.78-6.97
Asia Pacific Operations	**0.74 - 2.66**	0.32-2.17
All Segments	**(0.22) - 2.70**	1.37-2.34

How we account for the numbers

AASB 1023 *General Insurance Contracts* requires that the net central estimate is discounted to reflect the time value of money using risk-free rates that are based on current observable, objective rates that relate to the nature, structure and terms of the future obligations.

Notes to the financial statements

FOR THE YEAR ENDED 31 DECEMBER 2018

2 UNDERWRITING ACTIVITIES CONTINUED

2.3.5 Weighted average term to settlement

Overview

The weighted average term to settlement refers to the period from the balance date to the expected date of claims settlement. All other factors being equal, a longer weighted average term to settlement generally results in a larger benefit from discount and a resulting lower net discounted central estimate.

	2018						2017					
	YEARS						YEARS					
	$	£	A$	€	OTHER	TOTAL	$	£	A$	€	OTHER	TOTAL
North American Operations	**5.5**	**5.3**	**5.4**	**5.5**	**5.3**	**5.5**	4.5	-	0.5	-	-	4.5
European Operations	**5.8**	**4.1**	**3.3**	**2.9**	**2.8**	**4.8**	3.9	4.0	3.8	3.6	3.1	4.2
Australian & New Zealand Operations	**3.8**	**0.8**	**3.4**	**0.5**	**1.7**	**1.7**	2.4	0.8	2.6	0.5	1.5	2.1
Latin American Operations	**1.8**	**-**	**-**	**-**	**0.9**	**1.7**	0.8	-	-	-	1.6	0.9
Asia Pacific Operations	**2.4**	**0.5**	**1.6**	**-**	**1.5**	**0.5**	2.5	0.5	2.0	-	1.4	1.4
All Segments	**5.8**	**4.1**	**3.3**	**2.9**	**1.6**	**3.9**	4.0	4.0	3.0	3.6	1.4	1.4

2.3.6 Net discounted central estimate maturity profile

Overview

The maturity profile is the Company's expectation of the period over which the net central estimate will be settled. The Company uses this information to ensure that it has adequate liquidity to pay claims as they are due to be settled and to inform the Company's investment strategy. The expected maturity profile of the Company's net discounted central estimate is analysed below.

	1 YEAR OR LESS $M	1 TO 2 YEARS $M	2 TO 3 YEARS $M	3 TO 4 YEARS $M	4 TO 5 YEARS $M	OVER 5 YEARS $M	TOTAL $M
As at December 2018	**510**	**372**	**177**	**45**	**112**	**310**	**1,526**
As at December 2017	1,284	604	293	232	156	687	3,256

Notes to the financial statements

FOR THE YEAR ENDED 31 DECEMBER 2018

2 UNDERWRITING ACTIVITIES CONTINUED

2.3.7 Impact of changes in key variables on the net outstanding claims liability

Overview

The impact of changes in key variables used in the calculation of the outstanding claims liability is summarised in the table below. Each change has been calculated in isolation from the other changes and shows the after-tax impact on profit or loss assuming that there is no change to any of the other variables. In practice, this is considered unlikely to occur as, for example, an increase in interest rates is normally associated with an increase in the rate of inflation. Over the medium to longer term, the impact of a change in discount rates is expected to be largely offset by the impact of a change in the rate of inflation.

The sensitivities below assume that all changes directly impact profit after tax. In practice, however, if the central estimate was to increase, it is possible that part of the increase may result in an offsetting change in the level of risk margin required rather than in a change to profit after tax, depending on the nature of the change in the central estimate and risk outlook. Likewise, if the coefficient of variation were to increase, it is possible that the probability of adequacy would reduce from its current level rather than result in a change to net profit after income tax.

	SENSITIVITY %	PROFIT (LOSS)[1] 2018 $M	2017 $M
Net discounted central estimate	+5	**(65)**	(138)
	-5	**65**	138
Inflation rate	+1	**(43)**	(168)
	-1	**39**	156
Discount rate	+1	**39**	156
	-1	**(43)**	(168)
Coefficient of variation	+1	**(16)**	(36)
	-1	**16**	39
Probability of adequacy	+1	**(12)**	(23)
	-1	**11**	22
Weighted average term to settlement	+10	**10**	31
	-10	**(10)**	(36)

1 The impact of a change in interest rates on net profit after income tax due to market value movements on fixed interest securities is shown in note 4.4.

2 UNDERWRITING ACTIVITIES CONTINUED

2.4 Claims development – net undiscounted central estimate

Overview

The claims development table demonstrates the extent to which the original estimate of net ultimate claims payments in any one accident year (item (a) in the table below) has subsequently developed favourably (i.e. claims cost estimates have reduced) or unfavourably (i.e. further claims expense has been recognised in subsequent years). This table therefore illustrates the variability and inherent uncertainty in estimating the central estimate each year. The ultimate claims cost for any particular accident year is not known until all claims payments have been made which, for some long tail classes of business, could be many years into the future. The estimated ultimate claims payments at the end of each subsequent accident year demonstrates how the original estimate has been revised over time (b).

Cumulative net claims payments (d) are deducted from the estimate of net ultimate claims payments in each accident year (c) at the current balance date, resulting in the undiscounted central estimate at a fixed rate of exchange (e). This is revalued to the balance date rate of exchange (f) to report the net undiscounted central estimate (g), which is reconciled to the discounted net outstanding claims liability (h). The treatment of foreign exchange in the claims development table is explained on the following page.

The net increase (decrease) in estimated net ultimate claims payments (i) reflects the estimated ultimate net claims payments at the end of the current financial year (c) less the equivalent at the end of the previous financial year (b). This is further summarised in note 2.4.1. The claims development table is presented net of reinsurance.

		ACCIDENT YEARS											
		2008 & PRIOR $M	2009 $M	2010 $M	2011 $M	2012 $M	2013 $M	2014 $M	2015 $M	2016 $M	2017 $M	2018 $M	TOTAL $M
Net ultimate claims payments													
(a)	Original estimate of net ultimate claims payments		1,490	1,386	2,260	1,991	1,756	1,929	1,093	1,290	2,421	425	16,041
(b)	One year later		1,506	1,402	2,380	2,031	1,776	1,970	1,169	1,192	2,509	-	15,935
	Two years later		1,426	1,421	2,420	1,998	1,843	1,970	1,038	1,194	-	-	13,310
	Three years later		1,448	1,468	2,399	2,023	1,843	1,935	1,069	-	-	-	12,185
	Four years later		1,474	1,433	2,417	2,000	1,830	1,945	-	-	-	-	11,099
	Five years later		1,432	1,410	2,381	1,994	1,818	-	-	-	-	-	9,035
	Six years later		1,316	1,384	2,399	1,969	-	-	-	-	-	-	7,068
	Seven years later		1,237	1,373	2,453	-	-	-	-	-	-	-	5,063
	Eight years later		1,227	1,371	-	-	-	-	-	-	-	-	2,598
	Nine years later		1,213	-	-	-	-	-	-	-	-	-	1,213
(c)	Current estimate of net ultimate claims payments		**1,213**	**1,371**	**2,453**	**1,969**	**1,818**	**1,945**	**1,069**	**1,194**	**2,509**	**425**	**15,966**
(d)	Cumulative net payments to date[1]		(1,453)	(1,357)	(2,363)	(1,935)	(1,777)	(1,646)	(1,038)	(1,298)	(1,491)	(394)	(14,752)
(e)	Net undiscounted central estimate at fixed rate of exchange[2]	55	(240)	14	90	34	41	299	31	(104)	1,018	31	1,269
(f)	Foreign exchange impact												129
(g)	Net undiscounted central estimate at 31 Dec 2018[1]												**1,398**
	Discount to present value												**(106)**
	Claims settlement costs												**1**
	Risk margin												**230**
	Other												**3**
(h)	Net outstanding claims liability at 31 Dec 2018 (note 2.3)												**1,526**
(i)	Net (increase) decrease in estimated ultimate claims payments in current financial year (note 2.4.1)	**3**	**(14)**	**(2)**	**54**	**(25)**	**(12)**	**10**	**31**	**2**	**88**	**425**	**560**

1 Includes impact of novation to Blue Ocean and Lloyds commutation

2 Excluding claims settlement costs.

Notes to the financial statements

FOR THE YEAR ENDED 31 DECEMBER 2018

2 UNDERWRITING ACTIVITIES CONTINUED

How we account for the numbers

The estimate of net ultimate claims payments attributable to business acquired is generally included in the claims development table in the accident year in which the acquisition was made. This includes the acquisition of net outstanding claims liabilities via loss portfolio transfers.

The Company writes business in currencies other than the US dollar. The translation of ultimate claims estimates denominated in foreign currencies gives rise to foreign exchange movements which have no direct bearing on the development of the underlying claims. To eliminate this distortion, amounts have been translated to the functional currencies of our segment ledgers at constant rates of exchange. All estimates of ultimate claims payments for the 10 most recent accident years reported in ledger currencies other than US dollars have been translated to US dollars using the 2018 average rate of exchange.

2.4.1 Reconciliation of claims development table to profit or loss

Overview

The table below reconciles the net increase or decrease in estimated net ultimate claims payments in the current financial year from the claims development table in note 2.4 (i) to the analysis of current and prior accident year central estimate development recognised in profit or loss (note 2.4.2).

	2018			2017		
	CURRENT ACCIDENT YEAR $M	PRIOR ACCIDENT YEARS $M	TOTAL $M	CURRENT ACCIDENT YEAR $M	PRIOR ACCIDENT YEARS $M	TOTAL $M
Net undiscounted central estimate movement (note 2.4) [1]	**425**	**135**	**560**	2,438	(398)	2,040
Foreign exchange	**(5)**	**(20)**	**(25)**	8	(20)	(12)
Movement in claims settlement costs	**-**	**-**	**-**	(1)	-	(1)
Movement in discount	**(12)**	**30**	**18**	(103)	(3)	(106)
Movement in risk margin	**(106)**	**32**	**(74)**	(8)	85	77
Other movements	**-**	**(1)**	**(1)**	1	1	2
Movement in net discounted central estimate (note 2.4.2)	**302**	**176**	**478**	2,335	(335)	2,000

1 Excluding claims settlement costs

2 UNDERWRITING ACTIVITIES CONTINUED

2.4.2 Net central estimate development

Overview

The table further analyses the current and prior accident year movement in the net discounted central estimate, separately identifying the gross and reinsurance components. Prior accident year claims are those claims that occurred in a previous year but for which a reassessment of the claims cost has impacted the result in the current period.

	2018			2017		
	CURRENT ACCIDENT YEAR $M	PRIOR ACCIDENT YEARS $M	TOTAL $M	CURRENT ACCIDENT YEAR $M	PRIOR ACCIDENT YEARS $M	TOTAL $M
Gross central estimate development						
Undiscounted	**858**	**135**	**993**	3,864	49	3,913
Discount	**(73)**	**46**	**(27)**	(138)	7	(131)
	785	**181**	**966**	3,726	56	3,782
Reinsurance and other recoveries						
Undiscounted	**(544)**	**11**	**(533)**	(1,426)	(381)	(1,807)
Discount	**61**	**(16)**	**45**	35	(10)	25
	(483)	**(5)**	**(488)**	(1,391)	(391)	(1,782)
Net central estimate development						
Undiscounted	**314**	**146**	**460**	2,438	(332)	2,106
Discount	**(12)**	**30**	**18**	(103)	(3)	(106)
Net discounted central estimate development (note 2.4.1)	**302**	**176**	**478**	2,335	(335)	2,000

2.5 Unearned premium and deferred insurance costs

Overview

Unearned premium

Gross written premium is earned in profit or loss in accordance with the pattern of incidence of risk of the related business. The unearned premium liability is that portion of gross written premium that the Company has not yet recognised in profit or loss as it represents insurance coverage to be provided by the Company after the balance date.

Deferred insurance costs

Premium ceded to reinsurers by the Company in exchange for reinsurance protection is expensed in profit or loss in accordance with the reinsurance contract's expected pattern of incidence of risk. The deferred reinsurance premium asset is that portion of the reinsurance premium that the Company has not yet recognised in profit or loss as it represents reinsurance coverage to be received after the balance date.

Acquisition costs are the costs associated with obtaining and recording insurance business. Acquisition costs are similarly capitalised and amortised, consistent with the earning of the related premium for that business. Commissions are a type of acquisition cost but are disclosed separately.

Notes to the financial statements

FOR THE YEAR ENDED 31 DECEMBER 2018

2 UNDERWRITING ACTIVITIES CONTINUED

Summary of unearned premium and deferred insurance costs balances

	2018 $M	2017 $M
Unearned premium (a)	**355**	1,117
To be earned within 12 months	**355**	893
To be earned in greater than 12 months	**-**	224
Unearned premium	**355**	1,117
Deferred reinsurance premium[1]	**66**	465
Deferred net commission	**60**	258
Deferred insurance costs (b)	**126**	723
To be expensed within 12 months	**126**	592
To be expensed in greater than 12 months	**-**	131
Deferred insurance costs	**126**	723
Net premium liabilities (a) - (b)	**229**	394

1 Deferred reinsurance premium relating to future business not yet written was $nil (2017 $337 million).

Unearned premium movements

	2018 $M	2017 $M
At 1 January	**1,117**	1,150
Deferral of premium on contracts written in the financial year	**270**	904
Earning of premium written in previous financial years	**(1,007)**	(988)
Foreign exchange	**(25)**	51
At 31 December	**355**	1,117

Deferred insurance costs movements

	DEFERRED REINSURANCE PREMIUM		DEFERRED NET COMMISSION		DEFERRED ACQUISITION COSTS	
	2018 $M	2017 $M	2018 $M	2017 $M	2018 $M	2017 $M
At 1 January	**465**	45	**258**	246	**-**	2
Costs deferred in financial year	**66**	453	**34**	127	**-**	-
Amortisation of costs deferred in previous financial years	**(456)**	(46)	**(224)**	(125)	**-**	(2)
Foreign exchange	**(9)**	13	**(8)**	10	**-**	-
At 31 December	**66**	465	**60**	258	**-**	-

How we account for the numbers

Unearned premium

Unearned premium is calculated based on the coverage period of the reinsurance contract and in accordance with the expected pattern of the incidence of risk, using either the daily pro-rate method or the 24ths method, adjusted where appropriate to reflect different risk patterns.

Deferred insurance costs

Deferred reinsurance premium is calculated based on the period of indemnity provided to the Company by the reinsurance contract and in accordance with the related pattern of the incidence of risk.

Acquisition costs are capitalised when they relate to new business or the renewal of existing business and are amortised on the same basis as the earning pattern for that business. At the balance sheet date, deferred acquisition costs represent the capitalised acquisition costs that relate to unearned premium and are carried forward to a subsequent accounting period in recognition of their future benefit. The carrying value of deferred acquisition costs is subject to impairment testing in the form of the liability adequacy test (note 2.5.1).

Due to the captive nature of the Company, there are generally no external costs incurred in the acquisition of business. The only costs relating to acquired business are those of the small underwriting function. As these costs are expensed through-out the year, in a manner that largely matches premium recognition, and are relatively consistent year on year, management consider it appropriate to expense these costs as incurred rather than deferring any portion.

Notes to the financial statements

FOR THE YEAR ENDED 31 DECEMBER 2018

2 UNDERWRITING ACTIVITIES CONTINUED

2.5.1 Liability adequacy test

Overview

At each balance date, the Company is required to assess net premium liabilities (being unearned premium less deferred insurance costs) to determine whether the amount provided is sufficient to pay future claims net of reinsurance recoveries.

If the present value of expected future net claims including a risk margin exceeds the net premium liabilities, adjusted for deferred reinsurance premium relating to future business not yet written, the net premium liability is deemed deficient. This deficiency is immediately recognised in profit or loss. In recognising the deficiency, an insurer must first write down any related intangible assets and then deferred acquisition costs before recognising an unexpired risk liability.

Expected present value of future cash flows for future claims including risk margin

	2018 $M	2017 $M
Undiscounted net central estimate	**174**	630
Discount to present value	**(12)**	(34)
	162	595
Risk margin at the 75th percentile of insurance liabilities	**15**	54
Expected present value of future cash flows for future claims including risk margin	**177**	649

The application of the liability adequacy test did not identify a deficiency at either 31 December 2018 or 2017.

How we account for the numbers

At each balance date, the adequacy of the unearned premium liability is assessed on a net of reinsurance basis against the present value of the expected future claims cash flows in respect of the relevant insurance contracts, plus an additional risk margin to reflect the inherent uncertainty of the central estimate. The assessment is carried out at an overall company level.

Critical accounting judgements and estimates

In assessing the adequacy of net premium liabilities, AASB 1023 *General Insurance Contracts* requires the inclusion of a risk margin but does not prescribe a minimum level of margin. Whilst there is established practice in the calculation of the probability of adequacy of the outstanding claims liability, no such guidance exists in respect of the level of risk margin to be used in determining the adequacy of net premium liabilities.

The Company has adopted a risk margin of 9.2% (2017: 9.0%) for the purpose of the liability adequacy test to produce a 75% probability of adequacy in respect of total insurance liabilities. The 75% basis is a recognised industry benchmark in Australia, being the minimum probability of adequacy required for Australian licensed insurers by APRA. The Company's ultimate parent undertaking is domiciled in Australia.

Notes to the financial statements

FOR THE YEAR ENDED 31 DECEMBER 2018

2 UNDERWRITING ACTIVITIES CONTINUED

2.6 Trade and other receivables

Overview

Trade and other receivables are principally amounts owed to the Company by policyholders or reinsurance counterparties. Unclosed premium receivables are estimated amounts due to the Company in relation to business for which the Company is on risk but where the policy is not billed to the counterparty at the balance date. Funds withheld by cedants represent net balances due to the Company on certain contracts where the contract wording permits the reinsured to retain premium otherwise owed to the Company and use this to offset claims and other amounts owed to it, by the Company, in relation to the same contract, with a net balance being paid to the Company a number of years after that in which the reinsurance contract was originally underwritten.

	2018 $M	2017 $M
Trade debtors		
Premium receivable[1]	**22**	379
Funds withheld by cedents	**-**	1,186
Reinsurance and other recoveries	**695**	70
Unclosed premium	**76**	77
	793	1,712
Other receivables	**4**	-
Investment receivables	**11**	20
Amounts due from related entities[2]	**583**	600
Trade and other receivables	**1,391**	2,332
Receivable within 12 months	**1,391**	1,146
Receivable in greater than 12 months[2]	**-**	1,186
Trade and other receivables	**1,391**	2,332

1 Net of a provision for impairment of $nil (2017 $nil).

2 Included in amounts due from related entities is a loan of $311 million to QBE Strategic Capital Company Pty Limited (2017 $492 million) and an additional loan for $178 million to QBE Strategic Capital (Europe) Limited, both on commercial terms. The loan with QBE Strategic Capital Company Pty Limited has been rolled until 9 June using an all in interest rate of 2.910%; and the loan with QBE Strategic Capital (Europe) Limited has been rolled until 25 June with an all in interest rate of 2.710%.

Due to the predominantly short-term nature of these receivables, the carrying value is assumed to approximate the fair value.

The maximum exposure to credit risk at the reporting date is the fair value of each class of receivables. As at 31 December 2018, no receivables are pledged by the Company as collateral for liabilities. Information on the ageing and credit rating of these balances is included in note 4.3.

How we account for the numbers

Receivables are recognised at fair value and are subsequently measured at amortised cost less any impairment. A provision for impairment is established when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of the receivable. Any increase or decrease in the provision for impairment is recognised in profit or loss within underwriting expenses.

2 UNDERWRITING ACTIVITIES CONTINUED

2.7 Trade and other payables

Overview

Trade payables primarily comprise amounts owed to reinsurance counterparties and cedants.

	2018 $M	2017 $M
Trade payables	**256**	1,119
Amounts due to related entities[1]	**453**	369
Other payables and accrued expenses	**4**	4
Trade and other payables	**713**	1,492
Payable within 12 months	**357**	1,136
Payable in greater than 12 months	**356**	356
Trade and other payables	**713**	1,492

1 Included in Amounts due to related entities is a loan of $350 million (2017 $350 million), plus accrued interest thereon of $6 million (2017 $6 million), issued on commercial terms from QBE Strategic Capital Company Pty Limited. This loan was provided in line with the terms of the Contingent Capital Facility with an all in interest rate of 8.5425% with that entity.

How we account for the numbers

Trade payables are recognised at their fair value.

Notes to the financial statements

FOR THE YEAR ENDED 31 DECEMBER 2018

3 INVESTMENT ACTIVITIES

Overview

Premiums collected from policyholders are invested to meet the Company's cash flow needs to pay claims and other expenses, as well as generating a return that contributes to the Company's profitability. A sound investment strategy is therefore integral to the success of the Company's operations.

The Company invests across a diversified range of instruments to achieve an appropriate balance between risk and return. Decisions on where to invest is dependent on expected returns, cash flow requirements of the Company, liquidity of the instrument, credit quality of the instrument and the Company's overall risk appetite. Further details on the management of risk associated with investment assets can be found in note 4.

The Company's investment assets are categorised as either backing policyholders' or shareholders' funds, with the former being investment assets which back insurance liabilities whilst the latter comprises all other investment assets.

3.1 Investment income

	2018 $M	2017 $M
Income on growth assets	**95**	80
Income on fixed interest securities, short-term money and cash	**17**	86
Income on other financial assets	**(25)**	(107)
Gross investment income [1]	**87**	59
Investment expenses	**(2)**	(3)
Net investment income	**85**	56
Foreign exchange loss	**(1)**	(6)
Interest expense	**(29)**	-
Finance costs paid or payable	**(6)**	(5)
Total investment income	**49**	45
Investment and other income – policyholders' funds	**29**	135
Investment expenses – policyholders' funds	**(2)**	(3)
Investment and other income (loss) – shareholders' funds	**29**	(82)
Investment expenses – shareholders' funds	**(1)**	-
Financing and other costs	**(6)**	(5)
Total investment income	**49**	45

1 Includes net fair value losses of $34 million (2017 $39 million gain), dividend income of $0.8 million (2017 $22 million) and loss related to other financial assets held at fair value through profit and loss of $25 million (2017 $107 million) as described in note 3.2.1.

How we account for the numbers

Interest income is recognised in the period in which it is earned. Dividends are recognised when the right to receive payment is established. Investment income includes realised and unrealised gains or losses on financial assets which are reported on a combined basis as fair value gains or losses on financial assets.

3 INVESTMENT ACTIVITIES CONTINUED

3.2 Investment assets

	2018 $M	2017 $M
Fixed income		
Short-term money	16	132
Government bonds	209	722
Corporate bonds	1,378	2,211
Infrastructure debt	43	47
	1,646	3,112
Growth assets		
Developed market equity	19	34
Emerging market equity	12	1
Unlisted property trusts	84	214
Infrastructure assets	255	267
Private equity	80	38
	450	554
Other financial assets	23	47
Total investments	2,119	3,713
Amounts maturing within 12 months	187	617
Amounts maturing in greater than 12 months	1,932	3,096
Total investments	2,119	3,713

How we account for the numbers

Investments are designated at fair value through profit or loss. They are initially recognized at the cost of acquisition excluding transaction costs and are subsequently remeasured to fair value at each reporting date. The fair value hierarchy and the Company's approach to measuring the fair value of each investment instrument is disclosed in note 3.2.1.

All purchases and sales of investments that require delivery of the asset within the time frame established by regulation or market convention are recognised at trade date, being the date on which the Company commits to buy or sell the asset. Investments are derecognised when the right to receive future cash flows from the asset has expired or has been transferred and the Company has transferred substantially all the risks and rewards of ownership.

In 2016, the Company entered into agreements with each QBE division, whereby the divisions reassigned their rights to recoveries under the external Group Aggregate Risk (GAR) reinsurance program, across underwriting years with effective dates 1 January 2011 through 2014, to the Company. In exchange for this reassignment of recoveries, the Company paid cash to each division, equivalent to the discounted central estimate of their share of the GAR recovery at the date of the rights reassignment.

The amount recognised as other financial assets represents the portion of the GAR asset that does not directly relate to the underwriting activities of the Company and henceforth any gain or loss on the asset (relating to divisional claims experience) is recognised in the statement of comprehensive income as investment and other income related to shareholder funds.

The asset is classified as a 'financial asset held at fair value through profit and loss' according to AASB 139.

During 2017, a number of contracts of reinsurance were provided to QBE divisions, which generate a gross outstanding claims liability for the Company, and for which the Company is entitled to recoveries under the external GAR program. As such, a portion of the asset that was previously recognised as an other financial asset has been reclassified as a reinsurance recovery, given that there is now a clear relationship between gross claims of the Company and the related asset. This reclassification has generated an investment loss of $25 million in 2018.

3 INVESTMENT ACTIVITIES CONTINUED

3.2.1 Fair value hierarchy

Overview

The Company's Board Risk and Capital Committee is responsible for the governance and oversight of the investment valuation process. The fair value of investments is determined in accordance with the Company's investment valuation policy. This Board committee relies on the advice and recommendation of the Management Investment Committee.

The investments of the Company are disclosed in the table below using a fair value hierarchy which reflects the significance of inputs into the determination of fair value as follows:

Level 1: Valuation is based on quoted prices in active markets for the same instruments.

Level 2: Valuation is based on quoted prices for identical instruments in markets which are not active, quoted prices for similar instruments, or valuation techniques for which all significant inputs are based on observable market data, for example, consensus pricing using broker quotes or valuation models with observable inputs.

Level 3: Valuation techniques are applied in which one or more significant inputs are not based on observable market data.

There were no movements between Level 1, Level 2 and Level 3 assets other than purchases and sales in the normal course of business.

	2018				2017			
	LEVEL 1 $M	LEVEL 2 $M	LEVEL 3 $M	TOTAL $M	LEVEL 1 $M	LEVEL 2 $M	LEVEL 3 $M	TOTAL $M
Fixed income								
Short-term money	12	4	-	16	74	58	-	132
Government bonds	165	44	-	209	433	289	-	722
Corporate bonds	-	1,378	-	1,378	-	2,211	-	2,211
Infrastructure debt	-	-	43	43	-	-	47	47
	177	1,426	43	1,646	507	2,558	47	3,112
Growth assets								
Developed market equity	19	-	-	19	34	-	-	34
Emerging market equity	12	-	-	12	-	1	-	1
Unlisted property trusts	-	84	-	84	-	214	-	214
Infrastructure assets	-	-	255	255	-	-	267	267
Private equity	-	-	80	80	-	-	38	38
	31	84	335	450	34	215	305	554
Other financial asset	-	-	23	23	-	-	47	47
Total investments	208	1,510	401	2,119	541	2,773	399	3,713

The Company's approach to measuring the fair value of investments is described below:

Short-term money

Term deposits are valued at par plus accrued interest and are classified as level 1 fair value instruments. Other short-term money (bank bills, certificates of deposit, treasury bills and other short-term instruments) is priced using interest rates and yield curves observable at commonly quoted intervals.

Government bonds and corporate bonds

Bonds which are traded in active markets and have quoted prices from external data providers are classified as level 1 fair value instruments. Bonds which are not traded in active markets are priced using broker quotes, using comparable prices for similar instruments or using pricing techniques set by local regulators or exchanges.

Infrastructure debt

Infrastructure debt prices are sourced from the investment manager who may use a combination of observable market prices or comparable market prices where available and other valuation techniques.

Developed market equity

Listed equities traded in active markets are valued by reference to quoted bid prices. Unlisted equities are priced using the Company's share of the net assets of the entity.

Emerging market equity, unlisted property trusts and infrastructure assets

These assets are valued using quoted bid prices in active markets or current unit prices as advised by the responsible entity, trustee or equivalent of the investment management scheme.

Notes to the financial statements

FOR THE YEAR ENDED 31 DECEMBER 2018

3 INVESTMENT ACTIVITIES CONTINUED

Private equity and alternatives

Alternatives comprise fund of funds vehicles. Fair value is based on the net asset value of the vehicle, and the responsibility for the valuation of the underlying securities lies with the external manager. In most cases, an independent administrator will be utilised by the external fund manager for pricing and valuation. A combination of observable market prices or comparable market prices (where available) and other valuation techniques may be used in the determination of fair value.

Other financial assets

The financial asset is not actively traded and therefore no external price or benchmark exists. It is valued using commonly accepted actuarial valuation techniques taking into consideration the value of the underlying assets upon which the financial asset is based, and the expected timing of future cashflows relating to this asset.

Movements in level 3 investments

The following table provides an analysis of investments valued with reference to level 3 inputs.

LEVEL 3	2018 $M	2017 $M
At 1 January	**399**	329
Purchases[1]	**185**	209
Disposals	**(137)**	(53)
Fair value realised (losses) gains recognised in profit or loss	**5**	0
Fair value unrealised (losses) gains recognised in profit or loss[1]	**(28)**	(95)
Foreign exchange	**(23)**	9
At 31 December	**401**	399

1 During 2016 the Company recognised a financial asset following a reassignment by QBE divisions of a Group Aggregate Reinsurance arrangement to the Company in return for a cash payment. As at 31 December 2018 the financial asset is valued at $23 million (2017 $47 million). The decrease in the valuation at the year-end resulted in a loss of $25 million recognised in the statement of comprehensive income and was driven by the reclassification of this asset to reinsurance recoveries. The investment loss is therefore offset by an increase in reinsurance recoveries in the underwriting result.

3.2.2 Charges over investments and restrictions on use

Included in investments are amounts totalling $757 million (2017 $1,764 million) which are held in portfolio trust funds for the benefit of various QBE ceding affiliates. In addition, a further $1 million (2017 $1 million) was held in trust by a third party to support the issuance of letters of credit to QBE ceding affiliates collateralising underlying reinsurance recoverables of ceding affiliates, due from the Company. These funds can only be used to settle such recoverable amounts and amounts cannot be withdrawn from the funds without the permission of the respective QBE ceding affiliate.

Notes to the financial statements

FOR THE YEAR ENDED 31 DECEMBER 2018

4 RISK MANAGEMENT

Overview

The Company is in the business of managing risk. The Company's ability to satisfy policyholder risk management needs is central to what we do. The Company aims to generate wealth and maximise returns for its shareholder by pursuing opportunities that involve risk. Our people are responsible for ensuring that the Company's risks are managed and controlled on a day to day basis. The Company aims to use its ability to properly manage risk to provide more certainty and improved outcomes for all stakeholders.

The Company applies QBE's consistent and integrated approach to enterprise risk management (ERM). QBE's global risk management framework sets out the approach to managing key risks and meeting strategic objectives whilst taking into account the creation of value for our shareholder. QBE's risk management framework is articulated in the Risk Management Strategy (RMS) and Reinsurance Management Strategy (REMS), both of which are approved annually by the QBE Group's Board and lodged with APRA.

The framework consists of complementary elements that are embedded throughout the business management cycle and culture of the organisation. Key aspects include: risk appetite, governance, reporting, risk assessments, modelling and stress testing, management, and monitoring and risk culture.

Risk management is a continuous process and an integral part of robust business management. The Company's approach is to integrate risk management into the broader management processes of the organisation. Specifically, the management of risk must occur at each point in the business management cycle.

The Company's strategy for managing risk is to:

- achieve competitive advantage by better understanding the risk environments in which we operate;
- operate within our stated risk appetite and more effectively allocate capital and resources by assessing the balance of risk and reward; and
- avoid unwelcome surprises to the achievement of business objectives by reducing uncertainty and volatility through the identification and management of risks.

The framework is supported by a suite of risk policies that detail the Company's approach to the following key risk categories used by the Company to classify risk:

- Strategic risk (note 4.1)
- Insurance risk including underwriting and reserving (note 4.2)
- Credit risk (note 4.3)
- Market risk (note 4.4)
- Liquidity risk (note 4.5)
- Operational risk (note 4.6)

4 RISK MANAGEMENT CONTINUED

4.1 Strategic risk

Overview

Strategic risk is the current and prospective impact on earnings and/or capital as a result of strategic business decisions or responsiveness to internal and external change. The Company classifies strategic risk into four subcategories, as follows:

- Business, product and market distribution approach;
- Capital structure and management;
- Tax planning and decisioning; and
- Investment strategy.

The Company's approach to managing strategic risk is underpinned by the Company's strategic risk appetite statement as set by the Board and is summarised below.

Business, product and market distribution

Business: The Company is a wholly owned internal reinsurer for the QBE Group. Our QBE Group is a geographically diversified international general insurance and reinsurance group, underwriting most major commercial and personal line classes of business through operations in 31 countries. Domiciled in Bermuda, the Company provides reinsurance protections to the QBE Group's operations around the world to assist in management of QBE's capital, balance sheet and net exposure to large individual risk and catastrophe claims. Business written and retained by the Company is within the risk appetite of the Company and QBE Group and is designed to support the management of aggregate exposures to any one large individual risk or catastrophe claim and to optimise the levels of capital held within the QBE Group.

The board of the Company meet at least quarterly to review performance against business plans. Actual results are monitored and analysed to identify adverse trends so that remedial action, if any, can be taken at an early stage.

Product: The Company reviews the structuring of its diversified range of products on an ongoing basis in line with developments in the market, legislation, claims performance and the needs of our divisional customers.

Market distribution: As a captive reinsurer of the QBE Group, market distribution is not a relevant risk for the Company.

Capital structure and management

The Company's objective when managing capital is to maintain an optimal capital structure to maximise the return on capital whilst meeting capital adequacy requirements, providing security for policyholders and continuing to provide returns to its shareholder.

Where appropriate, adjustments are made to capital levels in light of changes in economic conditions and risk characteristics of the Company. In order to maintain or adjust the capital structure, the Company has the option to adjust the amount of dividends paid to the shareholder, return capital or issue new shares.

The Company uses an economic capital model (ECM) to assess the level of capital required for the underwriting, claims estimation, credit, market, liquidity and operational risk to which it is exposed. Economic capital is determined as the level of capital that the Company needs to ensure that it can, with a pre-specified probability, satisfy its ultimate policyholder obligations in relation to all reinsurance contracts issued on or before the end of the business plan year. The ECM is used by management to help in the determination of strategic capital allocation, business planning, underwriting performance, pricing, reserve adequacy, reinsurance arrangements and aggregate management. Using the ECM, capital is allocated to underwriting portfolios according to the associated risk. In the event of a significant change in risk profile, the ECM will be recalculated and the results reported to the Board.

As a Class 3B insurer, the company is subject to the capital requirements of the Bermuda Monetary Authority (BMA). These requirements are designed to ensure sufficient capital is maintained in order to provide adequate protection for policyholders and have Solvency II equivalence. For the current and prior year, the Company met the minimum and surplus requirements as prescribed by the BMA. The Company also met minimum liquidity margins.

The Company believes that insurer financial strength ratings provided by the major rating agencies are an important factor in demonstrating the financial strength and claims paying ability. The Company is rated "A+/Positive" by Standard & Poor's and A+, Outlook Stable by Fitch Ratings as at 31 December 2018.

Management monitors and actively manages the Company's capital levels on an ongoing basis. Management has a particular focus on the level of eligible regulatory capital that exceeds the Bermuda Monetary Authority requirements. Having determined that the current risk appetite of the Company remains appropriate, the Board has maintained the target level of regulatory capital of 150% of the Bermuda Solvency Capital Requirement (BSCR), and that the internal minimum level of capital is 120% of the BSCR.

The Company has dedicated staff responsible for understanding the regulatory capital requirements of the entity. These staff regularly interact with their global peers through-out QBE to assess the net capital impact of various transactions and reinsurances which the company provides. The quality of the Company's assets (particularly investments and reinsurance recoveries) are continuously monitored to ensure any potential issues are identified and remedial action, where necessary, is taken to restore effective capital performance and levels.

4 RISK MANAGEMENT CONTINUED

Tax planning and decisioning

The Company's approach to managing taxation risk is consistent with the QBE Group Tax Risk Management Framework, which is approved by the QBE Group Board and aligns with QBE's business strategy.

Investment strategy

The Company's approach to investment risk is consistent to the QBE Group's investment strategy, which is designed to strike an appropriate balance between the return objectives of the organisation and the Company's appetite for earnings volatility and capital consumption.

4.2 Insurance risk

Overview

Insurance risk is the risk of fluctuations in the timing, frequency and severity of insured events and claims settlements, relative to expectations.

The Company classifies insurance risk into four subcategories, as follows:

- Underwriting/pricing;
- insurance concentrations;
- reserving; and
- reinsurance.

The Company's approach to managing insurance risk is underpinned by the Company's insurance risk appetite statement as set by the Board and is summarised below.

Underwriting/pricing risk

The Company manages underwriting/pricing risk by appropriately setting and adjusting underwriting strategy, risk selection and pricing practices throughout the underwriting cycle.

The Company's underwriting strategy aims to diversify and limit the aggregation of a single type of reinsurance risk accepted. The underwriting strategy is implemented through QBE's annual business planning process, supported by underwriting authorities. These authorities reflect the level of risk that the Company is prepared to take with respect to each permitted reinsurance class.

Pricing of risks is controlled by the use of in-house pricing models relevant to specific portfolios and the markets in which the Company operates and is supported by external benchmark pricing. Underwriters and actuaries maintain pricing and claims analysis for each portfolio, combined with a knowledge of current developments in the respective markets and classes of business.

One of the core objectives of the Company is to provide the QBE Group with stability in pricing and ease of access to external reinsurance at a more competitive cost, on an aggregate basis, than otherwise available in the local division markets. The Company's underwriting strategy is supportive and linked to the annual divisional business planning process. In addition, the Company responds to ad-hoc or bespoke reinsurance requirements of the various divisions of the QBE Group.

Insurance concentration risk

The Company's exposure to concentrations of reinsurance risk is mitigated by maintaining a business portfolio that is diversified across countries and classes of business. Product diversification is pursued through a strategy of developing strong underwriting skills in a wide variety of classes of business and close partnership with the QBE operating divisions.

The table below demonstrates the diversity of the Company's operations.

GROSS EARNED PREMIUM	2018 $M	2017 $M
Property	**726**	1,170
Motor & motor casualty	**84**	458
Agriculture	**5**	123
Public/product liability	**202**	522
Workers' compensation	**44**	189
Marine energy & aviation	**205**	212
Professional indemnity	**61**	213
Financial & credit	**121**	102
Accident & health	**30**	50
Other	**39**	53
Multiclass[1]	**3**	316
	1,520	3,408

1 Multiclass represents aggregate reinsurance protections which provide protection for an aggregate of claims, above a certain excess, on a franchise basis, across various classes.

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4 RISK MANAGEMENT CONTINUED

Concentration risk includes the risks from natural or man-made events that have the potential to produce claims from multiple policyholders at the same time (e.g. natural catastrophes, industrial accidents, financial downturn, etc.). The Company currently uses a variety of methodologies to monitor aggregates and manage concentration/accumulation risk. These include the use of catastrophe models from third party vendors such as RMS and AIR, the Lloyd's realistic disaster scenarios (RDS) and group aggregate methodology. The Company sets its risk appetite in accordance with prevailing requirements of the Bermuda Monetary Authority and generally acceptable market practices, in addition to considering the relevance, where applicable, of catastrophe risk according to the QBE Group's risk appetite and APRA (the QBE Group's regulator) insurance concentration risk charge (ICRC).

Reserving risk

Reserving risk is managed through the quarterly actuarial valuation of insurance liabilities. The valuation of the net central estimate is performed by qualified and experienced actuaries, with reference to historical data and reasoned expectations of future events. The central estimate of outstanding claims is subject to a comprehensive independent review at least annually.

Reinsurance risk

The Company limits its exposure to an individual catastrophe or an accumulation of claims by reinsuring a portion of risks underwritten. This allows the Company to control exposure to frequency and severity of inwards reinsurance losses, reduce volatility of reported results and protect capital. Risks associated with reinsurance counterparty credit risk are discussed in note 4.3.

4.3 Credit risk

Overview

Credit risk is the risk of financial loss where a customer, counterparty or issuer fails to meet their financial obligations to the Company in accordance with agreed terms. The Company's exposure to credit risk arises from financial transactions with securities issuers, debtors, brokers, policyholders, reinsurers and guarantors.

The Company's approach to managing credit risk is underpinned by the Company's credit risk appetite as set by the Board and summarised below.

Reinsurance credit risk

The Company's objective is to maximise placement of reinsurance with highly rated counterparties. Concentration of risk with reinsurance counterparties is strictly monitored and regularly by the Company's board and the QBE Group's Security Committee and is controlled by reference to the following protocols:

- treaty or facultative reinsurance is placed in accordance with the requirements of the QBE Group REMS and QBE Group Security Committee guidelines;
- reinsurance arrangements are regularly reassessed to determine their effectiveness based on current exposures, historical claims and potential future losses based on the Company's inwards reinsurance concentrations; and
- exposure to reinsurance counterparties and the credit quality of those counterparties is actively monitored.

Credit risk exposures are calculated regularly and compared with authorised credit limits. In certain cases, the Company requires letters of credit or other collateral arrangements to be provided to guarantee the recoverability of the amount involved. The Company holds $1,397 million (2017 $779 million) in collateral to support reinsurance recoveries on outstanding claims. The credit rating analysis below includes the impact of such security arrangements. In some cases, further security has been obtained in the form of trust arrangements, reinsurer default protection and other potential offsets. This additional security has not been included in the credit rating analysis set out below.

The following table provides information about the quality of the Company's credit risk exposure in respect of reinsurance recoveries on outstanding claims on an undiscounted basis, at the balance date. The analysis classifies the assets according to Standard & Poor's (S&P) counterparty credit ratings. AAA is the highest possible rating. Rated assets falling outside the range of AAA to BBB are classified as speculative grade.

4 RISK MANAGEMENT CONTINUED

	CREDIT RATING						
	AAA $M	AA $M	A $M	BBB $M	SPECULATIVE GRADE $M	NOT RATED[2] $M	TOTAL $M
As at 31 December 2018							
Reinsurance recoveries on outstanding claims [1]	**-**	**2,244**	**108**	**-**	**-**	**478**	**2,830**
Reinsurance recoveries on paid claims	**-**	**664**	**20**	**-**	**-**	**11**	**695**
As at 31 December 2017							
Reinsurance recoveries on outstanding claims [1]	–	2,459	128	–	–	760	3,347
Reinsurance recoveries on paid claims	–	37	8	–	–	25	70

1 Net of a provision for impairment of $2.9 million (2017 $3.5 million).

2 Not rated are fully collateralized by "A" grade investments

The following table provides further information regarding the ageing of reinsurance recoveries on paid claims at the balance date.

	YEAR	NEITHER PAST DUE NOR IMPAIRED $M	PAST DUE BUT NOT IMPAIRED 0 TO 3 MONTHS $M	4 TO 6 MONTHS $M	7 MONTHS TO 1 YEAR $M	GREATER THAN 1 YEAR $M	TOTAL $M
Reinsurance recoveries on paid claims [1]	**2018**	**695**	**–**	**–**	**–**	**–**	**695**
	2017	70	–	–	–	–	70

1 Net of a provision for impairment.

Investment and treasury credit risk

The Company only transacts with investment counterparties within the limits outlined in the delegated authorities policy. Investment counterparty exposure limits are applied to individual counterparty exposures outside the QBE Group and to multiple exposures within a group of related companies in relation to investments, cash deposits and forward foreign exchange exposures. Counterparty exposure limit compliance is monitored daily.

The following table provides information regarding the Company's aggregate credit risk exposure at the balance date in respect of the major classes of financial assets. Trade and other receivables except balances due from related entities are excluded from this analysis on the basis that they comprise smaller credit risk items which generally cannot be rated and are not individually material. The analysis classifies the assets according to S&P counterparty credit ratings. AAA is the highest possible rating. Rated assets falling outside the range of AAA to BBB are classified as speculative grade.

	AAA $M	AA $M	A $M	BBB $M	TOTAL $M
As at 31 December 2018					
Cash and cash equivalents	**1**	**1**	**35**	**-**	**37**
Interest-bearing investments	**43**	**502**	**632**	**469**	**1,646**
Derivative financial instruments	**-**	**-**	**15**	**-**	**15**
Amounts due from related entities	**-**	**-**	**583**	**-**	**583**
As at 31 December 2017					
Cash and cash equivalents	10	-	27	-	37
Interest-bearing investments	161	1,172	1,178	601	3,112
Derivative financial instruments	-	-	23	-	23
Amounts due from related entities	-	-	600	-	600

The carrying amount of the relevant asset classes in the balance sheet represents the maximum amount of credit exposure. The fair value of derivatives shown on the balance sheet represents the current risk exposure but not the maximum risk exposure that could arise in the future as a result of changing values.

4 RISK MANAGEMENT CONTINUED

Insurance and other credit risk

As an internal captive reinsurer of the QBE Group, the Company almost always transacts with related entities. The Company regularly reviews the collectability of receivables and the adequacy of associated provisions for impairment. Balances are monitored on the basis of uncollected debt and debt outstanding in excess of six months. Concentration risk is also monitored.

The following table provides information regarding the ageing of the Company's financial assets that are past due but not impaired.

		PAST DUE BUT NOT IMPAIRED				
	NEITHER PAST DUE NOR IMPAIRED $M	0 TO 3 MONTHS $M	4 TO 6 MONTHS $M	7 MONTHS TO 1 YEAR $M	GREATER THAN 1 YEAR $M	TOTAL $M
As at 31 December 2018						
Premium receivable	-	-	17	7	(2)	22
Unclosed premium	76					76
Other receivables	4					4
Amounts due from related entities	583					583
Investment receivables	11					11
As at 31 December 2017						
Premium receivable	1,101	28	379	61	(4)	1,565
Unclosed premium	77	-	-	-	-	77
Other receivables	-	-	-	-	-	-
Amounts due from related entities	600	-	-	-	-	600
Investment receivables	20	-	-	-	-	20

4.4 Market risk

Overview

Market risk is the risk of adverse impacts on earnings resulting from changes in market factors. Market factors include, but are not limited to, interest rates, credit spreads, foreign exchange rates and equity prices.

The Company's approach to managing market risk is underpinned by its market risk appetite, as informed by the QBE Group, as set by the Company's Board and is summarised below.

The Company's approach to managing investment market movements is underpinned by its investment strategy which outlines the Company's view of the markets and its corresponding investment approach.

Investment market risk is managed through the application of exposure and asset limits. These limits are based on the market risk appetite as determined by the Board and apply to:

- losses generated on the investment portfolio under market stress scenarios. The scenarios assume adverse movements in market factors and are designed to reflect a significant market stress event;
- sensitivities to changes in interest rate and credit spread risk, measured in terms of modified duration and spread duration; and
- total combined holdings in equity, investment property and other growth assets as a proportion of the Company's total investment portfolio.

Interest rate risk

The Company is exposed to interest rate risk through its holdings in interest-bearing assets, emerging market debt and high yield debt investments. Financial instruments with a floating interest rate expose the Company to cash flow interest rate risk, whereas fixed interest rate instruments expose the Company to fair value interest rate risk.

The Company's risk management approach is to minimise interest rate risk by actively managing investment portfolios to achieve a balance between cash flow interest rate risk and fair value interest rate risk. The Company predominantly invests in high quality, liquid interest-bearing securities and cash, and may use derivative financial instruments to manage the interest rate risk of the fixed interest portfolio. The risk management processes over these derivative financial instruments include close senior management scrutiny, including appropriate board and other management reporting. Derivatives are used only for approved purposes and are subject to delegated authority levels provided to management. The level of derivative exposure is reviewed on an ongoing basis. Appropriate segregation of duties exists with respect to derivative use and compliance with policy, limits and other requirements is closely monitored.

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4 RISK MANAGEMENT CONTINUED

The net central estimate of outstanding claims is discounted to present value by reference to risk-free interest rates. The Company is therefore exposed to potential underwriting result volatility as a result of interest rate movements. In practice, over the longer term, an increase or decrease in interest rates is normally offset by a corresponding increase or decrease in inflation. Details are provided in note 2.3.7. As at the balance sheet date, the average modified duration of cash and fixed interest securities was 2.25 years (2017 1.72 years). Although the Company maintains a shorter asset duration relative to insurance liabilities, the Company's overall exposure to interest rate risk is not material give the quantum by which the value of fixed income assets exceeds the value of insurance liabilities and in light of the extension of fixed income asset duration during 2018.

All financial assets are measured at fair value through profit or loss. Movements in interest rates impact the fair value of interest-bearing financial assets and therefore impact reported profit after tax. The impact of a 0.5% increase or decrease in interest rates on interest-bearing financial assets owned by the Company at the balance date is shown in the table below.

	SENSITIVITY %	PROFIT (LOSS) 2018 $M	2017 $M
Interest rate movement – interest-bearing financial assets	+0.5	**(18)**	(27)
	-0.5	**18**	27

Price risk

Equity price risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from interest rate or currency risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded on the market.

The Company is exposed to equity price risk on its investment in equities and may use derivative financial instruments to manage this exposure. The risk management processes over these derivative financial instruments are the same as those explained above in respect of interest rate derivative financial instruments. Exposure is also managed by diversification across worldwide markets and currencies where possible.

All equities are measured at fair value through profit or loss. The impact of a 20% increase or decrease in the value of equity investments (including derivatives – refer to note 3.2.1) owned by the Company at the balance date on profit after tax is shown in the table below.

	SENSITIVITY %	PROFIT (LOSS) 2018 $M	2017 $M
FTSE 100	+20	**4**	7
	-20	**(4)**	(7)
Infrastructure Assets	+20	**51**	53
	-20	**(51)**	(53)
CIS - Emerging Markets	+20	**2**	-
	-20	**(2)**	-
Private Equity	-20	**16**	8
	-20	**(16)**	(8)

The Company is also exposed to price risk on its interest-bearing (fixed interest, emerging market and high yield debt) financial assets. All securities are measured at fair value through profit or loss.

Credit spread risk

Movements in credit spreads impact the value of corporate interest-bearing securities, emerging market debt and high yield debt and therefore impact reported profit after tax. This risk is managed by investing in high quality, liquid interest-bearing securities and by managing the credit spread duration of the corporate securities portfolio.

The impact of either a 0.5% increase or decrease in credit spreads on interest-bearing financial assets held by the Company at the balance date on profit after tax is shown in the table below.

	SENSITIVITY %	PROFIT (LOSS) 2018 $M	2017 $M
Credit spread movement – corporate interest-bearing financial assets	+0.5	**(16)**	(23)
	-0.5	**15**	16

The Company is also exposed to price risk on its investment in unlisted property trusts. All unlisted property trust investments are measured at fair value through profit or loss. The Company manages this risk by investing in high quality, diversified unlisted property funds. Movements in unit prices impact the value of unlisted property trusts and therefore impact reported profit after tax. The impact of a 10% increase or decrease in unit prices on unlisted property trust securities owned by the Company at the balance date was $8.4 million (2017 $21 million).

4 RISK MANAGEMENT CONTINUED

Foreign exchange

The Company's approach to foreign exchange management is underpinned by the Company's foreign currency strategy. The Company's foreign exchange exposure generally arises as a result of either the translation of foreign currency amounts to the functional currency of operational segments (operational currency risk) or due to the translation of operating segments net assets to the presentation currency of the Company of US dollars (currency translation risk).

Operational currency risk

Operational currency risk is managed as follows:

- the Company manages the volatility arising from changes in foreign exchange rates by matching liabilities with assets of the same currency, thus ensuring that any exposures to foreign currencies are minimised; and
- forward foreign exchange contracts are used to protect residual currency positions. These forward foreign exchange contracts are accounted for in accordance with the derivatives accounting policy set out in note 5.5.

Foreign exchange gains or losses arising from operational foreign currency exposures are reported in profit or loss consistent with the gains or losses from the related forward foreign exchange contracts. The risk management process covering the use of forward foreign exchange contracts involves close senior management scrutiny. All forward foreign exchange contracts are subject to delegated authority levels provided to management and the levels of exposure are reviewed on an ongoing basis.

The analysis below demonstrates the impact on profit after income tax of a 10% strengthening or weakening of the major currencies against the functional currencies of the Company's operating segments. The sensitivity is measured with reference to the Company's residual (or unmatched) operational foreign currency exposures at the balance sheet date. Operational foreign exchange gains or losses are recognized in profit or loss in accordance with the procedure outlined in note 1.2.3. The sensitivities provided demonstrate the impact of a change in one key variable in isolation whilst other assumptions remain unchanged.

The sensitivities shown in the table below are relevant only at the balance sheet date, as any unmatched exposures are actively monitored by management and the exposure subsequently matched.

	2018			2017		
EXPOSURE CURRENCY	RESIDUAL EXPOSURE $M	SENSITIVITY %	PROFIT (LOSS) $M	RESIDUAL EXPOSURE $M	SENSITIVITY %	PROFIT (LOSS) $M
Australian dollar[1]	**(1)**	**+10**	**-**	-	+10	-
	-	**-10**	**-**	-	-10	-
Euro	**31**	**+10**	**3**	26	+10	3
	-	**-10**	**(3)**	-	-10	(3)
New Zealand dollar	**(28)**	**+10**	**(3)**	(43)	+10	(4)
	-	**-10**	**3**	-	-10	4

1 The residual exposure to the Australian dollar is negative $0.5 million (2017 $0.4 million) and the impact to the profit and (loss) is $0.1 million (2017 $0.04 million).

Currency risk in relation to translation of net investment in foreign operations

The Company is exposed to currency risk in relation to the translation of operating segment functional currencies to the Company's presentation currency of US dollars.

The Company, in accordance with the QBE Group policy, does not ordinarily seek to use derivatives to mitigate currency translation risk on translation to its functional currency of United States dollars for the following reasons:

- currency translation gains and losses generally have no cash flow;
- currency translation gains and losses are accounted for in the foreign currency translation reserve (a component of equity) and therefore do not impact profit or loss unless related to the disposal of an entity; and
- management of translation risk needs to be balanced against the impact on capital requirements and liquidity risk which would be associated with hedging these exposures.

The analysis below demonstrates the impact on equity of a 10% strengthening or weakening against the US dollar of the major currencies to which the Company is exposed through its net asset value of operating segments. The basis for the sensitivity calculation is the Company's actual exposure at the balance date.

	2018			2017		
EXPOSURE CURRENCY	RESIDUAL EXPOSURE $M	SENSITIVITY %	EQUITY INCREASE (DECREASE) $M	RESIDUAL EXPOSURE $M	SENSITIVITY %	EQUITY INCREASE (DECREASE) $M
Australian dollar	**883**	**+10**	**88**	1,614	+10	161
		-10	**(88)**		-10	(161)
Sterling	**375**	**+10**	**38**	209	+10	21
		-10	**(38)**		-10	(21)

4 RISK MANAGEMENT CONTINUED

4.5 Liquidity risk

Overview

Liquidity risk is the risk of insufficient liquid assets to meet liabilities as they fall due to policyholders and creditors or only being able to do so at excessive cost.

The Company's approach to managing liquidity risk is underpinned by the liquidity risk appetite as set by the Board and is summarised below.

The Company manages liquidity risk using a number of tools, as follows:

- cash flow targeting;
- maintaining a proportion of liabilities in liquid assets;
- cash flow forecasting; and
- stress testing and contingency planning.

Liquidity is managed across the Company using a number of cash flow forecasting and targeting tools and techniques. Cash flow forecasting involves actively managing operational cash flow requirements.

In addition to treasury cash held for working capital requirements, and in accordance with the Company's liquidity policy, a minimum percentage of investments and cash is held in liquid, short-term money market securities to ensure that there are sufficient liquid funds available to meet insurance and investment obligations. At 31 December 2018, the weighted average duration of cash and fixed interest securities was 2.25 years (2017 1.72 years).

At 31 December 2018 trade payables of $256 million (2017 $1,119 million) have a maturity of one year or less.

The Company has amounts due to related entities of $453 million (2017 $369 million) of which $97 million is repayable in one year or less. The Company has no significant concentration of liquidity risk. The maturity profile of the Company's net discounted central estimate is analysed in note 2.3.6.

The maturity of the Company's directly held interest-bearing financial assets is shown in the table below. Interest bearing assets held indirectly through collective investment schemes (such as high yield debt and emerging market debt) are excluded from the analysis.

		INTEREST-BEARING FINANCIAL ASSETS MATURING IN						
		LESS THAN ONE YEAR	13 TO 24 MONTHS	25 TO 36 MONTHS	37 TO 48 MONTHS	49 TO 60 MONTHS	OVER 5 YEARS	TOTAL
As at 31 December 2018								
Fixed rate	$M	**141**	**401**	**199**	**98**	**177**	**483**	**1,499**
Weighted average interest rate	%	***2.60***	***3.05***	***3.04***	***2.36***	***3.62***	***4.00***	***3.33***
Floating rate	$M	**60**	**61**	**26**	**-**	**-**	**37**	**184**
Weighted average interest rate	%	***0.44***	***3.04***	***2.75***	**-**	**-**	***4.23***	***2.39***
As at 31 December 2017								
Fixed rate	$M	286	895	509	220	137	439	2,486
Weighted average interest rate	%	*1.75*	*2.05*	*2.32*	*2.35*	*1.90*	*3.25*	*2.30*
Floating rate	$M	369	49	106	72	1	67	664
Weighted average interest rate	%	*1.70*	*2.22*	*2.42*	*2.31*	*0.86*	*3.27*	*2.08*

4 RISK MANAGEMENT CONTINUED

4.6 Operational risk

Overview

Operational risk is the risk of financial loss resulting from inadequate or failed internal processes, people and systems or from external events.

Operational risk can materialise in a number of forms including fraud perpetrated by employees or by external parties (e.g. claims fraud or cyber-attacks), employment practices (losses arising from breaches of employment, health or safety laws, breach of employment contracts, payment of personal injury claims or diversity and discrimination events), improper business practices (failure to meet professional obligations or issues with the nature or design of an insurance product), disasters and other events, technology and infrastructure failures, or business and transaction processing failures.

The Company's approach to managing operational risk is underpinned by the Company's operational risk appetite as set by the Board and is summarized below.

The Company identifies and assesses operational risk through Risk and Control Assessment (RCA), Divisional Risk Assessment (DRA), top risks and emerging risks processes, and scenario analysis. The RCA process identifies and assesses the key risks to achieving business objectives and is conducted at the function unit level. The DRA process creates a single Company view of risk across all QBE risk categories. The top risks process involves the identification and assessment of the key risks relating to the entity by its Executive management board. The emerging risks process identifies and assesses new risks, which are characterized by incomplete but developing knowledge or existing risks that develop in new or surprising ways. The scenario analysis process assesses the impact of potentially extreme scenarios and the appropriateness of our contingency planning.

The Company manages operational risk through various systems, controls and processes, including effective segregation of duties, access controls, authorisations and reconciliation procedures, business continuity management, fraud management, information security and physical security. The Company monitors operational risk through control assurance, key risk indicators and internal loss events and issues and actions. Another key tool used by the Company is the targeted risk review process whereby reviews are conducted to identify whether there are any unmitigated risks or inadequacies in control design and provide recommendations to enhance the management of risk. The reviews are generally conducted by the Company's risk management and compliance function (the second line of defence) and involve various risk management techniques and approaches.

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5 CAPITAL STRUCTURE

Overview

The Company's objective in managing capital is to reduce the overall cost of capital whilst satisfying the capital adequacy requirements of its regulator and rating agencies, providing financial security for our policyholders and continuing to provide an adequate return to our shareholder.

Details of the Company's approach to capital risk management are disclosed in note 4.1.

5.1 Cash and cash equivalents

	2018 $M	2017 $M
Cash at bank and on hand	**37**	27
Cash management trusts	**-**	10
	37	37

Restrictions on use

There are no restrictions on amounts included in cash and cash equivalents as at December 31, 2018 and December 31, 2017.

How we account for the numbers

Cash and cash equivalents include cash at bank and on hand and deposits at call which are readily convertible to cash on hand and which are used for operational cash requirements. Amounts in cash and cash equivalents are the same as those included in the statement of cash flows.

The reconciliation of profit after income tax to cash flows from operating activities is included in note 7.3.

5 CAPITAL STRUCTURE CONTINUED

5.2 Equity and reserves

Overview

Ordinary shares in the Company rank after all creditors, have a par value of A$10.98 (2017 A$10.98) and entitle the holder to participate in dividends and the proceeds on winding up of the Company, in proportion to the number of shares held.

5.2.1 Share capital

	2018		2017	
	NUMBER OF SHARES MILLIONS	$M	NUMBER OF SHARES MILLIONS	$M
Authorised shares	**55**	**636**	55	636
Issued ordinary shares, fully paid at 1 January	**49**	**421**	38	307
Issued during the year	**-**	**-**	11	100
Foreign exchange	**-**	**(41)**	-	14
Issued ordinary shares, fully paid at 31 December	**49**	**380**	49	421

5.2.2 Reserves

	2018 $M	2017 $M
Share premium reserve		
At 1 January	**140**	134
Foreign exchange	**(14)**	6
At 31 December	**126**	140
Foreign currency translation reserve		
At 1 January	**(169)**	(270)
Movement	**(77)**	101
At 31 December	**(246)**	(169)
Total reserves at 31 December	**(120)**	(29)

With effect 1 January 2017 the Board passed a resolution to change the currency denomination of the Company's authorised share capital, from Australian dollars to United States dollars, using the exchange rate applicable at that date. Subsequent to the change in the currency denomination the authorised capital of 55,000,000 shares had a par value of US$8.159456 per share, compared to a previous value of A$11.32 per shares, from the date of denomination.

With effect 31 May 2017 the Board passed a resolution to change the currency denomination of the Company's authorised share capital, from United States dollars back to Australian dollars, using the exchange rate applicable at that date. As at the balance sheet date the authorised share capital of 55,000,000 shares has a par value of A$10.98.

5 CAPITAL STRUCTURE CONTINUED

5.3 Dividends

Overview

The Company seeks to transfer excess capital above its target capital level to its parent entity. Excess capital is determined with reference to the capital strategy which determines the capital target as the aggregate of the regulatory capital requirement and a buffer above regulatory minimum capital. The buffer is expressed as a percentage of the regulatory minimum and is determined with reference to a probability of breaching regulatory minimum. As per the Insurance Act s31B, Class 3B insurers cannot, without BMA prior approval, pay out more than 25% of total statutory capital and surplus as determined in the prior year's filing. The policy does not prescribe the split of divided between interim and final, as this will be contingent on the capital available at each date.

	2018	2017
Dividend per share (US dollar)	-	5.89
Total dividend payout ($ million)	-	290

5.4 Earnings per share

Overview

Earnings per share (EPS) is the amount of profit or loss after tax attributable to each share. The Company's shares are fully issued and paid and therefore not subject to any effect of dilution. The Company's shares are undiluted.

	2018 US $	2017 US $
Basic earnings per share	**5.45**	(11.44)

5.4.1 Earnings used in calculating earnings per share

	2018 $M	2017 $M
Net profit (loss) after income tax attributable to ordinary equity holders of the Company used in calculating basic earnings per share	**268**	(458)

5.4.2 Ordinary shares used in calculating earnings per share

	2018 NUMBER OF SHARES	2017 NUMBER OF SHARES
Number of ordinary shares used as the denominator in calculating basic earnings per share	**49,183,062**	40,025,091

How we account for the numbers

Basic earnings per share
Basic earnings per share is calculated by dividing net profit after income tax attributable to members of the company by the weighted average number of ordinary shares outstanding at the year end.

5 CAPITAL STRUCTURE CONTINUED

5.5 Derivatives

Overview

Derivatives may be used as a tool to hedge the Company's foreign exchange exposures. The Company manages operational foreign exchange volatility by matching liabilities with assets of the same currency, as far as practicable. Forward foreign exchange contracts are used to hedge residual currency exposures, with both the foreign exchange and derivatives impact reported through profit or loss.

Refer to note 4.4 for additional information relating to the Company's approach to managing currency risk.

The Company's exposure to foreign exchange derivatives at the balance date is set out in the table below:

	2018			2017		
	EXPOSURE $M	FAIR VALUE ASSET $M	FAIR VALUE LIABILITY $M	EXPOSURE $M	FAIR VALUE ASSET $M	FAIR VALUE LIABILITY $M
Forward foreign exchange contracts	**1,712**	**15**	**(23)**	2,684	24	(28)

How we account for the numbers

Derivatives are initially recognised at fair value, being the transaction price on the date a derivative contract is entered into and are subsequently remeasured to their fair value. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and the nature of the item being hedged. Derivatives which are not part of a hedging relationship are valued at fair value through profit or loss.

For derivatives traded in an active market, the fair value of derivatives presented as assets is determined by reference to published closing bid price quotations, and the fair value of derivatives presented as liabilities is determined by reference to published closing ask price quotations. For derivatives that are not traded, or which are traded in a market that is not sufficiently active, fair value is determined using generally accepted valuation techniques, including the use of forward exchange rates for the valuation of forward foreign exchange contracts.

6 TAX

Overview

Under current Bermuda law, the Company is not required to pay any taxes in Bermuda on either income or capital gains. The Company has received an undertaking from the Bermuda government exempting it from all local income, withholding and capital gains taxes until March 31, 2035. At the present time no such taxes are levied in Bermuda.

The Company's approach to managing tax risk is disclosed in note 4.1.

6.1 Income tax

Reconciliation of prima facie tax to income tax expense (credit)

	NOTE	2018 $M	2017 $M
Profit (loss) before income tax		283	(441)
Tax effect of permanent differences:			
Withholding tax on investment income		2	5
Creditable premium tax		13	12
Prima facie tax adjusted for permanent differences		15	17
Income tax expense		15	17
Analysed as follows:			
Current tax		15	17

How we account for the numbers

Non-creditable premium taxes deducted by foreign jurisdictions are expensed when notified and included within underwriting deductions.

Creditable income taxes withheld by ceding affiliates or investment counterparties on behalf of foreign jurisdictional tax authorities are recognised when so withheld and included in income tax expense. No deferred tax assets or liabilities are currently recognised given the Company's exempt tax status.

Notes to the financial statements

FOR THE YEAR ENDED 31 DECEMBER 2018

7 OTHER

Overview

This section includes other information that must be disclosed to comply with the Australian Accounting Standards or the *Corporations Act 2001* of the Commonwealth of Australia.

7.1 Other accounting policies

7.1.1 New and amended standards adopted by the Company

The Company adopted the following new or revised accounting standards which became effective for the annual reporting period commencing on 1 January 2018.

TITLE	
AASB 15	Revenue from Contracts with Customers
AASB 1048	Interpretation of Standards
AASB 2016-5	Classification and Measurement of Share-based Payment Transactions
AASB 2016-6	Applying AASB 9 Financial Instruments with AASB 4 Insurance Contracts
AASB 2017-1	Transfers of Investment Property, Annual Improvements 2014-2016 Cycle and Other Amendments
AASB 2017-3	Clarification to AASB 4
AASB Interpretation 22	Foreign Currency Transactions and Advance Consideration

The adoption of these new or revised standards did not materially change the Company's accounting policies or financial statements; however, the adoption of AASB 2016-6 and AASB 2017-3 allows insurers which meet certain criteria to defer the application of AASB 9 to 1 January 2021. This is discussed in note 7.1.2 below.

7.1.2 New accounting standards and amendments issued but not yet effective

TITLE		OPERATIVE DATE
AASB 16	Leases	1 January 2019
AASB 2017-7	Long-term Interests in Associates and Joint Ventures	1 January 2019
AASB 2018-1	Annual Improvements 2015-2017 Cycle	1 January 2019
AASB 2018-2	Plan Amendment, Curtailment or Settlement	1 January 2019
AASB Interpretation 23	Uncertainty over Income Tax Treatments	1 January 2019
Revised Conceptual Framework for Financial Reporting		1 January 2020
AASB 9	Financial Instruments	1 January 2021
AASB 17	Insurance Contracts	1 January 2021
AASB 2014-10	Sale of Contribution of Assets between an Investor and its Associate of Joint Venture	1 January 2022

The Australian Accounting Standards and amendments detailed in the table above are not mandatory for the Company until the operative dates stated; however, early adoption is often permitted.

The Company plans to adopt the standards and amendments detailed above in the reporting periods beginning on their respective operative dates. An initial assessment of the financial impact of the standards and amendments has been undertaken and they are not expected to have a material impact on the Company's financial statements, except where noted below.

AASB 16 *Leases*

AASB 16, which was issued in 2016 and sets out the principles for recognition, measurement, presentation and disclosure of leases, will replace existing accounting requirements for leases from 1 January 2019. Under current requirements leases are classified based on their nature, either as finance leases which are recognised on the balance sheet or operating leases which are not recognised on the balance sheet. The application of AASB 16 will result in the recognition of all leases on the balance sheet in the form of a right-of-use asset and corresponding lease liability. Over the life of the lease, the liability incurs interest and is reduced as lease payments are made, and the asset is amortised over its useful life.

The new standard is expected to impact leases which are currently classified by the Company as operating leases, being mainly leases over premises and equipment. On adoption of AASB 16, the Company will apply an exemption under the new standard and will not recognise low value leases and leases with a term of less than 12 months on the balance sheet. The resulting amount to be recognised as a gross up to the balance sheet at 1 January 2019 is approximately $1.3 million. The Company intends to apply the modified retrospective approach on adoption of the standard and expects that there will be no material impact to opening retained earnings at 1 January 2019. Future profit of loss is also not expected to be materially impacted by the adoption of this standard.

7 OTHER CONTINUED

AASB 9 *Financial Instruments*

AASB 9 was issued during 2014 and replaces existing accounting requirements for financial instruments. Accounting standards currently permit deferral of adoption of AASB 9 to 1 January 2021; however, the International Accounting Standards Board has tentatively decided to extend this to 1 January 2022. The QBE Group has elected to apply this temporary exemption as it meets the following relevant criteria:

- the carrying amount of the Company's insurance liabilities within the scope of AASB 1023 (being outstanding claims, unearned premium liabilities and reinsurance premiums payable) exceed 90% of the carrying amount of the Company's total liabilities.

The following information is provided to assist users in comparing the Company's financial statements with entities which have adopted AASB 9:

Impact on financial assets

The Company's investments are currently designated as fair value through profit of loss on initial recognition and are subsequently remeasured to fair value at each reporting date, reflecting the Company's business model for managing and evaluating the investment portfolio. Adoption of AASB 9 does not result in any changes to accounting for these investments.

Financial assets within the scope of AASB 1023, such as premiums receivable and reinsurance and other recoveries on paid claims, which together form the majority of the carrying value of the Company's trade and other receivables, as well as reinsurance recoveries on outstanding claims are outside the scope of AASB 9 and are unaffected by the new requirements.

Impact on financial liabilities

Financial liabilities within the scope of AASB 1023, such as reinsurance premiums payable and outstanding claims, are outside the scope of AASB 9 and are therefore unaffected by the new requirements.

AASB 17 *Insurance Contracts*

AASB 17, a new accounting standard for insurance contracts, was adopted by the Australian Accounting Standards Board in July 2017. It is currently effective for reporting periods beginning on or after 1 January 2021, but this is expected to be deferred to 1 January 2022 following a tentative decision of the International Accounting Standards Board (IASB) to delay the mandatory implementation date by one year.

The standard will be applicable to general, life and health insurance business and introduces a new 'general model' for recognition and measurement of insurance contracts. It also permits application of a simplified model (which is similar to the current basis on which general insurance is brought to account under AASB 1023) if the liability for remaining coverage under the simplified model would not materially differ from the general model.

The Company has completed an impact assessment and additional analysis on key areas of interpretation and has determined that the simplified approach is expected to apply to more than 95% of the Company's business, based on the existing business mix. This analysis also identified key requirements of AASB 17 where the technical interpretation remains unclear. In addition, the IASB is in the process of considering potential changes to the wording of IFRS 17 to remedy implementation issues identified and it is expected these changes would then be adopted into AASB 17. Given the potential for changes in AASB 17 and the broad scope, complexity and lack of general consensus on the interpretation of some key areas of the standard, the impact of AASB 17 on the Company's financial statements is still being determined; however, significant disclosure changes and some impact on reporting profit or loss are expected. We continue to monitor market developments in order to assess the impact of changes and evolving interpretation on the Company.

7 OTHER CONTINUED

7.2 Contingent liabilities

Overview

Contingent liabilities are disclosed when the possibility of a future settlement of economic benefits is considered to be less than probable but more likely than remote. If the expected settlement of the liability becomes probable, a provision is recognised.

In the normal course of business, the Company is exposed to contingent liabilities in relation to claims litigation and regulatory examination arising out of its insurance and reinsurance activities. The Company may also be exposed to the possibility of contingent liabilities in relation to non-insurance litigation and compliance matters.

Provisions are made for obligations that are probable and quantifiable. There are no amounts otherwise not provided for in the financial statements. The Company has no contingent liabilities to disclose. There are no individually significant amounts not provided for and such transactions are not considered likely to have a material impact on the net assets of the Company.

7.3 Reconciliation of profit (loss) after income tax to cash flows from operating activities

Overview

AASB 1054 *Australian Additional Disclosures* requires a reconciliation of profit after income tax to cash flows from operating activities.

	2018 $M	2017 $M
Profit (loss) after income tax	**268**	(458)
Adjustments for:		
Net foreign exchange losses	**2**	6
Other losses (gains) on financial assets	**11**	(86)
Balance sheet movements:		
(Decrease) increase in net outstanding claims	**(1,614)**	903
(Decrease) in unearned premium	**(715)**	(83)
Decrease (increase) in deferred insurance costs	**578**	(410)
Decrease (increase) in trade debtors	**724**	(27)
Decrease (increase) in other operating assets	**9**	(5)
Decrease (increase) in net amounts receivable from related entities	**11**	(315)
(Decrease) increase in trade payables	**(463)**	607
Increase in other payables and provisions	**-**	3
Net cash flows from operating activities	**(1,189)**	135

7 OTHER CONTINUED

7.4 Related parties

Overview

AASB 124 *Related Party Disclosures* requires disclosure of related party transactions. The majority of all inwards reinsurance business assumed is from related entities, with only an immaterial amount of third-party business being written during the year. All outwards reinsurance business is placed with third parties. In addition, the Company has entered into a number of outsourced service agreements with related entities.

All material information required to be disclosed under AASB 124: Related Party Disclosures has been included in the financial statements, as follows:

	Reference
Interest received or receivable from related entities	Note 3.1
Amounts due from related entities	Note 2.6
Amounts due to related entities	Note 2.7

The Company holds related party corporate bonds to the value of $286 million (2017 $305.2 million) within its investment portfolio (note 3.2) and has accrued interest in respect of those bonds of $2 million (2017 $2.8 million) within investment receivables (note 2.6).

The Company has entered into a number of outsourced service agreements with related entities. Details of related entities, the services provided, and the fees charged are as follows:

Related entity	Services provided	2018 $000	2017 $000
QBE Group Services Pty Ltd	Investment management services	**2,062**	2,753
QBE Group Services Pty Ltd	QBE Group head office services and license fee	**2,169**	2,662
QBE Group Services Pty Ltd	System and infrastructure support	**397**	351
QBE Group Shared Services Limited	Reinsurance technical services, financial reporting, claims administration support	**606**	648
QBE Blue Ocean Reinurances Limited	Intercompany balance with parent company	**(8,446)**	-
		(3,213)	6,414

7 OTHER CONTINUED

7.5 Remuneration of auditors

Overview

The Company may engage the external auditor for non-audit services other than excluded services, subject to the general principle that fees for non-audit services should not exceed 50% of all fees paid to the external auditor in any one financial year. The Board believes some non-audit services are appropriate given the external auditor's knowledge of the Company.

External tax services are generally provided by an accounting firm other than the external auditor. Consistent with prior periods, the external auditor cannot provide the excluded services of preparing accounting records or financial reports or acting in a management capacity.

	2018 $000	2017 $000
Audit and assurance services	**224**	206

7.6 Operating lease commitments

Overview

The Company leases office space at its registered office. The lease is classified as an operating lease as it does not transfer substantially all the risks and rewards incidental to ownership. The amount of the lease due to expire is provided below.

	2018 $000	2017 $000
Payable		
Not later than one year	**227**	227
Later than one year but not later than five years	**95**	322
	322	549

Directors' declaration

In the directors' opinion:

(a) the financial statements and notes set out on pages 10 to 56 are in accordance with the *Corporations Act 2001* of the Commonwealth of Australia, including:

(i) complying with accounting standards, the *Corporations Regulations 2001* of the Commonwealth of Australia and other mandatory professional reporting requirements applicable under Australian Accounting Standards; and

(ii) giving a true and fair view of the Company's financial position as at 31 December 2018 and of its performance for the financial year ended on that date; and

(b) there are reasonable grounds to believe that the company will be able to pay its debts as and when they become due and payable.

Note 1.2.1 confirms that the financial statements comply with International Financial Reporting Standards as issued by the International Accounting Standards Board.

Signed in HAMILTON, Bermuda this 26th day of April 2019, in accordance with a resolution of the directors.

J. Fiore
Director

R. Stone
Director

Independent auditor's report

To the Board of Directors and Shareholder of Equator Reinsurances Limited

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Our opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Equator Reinsurances Limited (the Company) as at December 31, 2018, and its financial performance and its cash flows for the year then ended in accordance with the Australian equivalent of International Financial Reporting Standards (otherwise known as Australian Accounting Standards).

What we have audited

The Company's financial statements comprise:

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

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the financial statements* 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 Company in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) and the ethical requirements of the Chartered Professional Accountants of Bermuda Rules of Professional Conduct (CPA Bermuda Rules) that are relevant to our audit of the financial statements in Bermuda. We have fulfilled our other ethical responsibilities in accordance with the IESBA Code and the ethical requirements of the CPA Bermuda Rules.

Other information

Management is responsible for the other information. The other information comprises the Annual Report (but does not include the financial statements and our auditor's report thereon).

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

PricewaterhouseCoopers Ltd., Chartered Professional Accountants, P.O. Box HM 1171, Hamilton HM EX, Bermuda
T: +1 (441) 295 2000, F: +1 (441) 295 1242, www.pwc.com/bermuda

In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed, 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 management and Those Charged with Governance for the financial statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with Australian Accounting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are 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 ISAs 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 these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If

we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

PricewaterhouseCoopers Ltd.

Chartered Professional Accountants

Hamilton, Bermuda
April 26, 2019

Reference: Independent Auditor's Report on the Financial Statements of Equator Reinsurances Limited as at December 31, 2018 and for the year then ended
Page 3 of 3

Glossary of insurance terms

Accident year experience	The matching of all claims occurring (regardless of when reported or paid) during a given 12-month period with all premium earned over the same period.
Acquisition cost	The total of net commission and operating expenses incurred in the generation of net earned premium and often expressed as a percentage of net earned premium.
Admitted insurance	Insurance written by an insurer that is admitted (or licensed) to do business in the (US) state in which the policy was sold.
Agent	One who negotiates contracts of insurance or reinsurance as an insurance company's representative i.e. the agent's primary responsibility is to the insurance carrier, not the insurance buyer.
Attritional claims ratio	Total of all claims with a net cost of less than $2.5 million as a percentage of net earned premium.
Broker	One who negotiates contracts of insurance or reinsurance on behalf of an insured party, receiving a commission from the insurer or reinsurer for placement and other services rendered. In contrast with an agent, the broker's primary responsibility is to the insurance buyer not the insurance carrier.
Capacity	In relation to a Lloyd's member, the maximum amount of insurance premiums (gross of reinsurance but net of brokerage) which a member can accept. In relation to a syndicate, the aggregate of each member's capacity allocated to that syndicate.
Cash profit	Net profit after tax attributable to QBE shareholders, adjusted for the post-tax effect of amortisation and impairment of intangibles and other non-cash items. This definition is used for the purpose of the QBE Group's dividend policy.
Casualty insurance	Insurance that is primarily concerned with the losses resulting from injuries to third persons or their property (i.e. not the policyholder) and the resulting legal liability imposed on the insured. It includes, but is not limited to, general liability, employers' liability, workers' compensation, professional liability, public liability and motor liability insurance.
Catastrophe reinsurance	A reinsurance contract (often in the form of excess of loss reinsurance) that, subject to specified limits and retention, compensates the ceding insurer for losses related to an accumulation of claims resulting from a catastrophe event or series of events.
Claim	The amount payable under a contract of insurance or reinsurance arising from a loss relating to an insured event.
Claims incurred	The aggregate of all claims paid during an accounting period adjusted by the change in the claims provision for that accounting period.
Claims provision	The estimate of the most likely cost of settling present and future claims and associated claims adjustment expenses plus a risk margin to cover possible fluctuation of the liability.
Claims ratio	Net claims incurred as a percentage of net earned premium.
Coefficient of variation	The measure of variability in the net discounted central estimate used in the determination of the probability of adequacy.
Combined operating ratio	The sum of the net claims ratio, commission ratio and expense ratio. A combined operating ratio below 100% indicates profitable underwriting results. A combined operating ratio over 100% indicates unprofitable underwriting results.
Commercial lines	Refers to insurance for businesses, professionals and commercial establishments.
Commission	Fee paid to an agent or broker as a percentage of the policy premium. The percentage varies widely depending on coverage, the insurer and the marketing methods.
Commission ratio	Net commission expense as a percentage of net earned premium.
Credit spread	The difference in yield between a corporate bond and a reference yield (e.g. LIBOR, BBSW or a fixed sovereign bond yield).
Credit spread duration	The weighted average term of cash flows for a corporate bond. It is used to measure the price sensitivity of a bond to changes in credit spreads.
Deductible	The amount or proportion of some or all losses arising under an insurance contract that the insured must bear.

Glossary of insurance terms

Deferred acquisition costs	Acquisition costs relating to the unexpired period of risk of contracts in force at the balance date which are carried forward from one accounting period to subsequent accounting periods.
Excess of loss reinsurance	A form of reinsurance in which, in return for a premium, the reinsurer accepts liability for claims settled by the original insurer in excess of an agreed amount, generally subject to an upper limit.
Expense ratio	Underwriting and administrative expenses as a percentage of net earned premium.
Facultative reinsurance	The reinsurance of individual risks through a transaction between the reinsurer and the cedant (usually the primary insurer) involving a specified risk.
General insurance	Generally used to describe non-life insurance business including property and casualty insurance.
Gross claims incurred	The amount of claims incurred during an accounting period before deducting reinsurance recoveries.
Gross earned premium (GEP)	The proportion of gross written premium recognised as income in the current financial year, reflecting the pattern of the incidence of risk and the expiry of that risk.
Gross written premium (GWP)	The total premium on insurance underwritten by an insurer or reinsurer during a specified period, before deduction of reinsurance premium.
Incurred but not reported (IBNR)	Claims arising out of events that have occurred before the end of an accounting period but have not been reported to the insurer by that date.
Insurance profit	The sum of the underwriting result and investment income on assets backing policyholders' funds.
Insurance profit margin	The ratio of insurance profit to net earned premium.
Inward reinsurance	See Reinsurance.
Large individual risk and catastrophe claims ratio	The aggregate of claims each with a net cost of $2.5 million or more as a percentage of net earned premium.
Lenders' mortgage insurance (LMI)	A policy that protects the lender (e.g. a bank) against non-payment or default on the part of the borrower on a residential property loan.
Lead/non-lead underwriter	A lead underwriter operates in the subscription market and sets the terms and price of a policy. The follower or non-lead is an underwriter of a syndicate or an insurance company that agrees to accept a proportion of a given risk on terms set by the lead underwriter.
Letters of credit (LoC)	Written undertaking by a financial institution to provide funding if required.
Lloyd's	Insurance and reinsurance market in London. It is not a company but is a society of individuals and corporate underwriting members.
Lloyd's managing agent	An underwriting agent which has permission from Lloyd's to manage one or more syndicates and carry on underwriting and other functions for a member.
Long tail	Classes of insurance business involving coverage for risks where notice of a claim may not be received for many years and claims may be outstanding for more than one year before they are finally quantifiable and settled by the insurer.
Managing General Agent (MGA)	A wholesale insurance agent with the authority to accept placements from (and often to appoint) retail agents on behalf of an insurer. MGAs generally provide underwriting and administrative services such as policy issuance on behalf of the insurers they represent. Some may handle claims.
Maximum event retention (MER)	An estimate of the largest claim to which an insurer will be exposed (taking into account the probability of that loss event at a return period of one in 250 years) due to a concentration of risk exposures, after netting off any potential reinsurance recoveries and inward and outward reinstatement premiums.
Modified duration	The weighted average term of cash flows in a bond. It is used to measure the price sensitivity of a bond to changes in credit spreads.

Glossary of insurance terms

Multi-peril crop scheme	US federally regulated crop insurance protecting against crop yield losses by allowing participating insurers to insure a certain percentage of historical crop production.
Net claims incurred	The amount of claims incurred during an accounting period after deducting reinsurance recoveries.
Net claims ratio	Net claims incurred as a percentage of net earned premium.
Net earned premium (NEP)	Net written premium adjusted by the change in net unearned premium.
Net investment income	Gross investment income including foreign exchange gains and losses and net of investment expenses.
Net written premium (NWP)	The total premium on insurance underwritten by an insurer during a specified period after the deduction of premium applicable to reinsurance.
Outstanding claims liability	The amount of provision established for claims and related claims expenses that have occurred but have not been paid.
Personal lines	Insurance for individuals and families, such as private motor vehicle and homeowners' insurance.
Policyholders' funds	Those financial assets held to fund the net insurance liabilities of the Company.
Premium	Amount payable by the insured or reinsured in order to obtain insurance or reinsurance protection.
Premium solvency ratio	Ratio of net tangible assets to net earned premium. This is an important industry indicator in assessing the ability of general insurers to settle their existing liabilities.
Prescribed Capital Amount (PCA)	This comprises the sum of the capital charges for asset risk, asset concentration risk, insurance concentration risk and operational risk as required by APRA. The PCA must be disclosed at least annually.
Probability of adequacy	A statistical measure of the level of confidence that the outstanding claims liability will be sufficient to pay claims as and when they fall due.
Proportional reinsurance	A type of reinsurance in which the original insurer and the reinsurer share claims in the same proportion as they share premiums.
Prudential Capital Requirement (PCR)	The sum of the Prescribed Capital Account (PCA) plus any supervisory adjustment determined by APRA. The PCR may not be disclosed.
Recoveries	The amount of claims recovered from reinsurance, third parties or salvage.
Reinsurance	An agreement to indemnify a primary insurer by a reinsurer in consideration of a premium with respect to agreed risks insured by the primary insurer. The enterprise accepting the risk is the reinsurer and is said to accept inward reinsurance. The enterprise ceding the risks is the cedant or ceding company and is said to place outward reinsurance.
Reinsurance to close	A reinsurance agreement under which members of a syndicate, for a year of account to be closed, are reinsured by members who comprise that or another syndicate for a later year of account against all liabilities arising out of insurance business written by the reinsured syndicate.
Reinsurer	The insurer that assumes all or part of the insurance or reinsurance liability written by another insurer. The term includes retrocessionaires, being insurers that assume reinsurance from a reinsurer.
Retention	That amount of liability for which an insurance company will remain responsible after it has completed its reinsurance arrangements.
Retrocession	Reinsurance of a reinsurer by another reinsurance carrier.
Return on allocated capital (RoAC)	Divisional management-basis profit as a percentage of allocated capital as determined by the Company's economic capital model.
Return on equity (ROE)	Company statutory net profit after tax as a percentage of average shareholders' funds.
Short tail	Classes of insurance business involving coverage for risks where claims are usually known and settled within 12 months.

Glossary of insurance terms

Stop loss reinsurance	A form of excess of loss reinsurance which provides that the reinsurer will pay some or all of the reassured's losses in excess of a stated percentage of the reassured's premium income, subject (usually) to an overall limit of liability.
Surplus (or excess) lines insurers	In contrast to "admitted insurers", every US state also allows non-admitted (or "surplus lines" or "excess lines") carriers to transact business where there is a special need that cannot or will not be met by admitted carriers. The rates and forms of non-admitted carriers generally are not regulated in that state, nor are the policies back-stopped by the state insolvency fund covering admitted insurance. Brokers must inform insurers if their insurance has been placed with a non-admitted insurer.
Syndicate	A member or Company of members underwriting insurance business at Lloyd's through the agency of a managing agent.
Survival ratio	A measure of how many years it would take for dust disease claims to exhaust the current level of claims provision. It is calculated on the average level of claims payments in the last three years.
Total shareholder return (TSR)	A measure of performance of a company's shares over time. It includes share price appreciation and dividend performance.
Treaty reinsurance	Reinsurance of risks in which the reinsurer is obliged by agreement with the cedant to accept, within agreed limits, all risks to be underwritten by the cedant within specified classes of business in a given period of time.
Underwriting	The process of reviewing applications submitted for insurance or reinsurance coverage, deciding whether to provide all or part of the coverage requested and determining the applicable premium.
Underwriting expenses	The aggregate of policy acquisition costs, excluding commissions, and the portion of administrative, general and other expenses attributable to underwriting operations.
Underwriting result	The amount of profit or loss from insurance activities exclusive of net investment income and capital gains or losses.
Underwriting year	The year in which the contract of insurance commenced or was underwritten.
Unearned premium	The portion of a premium representing the unexpired portion of the contract term as of a certain date.
Volume weighted average price (VWAP)	A methodology used for determining the share price applicable to dividend and other share related transactions.
Written premium	Premiums written, whether or not earned, during a given period.

QBE

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