# QBE INSURANCE GROUP
## Half year report to 30 June 2006

# QBE INSURANCE GROUP ABN 28 008 485 014

## Half year report to 30 June 2006

Contents



## Front cover

### Sammy Clarmont, *Goanna* 2005

Acrylic on canvas, 30.0 x 42.0 cm
Courtesy of Lockhart River Art Centre

2006 marks the 120th anniversary of the formation of QBE's founding company, The North Queensland Insurance Company Limited. Its activities were centred around the port of Townsville in Northern Queensland supporting the shipping and trading activities of its parent, Burns, Philp & Co Limited. Representative of the North Queensland region and depicted on the cover is an image by Sammy Clarmont who is a member of the Lockhart River Art Gang, a group of young Aboriginal artists from the Cape York region of Northern Queensland. His works are contemporary but reflect the traditional culture and environment of the region in which QBE's founding company first came into being.

# Highlights

for the half year ended 30 June 2006

## Profit and dividend payout

| | | 2006 | 2005 | % change |
|---|---|---|---|---|
| Net profit after income tax | $M | **591** | 491 | 20 |
| Net profit before income tax | $M | **809** | 675 | 20 |
| Basic earnings per share[1] | cents | **73.9** | 64.6 | 14 |
| Diluted earnings per share[1,2] | cents | **69.1** | 59.2 | 17 |
| Dividend per share | cents | **40.0** | 33.0 | 21 |
| Shareholders' funds | $M | **5,565** | 4,486 | 24 |

## Group operating performance

| | | 2006 | 2005 | % change |
|---|---|---|---|---|
| Gross written premium | $M | **5,656** | 5,123 | 10 |
| Gross earned premium | $M | **4,932** | 4,331 | 14 |
| Net earned premium | $M | **3,998** | 3,506 | 14 |
| Combined operating ratio | % | **87.9** | 90.3 | |
| Insurance profit | $M | **748** | 553 | 35 |
| Insurance profit to net earned premium | % | **18.7** | 15.8 | |
| Cash flow from operations | $M | **322** | 672 | (52) |

## Contributions by region

| | | | 2006 | 2005 | % change |
|---|---|---|---|---|---|
| Australia | Gross earned premium | $M | **1,213** | 1,199 | 1 |
| | Combined operating ratio | % | **82.7** | 86.2 | |
| Pacific Asia Central Europe | Gross earned premium | $M | **335** | 348 | (4) |
| | Combined operating ratio | % | **83.0** | 88.8 | |
| QBE Insurance (Europe) | Gross earned premium | $M | **1,280** | 1,138 | 12 |
| | Combined operating ratio | % | **90.8** | 90.2 | |
| Lloyd's division | Gross earned premium | $M | **1,201** | 1,015 | 18 |
| | Combined operating ratio | % | **90.3** | 96.2 | |
| the Americas | Gross earned premium | $M | **903** | 631 | 43 |
| | Combined operating ratio | % | **91.0** | 93.2 | |
| Equator Re[3] | Gross earned premium | $M | **255** | 143 | 78 |
| | Combined operating ratio | % | **86.9** | 83.1 | |
| Investment income | Gross | $M | **403** | 409 | (1) |
| | Net of finance costs and investment expenses | $M | **331** | 337 | (2) |

[1] Reflects shares notified to the Australian Stock Exchange. Refer to note 5 to the financial statements.
[2] Assumes that all hybrid securities are fully dilutive.
[3] Equator Re is the Group's captive reinsurance company based in Bermuda.

ALL AMOUNTS IN THIS REPORT ARE DENOMINATED IN AUSTRALIAN DOLLARS UNLESS OTHERWISE SPECIFIED.

# QBE history

| | | Half year ended 30 June | | | | | Year ended 31 December | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | **2006** | 2005 | 2004 | 2003[1] | 2002[1] | 2005 | 2004 | 2003[1] | 2002[1] | 2001[1] |
| Gross written premium | $M | **5,656** | 5,123 | 4,763 | 4,821 | 4,332 | 9,408 | 8,766 | 8,350 | 7,723 | 6,793 |
| Gross earned premium | $M | **4,932** | 4,331 | 3,982 | 3,882 | 3,470 | 9,171 | 8,571 | 7,816 | 7,197 | 6,298 |
| Net earned premium | $M | **3,998** | 3,506 | 3,114 | 3,083 | 2,679 | 7,386 | 6,781 | 6,036 | 5,642 | 4,634 |
| Claims ratio | % | **58.3** | 61.0 | 61.6 | 65.1 | 68.4 | 59.9 | 61.3 | 63.3 | 67.6 | 76.6 |
| Commission ratio | % | **17.6** | 17.0 | 16.8 | 18.7 | 18.2 | 16.9 | 17.5 | 18.2 | 17.7 | 20.2 |
| Expense ratio | % | **12.0** | 12.3 | 12.1 | 12.2 | 12.4 | 12.3 | 12.4 | 12.3 | 12.4 | 12.8 |
| Combined operating ratio | % | **87.9** | 90.3 | 90.5 | 96.0 | 99.0 | 89.1 | 91.2 | 93.8 | 97.7 | 109.6 |
| Investment income[2] | | | | | | | | | | | |
| before net fair value gains/losses | $M | **297** | 243 | 199 | 181 | 194 | 502 | 431 | 303 | 340 | 336 |
| after net fair value gains/losses | $M | **331** | 337 | 132 | 194 | 97 | 718 | 519 | 413 | 189 | 349 |
| Insurance profit (loss) | $M | **748** | 553 | 425 | 259 | 160 | 1,288 | 928 | 627 | 406 | (119) |
| Insurance profit (loss) to net earned premium | % | **18.7** | 15.8 | 13.6 | 8.4 | 6.0 | 17.4 | 13.7 | 10.4 | 7.2 | (2.6) |
| Profit (loss) | | | | | | | | | | | |
| before income tax | $M | **809** | 675 | 429 | 313 | 124 | 1,523 | 1,115 | 765 | 311 | (99) |
| after income tax and minority interest | $M | **591** | 491 | 343 | 241 | 115 | 1,091 | 857 | 572 | 279 | (25) |
| Number of shares on issue[3] | millions | **804** | 768 | 683 | 627 | 600 | 794 | 745 | 672 | 615 | 585 |
| Shareholders' funds | $M | **5,565** | 4,486 | 3,251 | 3,064 | 2,720 | 5,093 | 4,032 | 3,313 | 2,954 | 2,620 |
| Total assets | $M | **31,857** | 27,365 | 25,578 | 21,378 | 19,770 | 29,665 | 25,036 | 20,443 | 20,567 | 18,611 |
| Net tangible assets per share[3] | $ | **5.27** | 4.47 | 3.48 | 4.09 | 3.71 | 4.76 | 4.10 | 4.17 | 3.96 | 3.67 |
| Interest bearing liabilities to shareholders' funds[4] | % | **38.9** | 38.8 | 44.5 | 47.4 | 38.0 | 41.8 | 44.8 | 40.3 | 49.3 | 32.0 |
| Basic earnings per share[3] | cents | **73.9** | 64.6 | 50.7 | 37.3 | 17.5 | 142.5 | 123.1 | 86.5 | 42.7 | (10.5) |
| Diluted earnings per share[3,5] | cents | **69.1** | 59.2 | 44.8 | 32.7 | 17.7 | 130.8 | 109.1 | 77.5 | 43.4 | (4.9) |
| Return on average shareholders' funds[6,7] | % | **22.2** | 23.1 | 22.1 | 16.0 | 8.6 | 23.9 | 24.5 | 18.3 | 10.0 | (1.1) |
| Dividend per share[3] | cents | **40.0** | 33.0 | 24.0 | 20.0 | 16.5 | 71.0 | 54.0 | 42.0 | 35.0 | 30.0 |
| Dividend payout | $M | **322** | 254 | 164 | 133 | 99 | 556 | 392 | 281 | 213 | 155 |
| Cash flow from operations | $M | **322** | 672 | 898 | 726 | 455 | 1,987 | 2,110 | 2,089 | 1,511 | 280 |
| Total investments and cash[8,9] | $M | **18,165** | 15,721 | 14,338 | 11,495 | 9,461 | 17,597 | 14,975 | 11,823 | 11,504 | 9,183 |

1 2003 and prior QBE history has not been restated to reflect Australian equivalents to International Financial Reporting Standards ("AIFRS").
2 Excludes amortisation and impairment of goodwill/intangibles.
3 Reflects shares notified to the Australian Stock Exchange. Refer to note 5 to the financial statements.
4 Excludes ABC securities for funds at Lloyd's.
5 Assumes that all hybrid securities are fully dilutive.
6 2004 figures are calculated with reference to the AIFRS adjusted shareholders' funds of $2,951 million at 1 January 2004.
7 Includes convertible preference shares from 2000 to 2003 and the equity portion of hybrid securities issued in 2002 and 2004.
8 Excludes ABC financial assets pledged for funds at Lloyd's.
9 Includes financial assets, cash and investment properties.

# Results

for the half year ended 30 June 2006

QBE's geographic spread and product diversification have again been beneficial for shareholders. QBE produced a record insurance result and operating profit after tax for the half year following a continuation of the low frequency of claims and better than expected overall premium rate increases.

Operating profit after tax for the half year was $591 million, a 20% increase over the profit of $491 million for the same period last year. The increase in profit reflects the benefit of premium growth from acquisitions and improved insurance margins. These positives were partly offset by lower realised and unrealised gains on equities of $11 million after tax compared with $39 million after tax for the same period last year. Profit before tax was up 20% to $809 million.

Diluted earnings per share including all hybrid securities was 69.1 cents compared with 59.2 cents for the same period last year. Return on average shareholders' funds was 22.2% compared with 23.1% for the same period last year.

Insurance profit before tax for the half year increased by 35% to $748 million or 18.7% of net earned premium compared with 15.8% for the same period last year. The strong increase in insurance profit was achieved on net earned premium of $3,998 million, up 14% on the same period last year, mainly due to acquisitions in 2005. The substantial majority of the 42 countries in which we currently have operations produced insurance profits.

The Australia Pacific Asia Central Europe division ("APACE"), European operations division, the Americas division and our captive reinsurer, Equator Reinsurances Limited ("Equator Re"), all produced improved insurance profits. Consistent with recent years, insurance liabilities at 30 June 2006 included a substantial allowance for large losses and catastrophes which may occur in the second half of 2006.

## Interim dividend

In recognition of the strong operating performance, the directors declared an interim dividend of 40.0 cents per share, up 21% on the interim dividend of 33.0 cents per share for the first half of 2005. The interim dividend will be 60% franked compared with 50% franked for the same period last year. The interim dividend represents a payout of $322 million, up 27% from the previous interim dividend. The record date for the interim dividend is 1 September 2006. The Dividend Election Plan ("DEP") and the Dividend Reinvestment Plan ("DRP") have been suspended due to our strong capital adequacy.

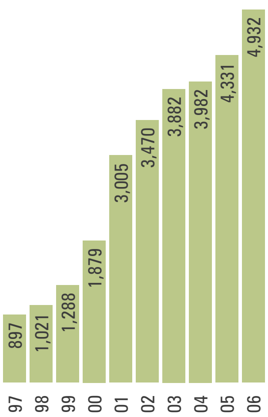
## Shareholders' funds

Since 31 December 2005, shareholders' funds have increased by 9% to $5,565 million. The increase is mainly due to the half year profit partly offset by the payment of the final 2005 dividend net of reinvestment.

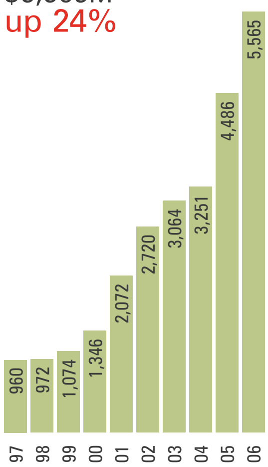
The ratio of borrowings to shareholders' funds at 30 June 2006 was 38.9%. This ratio is expected to be maintained within the range of 35% to 40% at year end. Since 30 June, we have raised $730 million through the issue of perpetual preferred securities. These securities are treated as Tier 1 capital for regulatory purposes. Proceeds from the issue of the securities were used to repay $400 million of short term borrowings and the balance for general corporate purposes.

We calculate the Group's capital adequacy multiple at 30 June 2006 to be around 1.9 times the estimated minimum capital requirement using the risk based capital approach of the Australian Prudential Regulation Authority ("APRA"). Including the Tier 1 perpetual preferred securities issued since 30 June 2006, the capital adequacy multiple has increased to around 2.1 times. We have made a number of assumptions in applying the APRA standards to the calculation of the Group's minimum capital requirement. APRA has not yet finalised the standards for calculating capital adequacy requirements for non-operating holding companies.

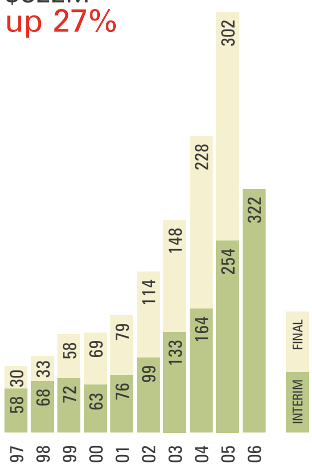
Gross earned premium
$4,932M
up 14%




Shareholders' funds
$5,565M
up 24%




Interim dividend payout
$322M
up 27%



## Results continued

for the half year ended 30 June 2006

### Key ratios – Group

| for the half year ended 30 June | | 2006 | 2005 |
|---|---|---|---|
| Gross written premium | $M | **5,656** | 5,123 |
| Gross earned premium | $M | **4,932** | 4,331 |
| Net earned premium | $M | **3,998** | 3,506 |
| Claims ratio | % | **58.3** | 61.0 |
| Commission ratio | % | **17.6** | 17.0 |
| Expense ratio | % | **12.0** | 12.3 |
| Combined operating ratio | % | **87.9** | 90.3 |
| Insurance profit to net earned premium | % | **18.7** | 15.8 |

### Worldwide portfolio mix

| Gross earned premium for the half year ended 30 June | 2006 % | 2005 % |
|---|---|---|
| Marine and aviation | **8.6** | 6.2 |
| Accident and health | **6.2** | 6.5 |
| Property | **29.8** | 28.9 |
| Motor and motor casualty | **14.7** | 13.6 |
| Financial and credit | **2.6** | 2.3 |
| Liability | **20.3** | 22.8 |
| Professional indemnity | **8.8** | 9.1 |
| Workers' compensation | **7.9** | 9.3 |
| Other | **1.1** | 1.3 |

### Segmental analysis

| Gross earned premium for the half year ended 30 June | 2006 % | 2005 % |
|---|---|---|
| Australia | **24.6** | 27.7 |
| Pacific Asia Central Europe | **6.8** | 8.0 |
| QBE Insurance (Europe) | **26.0** | 26.3 |
| Lloyd's division | **24.3** | 23.4 |
| the Americas | **18.3** | 14.6 |

## Group operating results

Gross written premium was up 10% to $5,656 million and gross earned premium increased 14% to $4,932 million. Premium growth has been assisted by the acquisitions made in 2005, improved customer retention and an overall increase in premium rates in excess of the expectations provided at the 2006 Annual General Meeting.

The combined operating ratio was 87.9% for the half year compared with 90.3% for the same period last year. Underwriting profit for the half year increased by 42% to $482 million due to the growth in premium and the continued strong performance of most of our portfolios around the world.

Reinsurance costs reduced to just less than 19% of gross earned premium, even though we incurred higher reinsurance costs to protect our inwards reinsurance business and to slightly reduce our maximum event retention as a percentage of net earned premium compared with 2005 levels. The maximum event retention is the estimated net cost of our largest realistic disaster scenario. Approximately 54% of our reinsurance costs are excess of loss and the balance is proportional reinsurance to reduce our aggregate exposures to property risks in Australia and protect selected insurance programmes in the Americas.

The claims ratio was 58.3% compared with 61.0% for the same period last year. The overall increase in premium rates during the half year and the continued low frequency and severity of claims has assisted the claims ratio. The favourable runoff of prior accident year claims has been offset by increased risk margins in outstanding claims in the current accident year. The risk margins in our outstanding claims have been increased to give a probability of adequacy of slightly above 95%. This is in excess of the high end of our internal target range of 85% to 94%. Consistent with previous years, we believe that the increased probability of adequacy is warranted at this time due to the cyclical nature of our business, particularly with the historically higher incidence of catastrophes in the second half of the year. The probability of adequacy of outstanding claims is significantly higher than the APRA minimum requirement of 75% for Australian licensed insurers. Risk margins in the Group's outstanding claims provisions have increased in recent years largely as a result of the increase in exposure to long tail classes of business. The probability of adequacy of the Group's outstanding claims provisions will vary from time to time depending on the mix of short, medium and long tail business and economic and industry conditions such as latency claims, claims inflation, interest rates and foreign currency movements. Total risk margins included in outstanding claims at 30 June 2006 were $1,422 million compared with $1,243 million at 31 December 2005.

The total acquisition cost ratio made up of commission and expenses was 29.6% of net earned premium compared with 29.3% for the same period last year. The commission ratio was 17.6% compared with 17.0% with the increase due to changes in business mix. The expense ratio reduced from 12.3% to 12.0%. The reduction reflects the synergies previously announced, partly offset by increased costs of implementing new systems in many countries throughout the world.

Investment income for the half year which is net of borrowing costs and investment expenses was $331 million compared with $337 million for the same period last year. This slight reduction reflects the lower gains on equity investments largely offset by the higher yields on cash and short duration fixed interest securities. Gross investment income was $403 million compared with $409 million for the same period last year. We underperformed on equities in the half year due to the relatively low exposure to equities in the January to March period.

Cash flow from operating activities was $322 million compared with $672 million for the same period last year. The reduction in cash flow is due to the settlement of claims in respect of the catastrophes that occurred in the second half of 2005, timing differences relating to recoveries from reinsurers on those catastrophes and significant contributions to fund the defined benefit pension deficits.

## Impact of exchange rate movements

| | **2006 actual $M** | **2006 at 2005[1] exchange rates $M** | **Exchange rate impact %** |
|---|---|---|---|
| Gross written premium | **5,656** | 5,637 | – |
| Gross earned premium | **4,932** | 4,915 | – |
| Net earned premium | **3,998** | 3,991 | – |
| Net investment income | **331** | 328 | 1 |
| Net profit after income tax | **591** | 589 | – |
| Total investments and cash | **18,165** | 17,844 | 2 |
| Total assets | **31,857** | 31,289 | 2 |
| Gross outstanding claims | **15,714** | 15,437 | 2 |
| Total liabilities | **26,230** | 25,792 | 2 |

[1] Income statement items are restated to 30 June 2005 cumulative average rates of exchange and balance sheet items to 31 December 2005 closing rates of exchange. Refer to commentary on page 6.

Income tax expense reduced slightly to 26.5% of profit before tax, primarily due to profits in lower tax paying countries.

The table below shows the contributions from each of our insurance divisions. It also shows the contribution from general insurance and reinsurance business. The growth in inwards reinsurance business is entirely due to premium rate increases and the reduced profit attributable to reinsurance business is due to increased risk margins in insurance liabilities.

## Captive reinsurer

Our captive reinsurer, Equator Re, produced a combined operating ratio of 86.9% for the half year after increasing risk margins in outstanding claims. Insurance profit was $44 million or 22.2% of net earned premium.

Equator Re provides excess of loss protections for most of QBE's subsidiaries around the world below the retentions deemed appropriate for the Group. Equator Re also participates on a number of the Group's excess of loss and proportional reinsurance protections placed with external reinsurers and has, for the first time, provided quota share protections to our Lloyd's syndicates. The exposures written by Equator Re are included in the Group's maximum event retention.

Gross written premium for the half year was up 112% to $517 million and net earned premium increased 52% to $198 million. The main reasons for the increase were the higher premium rates achieved on excess of loss protections, particularly for US catastrophe exposed risks, and the new quota share arrangements provided to our Lloyd's syndicates.

We mentioned in the 2005 annual report that we expected Equator Re would increase its premium income from proportional reinsurance from our insurance divisions and, at the same time, not substantially increase its exposure to any one catastrophe.

## Acquisitions

We have again been successful with acquisitions during the period. Our acquisition activity has resulted in additional annualised premium for the Group of $350 million. We acquired a general aviation business in Denmark, a new general aviation team for our Lloyd's operations and, subject to definitive agreements and regulatory approvals, a farm and agricultural portfolio in the mid-west states of the US.

## The impact of exchange rate movements

Consistent with our previous reports, we set out in the table on page 5 the impact of exchange rate movements for the first half of 2006. The Group translates income and expense items using the year to date cumulative average rates of exchange. Balance sheet items are translated at the closing rates of exchange. The impact of exchange rate movements for the half year was minimal.

## Outlook

We achieved an overall weighted average increase in premium rates for the Group for the six months of close to 6.5%. This is well in excess of our expectations of around 4% advised in our 2005 annual report and at the 2006 Annual General Meeting. Substantial premium rate increases were achieved on our property insurance and reinsurance portfolios exposed to catastrophes in the northern hemisphere and by our marine and energy Lloyd's syndicates. These rate increases were partly offset by reductions in premium rates for our profitable large portfolio of non-US casualty products and other products in our APACE division. Premium rates at the 30 June renewal date saw overall premium rate increases slightly ahead of the six months weighted average for the Group, but continued pressure remains on non-US casualty products and across most lines in Australia. The Group's ratio of net claims of less than $2.5 million to net earned premium ("attritional loss ratio") is not showing any material increase.

## Contributions by region

| | **Gross written premium** | | **Net earned premium** | | **Net profit after income tax** | | **Combined operating ratio** | |
|---|---|---|---|---|---|---|---|---|
| **for the half year ended 30 June** | **2006 $M** | **2005 $M** | **2006 $M** | **2005 $M** | **2006 $M** | **2005 $M** | **2006 %** | **2005 %** |
| Australia | **1,291** | 1,255 | **1,031** | 1,004 | **184** | 166 | **82.7** | 86.2 |
| Pacific Asia Central Europe | **345** | 358 | **265** | 260 | **39** | 34 | **83.0** | 88.8 |
| QBE Insurance (Europe) | **1,370** | 1,407 | **1,081** | 971 | **159** | 148 | **90.8** | 90.2 |
| Lloyd's division | **1,667** | 1,393 | **877** | 786 | **121** | 91 | **90.3** | 96.2 |
| the Americas | **983** | 710 | **546** | 355 | **47** | 28 | **91.0** | 93.2 |
| Equator Re | **517** | 244 | **198** | 130 | **41** | 24 | **86.9** | 83.1 |
| Elimination – internal reinsurance | **(517)** | (244) | **–** | – | **–** | – | **–** | – |
| Group | **5,656** | 5,123 | **3,998** | 3,506 | **591** | 491 | **87.9** | 90.3 |
| General insurance | **4,139** | 3,816 | **2,951** | 2,768 | **503** | 373 | **86.0** | 90.3 |
| Inward reinsurance | **1,517** | 1,307 | **1,047** | 738 | **88** | 118 | **93.6** | 90.4 |
| Group | **5,656** | 5,123 | **3,998** | 3,506 | **591** | 491 | **87.9** | 90.3 |

The overall premium rate increases expected for the full year together with acquisitions and higher customer retention give us confidence of increasing gross written premium to $10.3 billion and net earned premium to $8.4 billion for 2006. This is of course subject to no material appreciation of the Australian dollar against overseas currencies, particularly the US dollar and sterling.

As previously mentioned, the Group's probability of adequacy of outstanding claims is slightly in excess of the high end of our internal target range. In addition, our unearned premium liabilities include a significant allowance for large losses and catastrophes in the second half. In the US, we have increased deductibles, changed attachment points and cancelled property direct and reinsurance and marine reinsurance business for catastrophe exposed areas where the reward for the risk was deemed to be insufficient to meet our profit criteria.

We continue to maintain a cautious approach and a relatively low exposure to listed equities at 7.9% of total investments and cash. We also continue to actively manage and limit interest rate volatility through our quality short duration fixed interest and cash portfolios which average around 0.8 years to maturity. Investment income will further benefit from the higher interest rates in the US, UK and Australia in the second half. We expect to increase our net invested funds from $16.0 billion to $17.5 billion by the end of 2006 due to expected strong cash flow in the second half of the year.

We have a number of acquisitions that are currently being investigated and it is possible that we will convert some of them by year end. Prices for large acquisitions have increased significantly in recent times to a level, in most cases, that exceeds our valuation criteria. We are therefore concentrating on small to medium opportunities which can be bolted on to existing businesses. We have sufficient capital to finance up to $1.5 billion of additional net written premium. We are confident that our current level of capital and debt together with expected profit is sufficient for our current acquisition activity, and we will continue to review the level of capital to maximise the return to shareholders.

We will continue to pursue a strategy of maintaining a well diversified spread of business both geographically and by product which has, over a long period, proved beneficial to shareholders. We continue to lead terms and conditions on most of the business that we write around the world. Although competition has increased in most markets, our pricing is still at a level which enables us to meet the profit targets for the substantial majority of our portfolios. Attritional claims ratios for the half year across the Group are slightly less than 47% which leaves a significant allowance for large losses and catastrophes to meet our revised full year profit targets for 2006. The strength and focus of our management, professional underwriting teams and support staff also give us confidence that we will achieve our goals over the short and long term.

We have been successful in retaining a large portion of our customers during the period to 30 June. In some cases we have had to reduce prices to reflect the level of our profitability, particularly for our large non-US casualty portfolios. We are prepared to lapse business where the price does not meet our requirements for profitability. Statistical analysis of our various portfolios around the world, actions taken on some parts of these portfolios and our risk selection have enabled us to keep attritional loss ratios at levels in line with our business plans.

Our focused and hard-working teams should be very satisfied with the performance of the Group for the half year and the solid position that we hold in the majority of markets in which we operate. Our staff are well aware of the need to focus on our core values, especially the creation of wealth for shareholders which comes from improved profitability.

Subject to large losses and catastrophes not exceeding the substantial allowance in our insurance liabilities, we are confident that we can exceed our previously advised insurance profit target of 16.0% to 17.0% and achieve a margin of 17.0% to 18.0% for the full year.

# Australia Pacific Asia Central Europe

The APACE division, which comprises operations in 26 countries, produced another outstanding underwriting result. The combined operating ratio for the half year was 82.8% compared with 86.7% for the same period last year. The results have been achieved after a further increase in risk margins in outstanding claims.

Gross written premium for the half year increased 1% to $1,636 million. Net earned premium was up 3% to $1,296 million. Growth has been affected by increased competition and a slight overall reduction in premium rates for the division, which was expected given the strong combined operating ratios achieved in recent years.

While increased competition has meant premium rates for the majority of products are lower than last year, price adjustments also reflect our lower claims costs. Overall, insurance margins are very strong and premium rates are at levels sufficient to achieve our profit expectations.

Insurance profit for APACE increased by 23% to $316 million or, as a percentage of net earned premium, up from 20.3% to a very healthy 24.4%.

## Australia

Australian operations continued to produce excellent underwriting results. The combined operating ratio was 82.7% compared with 86.2% for the same period last year. Insurance profit as a percentage of net earned premium improved from 21.4% to an outstanding 25.2%. The result has benefited from a continued focus on insurance profitability, risk selection and controlling attritional loss ratios.

Gross written premium increased 3% to $1,291 million and net earned premium was up 3% to $1,031 million. An increase in the retention of customers and organic growth were partly offset by an overall reduction in premium rates to reflect our lower claims costs and competition. Overall premium rate reductions were less than expected.

QBE continues to be a market leader in most of the commercial products that it underwrites in the Australian market. We have experienced a marginal increase in attritional loss ratios in some portfolios from the lower pricing. Customer retention continues to be extremely high for business that we wish to retain. The majority of our portfolios in Australia produced underwriting results ahead of plan. The main exceptions were property and agricultural portfolios which were affected by claims from Cyclone Larry and the travel portfolio which was impacted by the Egyptian bus crash in January.

The claims ratio was 55.2% compared with 59.1% for the same period last year. The continued low level of attritional claims assisted the improvement in the claims ratio. Prior year development of longer tail classes such as workers' compensation, liability and CTP has been positive.

## Key ratios – Australia Pacific Asia Central Europe

| | | Australia | | PACE | | APACE | |
|---|---|---|---|---|---|---|---|
| **for the half year ended 30 June** | | **2006** | **2005** | **2006** | **2005** | **2006** | **2005** |
| Gross written premium | $M | **1,291** | 1,255 | **345** | 358 | **1,636** | 1,613 |
| Gross earned premium | $M | **1,213** | 1,199 | **335** | 348 | **1,548** | 1,547 |
| Net earned premium | $M | **1,031** | 1,004 | **265** | 260 | **1,296** | 1,264 |
| Claims ratio | % | **55.2** | 59.1 | **40.8** | 44.6 | **52.3** | 56.1 |
| Commission ratio | % | **13.1** | 14.3 | **19.6** | 19.2 | **14.4** | 15.3 |
| Expense ratio | % | **14.4** | 12.8 | **22.6** | 25.0 | **16.1** | 15.3 |
| Combined operating ratio | % | **82.7** | 86.2 | **83.0** | 88.8 | **82.8** | 86.7 |
| Insurance profit to net earned premium | % | **25.2** | 21.4 | **21.1** | 15.8 | **24.4** | 20.3 |

## Portfolio mix – Australia

| **Gross earned premium for the half year ended 30 June** | **2006 %** | **2005 %** |
|---|---|---|
| Professional indemnity | **5.9** | 5.2 |
| Credit and surety | **4.3** | 4.6 |
| Accident and health | **8.4** | 6.5 |
| Property | **14.3** | 17.6 |
| Motor vehicle | **9.8** | 9.0 |
| Travel | **1.6** | 1.7 |
| Householders | **10.2** | 10.8 |
| Compulsory third party ("CTP") | **7.2** | 7.5 |
| General liability | **19.8** | 18.4 |
| Workers' compensation | **8.6** | 8.3 |
| Marine and aviation | **4.6** | 4.6 |
| Other | **5.3** | 5.8 |

However, these releases have been added to risk margins in outstanding claims during the half year to further increase the probability of adequacy levels.

The commission ratio decreased from 14.3% to 13.1%, reflecting the benefits of acquiring distribution agencies in 2004 and 2005. The expense ratio increased from 12.8% to 14.4% mainly from merging IT systems and the expenses of the new agencies.

For 30 June renewals, premium rates slightly decreased for the majority of commercial and personal lines classes of business to reflect the continued low claims frequency and increased competition. We are confident that current pricing is sufficient to enable us to achieve our profit expectations for the various portfolios that we underwrite. Pricing is only one part of the equation. Our ability to manage the attritional loss ratio and other key profit drivers and retention of our quality customers are also a significant part of that equation.

We expect that gross written premium for 2006 will be around $2.5 billion. We also expect to maintain our insurance margin above 20% for the rest of the year. However, as mentioned in the 2005 annual report, we expect our insurance margins in Australia to decline slightly in 2007 to reflect the reduction in pricing in recent times.

## Pacific Asia Central Europe ("PACE")

Our PACE operations produced another very strong underwriting result. The combined operating ratio was 83.0% compared with 88.8% for the same period last year. The substantial majority of the countries in which PACE carries on business produced an underwriting profit for the half year. Insurance profit increased from 15.8% of net earned premium to an outstanding 21.1%.

Gross written premium decreased by 4% to $345 million. Premium growth was affected by increased competition, particularly in the Asian and New Zealand markets for large corporate risks and motor business. Net earned premium increased by 2% to $265 million, reflecting the benefits of Group reinsurance protections and change in business mix.

The claims ratio remains very low at 40.8% compared with 44.6% for the same period last year. The reduction in the claims ratio reflects the focus on controlling attritional loss ratios. Large loss and catastrophe claims increased slightly during this half year.

The commission ratio was up slightly at 19.6% due to higher agency commissions on profitable business. The expense ratio reduced from 25.0% to 22.6% due to business improvement efficiencies, partly offset by higher costs of the initial implementation of new IT systems in the majority of countries in which we operate.

We continue to increase business retention and grow our specialist product lines through international and local insurance brokers. We have considered a number of acquisitions in the PACE region that can be bolted on to existing operations or which will take us into new countries. The acquisition of the general aviation business in March is one example. Unfortunately, prices of acquisitions have increased significantly which has meant that we have not been as successful as we would have liked. We are not interested in acquiring minority shareholdings. Our policy has always been to have management control and at least a 50% shareholding to ensure that we remain the master of our destiny.

We are satisfied that current premium rates are sufficient to meet our profit criteria for the majority of products that we write throughout PACE. We expect that gross written premium for the full year will be around $0.7 billion. We have excellent businesses throughout Asia-Pacific and Central Europe, and we are confident of meeting our targets for 2006.

## Summary

The recent price reductions in many of the countries in which APACE writes business have been countered by our underwriting, risk selection and statistical analysis which have enabled us to control the attritional loss ratios. However, as mentioned in our 2005 annual report, we do expect that our excellent combined operating ratios will slightly deteriorate in 2007. We are starting to see the benefits of the merger of Australian operations and PACE in 2005 and the large acquisition made in Australia in June 2004.

We are confident that APACE can achieve gross written premium of around $3.2 billion and our profitability targets for 2006, subject to the usual caveats on large losses and catastrophes.

## Portfolio mix – PACE

| **Gross earned premium for the half year ended 30 June** | **2006 %** | **2005 %** |
|---|---|---|
| Professional indemnity | **11.9** | 10.1 |
| Marine | **13.2** | 10.8 |
| Workers' compensation | **6.0** | 5.7 |
| Motor and motor casualty | **18.1** | 18.5 |
| Property | **24.1** | 25.0 |
| Accident and health | **8.1** | 7.2 |
| Liability | **7.3** | 6.8 |
| Engineering | **3.5** | 3.0 |
| Travel | **2.4** | 3.6 |
| Householders | **3.8** | 3.7 |
| Other | **1.6** | 5.6 |

# European operations

QBE's European operations comprise QBE Insurance (Europe) ("QIE") and our Lloyd's division, trading as Limit.

The combined operating ratio for European operations was an excellent 90.6% compared with 92.9% for the same period last year. The strong underwriting results reflect our focus on portfolio profitability and a relatively low level of catastrophes in the first half. Insurance profit increased by 37% to $320 million and, as a percentage of net earned premium, improved from 13.3% to 16.3%.

Gross written premium for European operations increased by 9% to $3,037 million and net earned premium increased 11% to $1,958 million. The increase is in line with our business plan and reflects strong business retention, acquisitions made in 2005 and increased premium rates for catastrophe exposed property, marine and energy risks. These were offset partly by rate reductions for other classes, particularly our non-US casualty portfolios.

## QBE Insurance (Europe)

QIE writes insurance business in the UK, Ireland, France, Germany, Italy, Luxembourg and Spain, and reinsurance business in Ireland.

Gross written premium was down 3% to $1,370 million due to the transfer of reinsurance business to Limit, generally increased competition and lower premium rates. These were partly offset by income from the acquisitions in 2005, in particular British Marine. Growth in gross written premium excluding reinsurance business transferred was 9%. Net earned premium increased by 11% to $1,081 million due to acquisitions in 2005, a change in business mix and consolidation of reinsurance protections. Premium growth for our significant non-US casualty portfolios has been affected by lower premium rates, although this was expected and largely factored into our business plans. Competition remains, on the whole, disciplined with the hard earned improvements in terms and conditions of recent years generally being maintained.

The combined operating ratio was 90.8% compared with 90.2% for the same period last year. The slight deterioration in the combined operating ratio reflects the casualty premium rate reductions, two large property risk losses and additional risk margins included in outstanding claims in the half year. Insurance profit increased by 29% to $182 million or, as a percentage of net earned premium, it improved from 14.5% to 16.8%. The acquisitions made in 2005 have performed in line with expectations.

The claims ratio was 63.1%, up slightly from the same period last year for the reasons highlighted in the previous paragraph. It is pleasing to see attritional loss ratios remain low even though premium rates have reduced in the past 18 months for most of the classes underwritten by QIE.

The commission ratio was 15.8% compared with 15.6% for the same period last year. The slight increase is due to the change in mix of business. The expense ratio was

## Key ratios – European operations

| for the half year ended 30 June | | QBE Insurance (Europe) 2006 | QBE Insurance (Europe) 2005 | Lloyd's division 2006 | Lloyd's division 2005 | European operations 2006 | European operations 2005 |
|---|---|---|---|---|---|---|---|
| Gross written premium | $M | **1,370** | 1,407 | **1,667** | 1,393 | **3,037** | 2,800 |
| Gross earned premium | $M | **1,280** | 1,138 | **1,201** | 1,015 | **2,481** | 2,153 |
| Net earned premium | $M | **1,081** | 971 | **877** | 786 | **1,958** | 1,757 |
| Claims ratio | % | **63.1** | 62.7 | **58.9** | 64.8 | **61.3** | 63.6 |
| Commission ratio | % | **15.8** | 15.6 | **21.0** | 19.2 | **18.1** | 17.2 |
| Expense ratio | % | **11.9** | 11.9 | **10.4** | 12.2 | **11.2** | 12.1 |
| Combined operating ratio | % | **90.8** | 90.2 | **90.3** | 96.2 | **90.6** | 92.9 |
| Insurance profit to net earned premium | % | **16.8** | 14.5 | **15.7** | 11.8 | **16.3** | 13.3 |

## Portfolio mix – QBE Insurance (Europe)

| Gross earned premium for the half year ended 30 June | 2006 % | 2005 % |
|---|---|---|
| Professional indemnity | **15.0** | 13.7 |
| Financial and credit | **3.2** | 2.2 |
| Marine and aviation | **8.8** | 2.5 |
| Accident and health | **2.1** | 4.1 |
| Bloodstock | **2.3** | 2.3 |
| Property treaty | **4.5** | 5.5 |
| Property facultative and direct | **9.6** | 11.0 |
| Workers' compensation | **11.3** | 14.7 |
| Motor vehicle | **21.9** | 15.9 |
| Casualty | **2.1** | 5.0 |
| Public/product liability | **16.5** | 19.7 |
| Other | **2.7** | 3.4 |

11.9%, unchanged from the same period last year. Savings in expenses from the synergies following the restructures in 2004 and 2005 were offset by the cost of implementing new IT systems and the further rationalisation of premises.

Current pricing is sufficient to meet the profit requirements of the majority of our portfolios. We are confident that we can maintain strong combined operating ratios through 2006, subject to large losses and catastrophes not exceeding the significant allowance in our insurance liabilities.

## Limit

Limit is the manager of our Lloyd's syndicates and provider of around £1 billion of capacity at Lloyd's for 2006.

Gross written premium was up 20% and net earned premium was up 12%. Growth was assisted by the increases in premium rates for catastrophe exposed property, marine and energy risks and the transfer of treaty reinsurance business from QIE. Premium growth has been held back slightly by our decision to cancel some catastrophe exposed property and energy risks where the rewards for the risks were not deemed to be sufficient. In particular, we reduced our exposure to US nationwide property reinsurance, certain types of property risks in wind exposed territories and energy exposures in the Gulf of Mexico. Net earned premium has been affected by the new quota share reinsurance to our captive reinsurer, Equator Re.

The combined operating ratio was an excellent 90.3% compared with 96.2% for the same period last year. Insurance profit increased by 48% to $138 million or 15.7% of net earned premium compared with 11.8% for the same period last year. The claims ratio reduced from 64.8% to 58.9%. The improved claims ratio reflects the continued low attritional claims, a relatively low level of catastrophes in the half year and the absence of upgrades of old US casualty claims provisions in runoff syndicates. Risk margins in outstanding claims have been increased.

The commission ratio was 21.0% compared with 19.2% due to a slight change in mix of business. The expense ratio was lower at 10.4% compared with 12.2% last year, reflecting savings from the management restructures in 2004 and 2005.

The substantial increases in premium rates for catastrophe exposed property, marine and energy classes have enabled our 100% owned syndicates to increase our premium expectations by 4% for 2006. Rate reductions for the non-US casualty portfolios underwritten by our 69% owned syndicate 386 have been broadly in line with plan reflecting the anticipated increased competition in response to the high margins and lower claims cost of recent years. Current premium rates remain sufficient to meet the profit requirements for the majority of our portfolios.

The strength of our insurance liabilities and our lower risk profile, together with our leading position in the Lloyd's market, give us confidence that we will achieve our full year profit targets, subject to the usual caveats in respect of large losses and catastrophes.

## Summary

The restructure of our European operations during 2004 and 2005 has enabled us to achieve a number of synergies. We expect further expense reductions to be realised in the next few years. We have successfully merged several of our reinsurance protections, consolidated our management teams and premises in the UK and have been successful with the initial implementation of new IT systems to meet our future needs.

Overall, premium rates have increased during the half year by more than expected when we announced our 2005 results. We have been able to increase pricing significantly in the catastrophe exposed property and energy portfolios and, at the same time, reduce the risk profile through higher deductibles and cancelling business where the reward for the risk was insufficient. As expected, premium rates for casualty classes, which include professional liability, general liability and employers' liability (all predominantly ex-US) have reduced. We have comprehensive statistical information to enable us to monitor and manage the impact of price movements on our attritional loss ratios.

We continue to look at a number of opportunities to achieve growth for 2007. We have been fortunate to hire a new team which will begin writing aviation business from 1 October 2006. The focus will be predominantly on general aviation, a new class of business for our London operation but one which QBE has successfully written in the APACE division for a number of years.

As with other operations in QBE, insurance liabilities include a substantial allowance for large losses and catastrophes in the second half of 2006. This, together with the quality of our portfolios, gives us confidence regarding our performance for the rest of 2006 and the achievement of gross written premium of around $5.1 billion.

## Portfolio mix – Lloyd's division

| Gross earned premium for the half year ended 30 June | 2006 % | 2005 % |
|---|---|---|
| Professional indemnity | **10.8** | 13.8 |
| Marine and aviation | **15.3** | 12.2 |
| Property | **43.1** | 34.7 |
| Casualty | **27.3** | 34.8 |
| Motor | **0.6** | 3.3 |
| Other | **2.9** | 1.2 |

## the Americas

QBE the Americas comprises general insurance and reinsurance businesses in the US and a number of countries in Latin America.

The combined operating ratio for the half year was an excellent 91.0% compared with 93.2% for the same period last year. The combined operating ratio reflects careful risk selection and growth of our primary insurance business over the past five years assisted by rate increases for the majority of products during the half year. Overall premium rates have significantly increased since the hurricane losses in 2005. Insurance profit was up 89% to $68 million, or 12.5% of net earned premium compared with 10.1% for the same period last year.

Gross written premium increased 38% to $983 million and net earned premium increased 54% to $546 million. The substantial increase is due to acquisitions made in 2005 and the increase in premium rates, partly offset by increased competition in some of our regional portfolios in the US. The higher growth in net earned premium compared with gross written premium reflects reduced proportional reinsurance ceded and the lower cost of reinsurance for the acquisitions made in 2005.

General insurance business now represents 76% of gross written premium compared with 71% for the same period last year. This is in line with our strategy and is mainly as a consequence of the acquisition of the National Farmers Union Property and Casualty Company ("NFU") and Central de Seguros ("QBE Colombia") in 2005 and our continued focus on building our general insurance business throughout the Americas. As in previous years, many of our general insurance programme portfolios continue to be protected by proportional reinsurance with highly rated reinsurers.

The claims ratio for the half year was 57.8% compared with 62.0% for the same period last year. The 2003, 2004 and 2005 underwriting years continue to produce excellent results while year to date reported claims for 2006 have been much lower than expected. The claims ratio for the half year is after increasing risk margins in outstanding claims.

The commission ratio was unchanged from the same period last year at 24.2%. The expense ratio increased from 7.0% to 9.0% mainly due to the higher proportion of general insurance business following the acquisition of NFU and QBE Colombia in 2005.

All our general insurance and reinsurance portfolios in the US and Latin America produced insurance profits for the half year. Our new acquisitions, NFU and QBE Colombia, produced combined operating ratios of 84.9% and 94.0% respectively.

We continue to focus on diversification in selected regional portfolios in the US and Latin America that are relatively stable over longer periods and not exposed to market cycles. In support of this strategy, we are in the process of acquiring a portfolio of farm and agricultural insurance business in the mid-west states of the US.

Overall premium rate increases achieved are ahead of plan during the first half of 2006. We continually review our exposure to catastrophes and vary our underwriting strategy and risk appetite to improve the reward for the risks we underwrite throughout the Americas. We are now perceived as a leader in the segments of the market in which we operate. We continue to avoid writing long tail US casualty, including US workers' compensation business.

We are on target to produce around $2.0 billion of gross written premium in 2006. Our allowances for large losses and catastrophes in our insurance liabilities remain prudent and comprehensive reinsurance protections are in place for the second half of the year. The continued strong underwriting performances from our various teams give us confidence that the Americas will again achieve its profit targets for 2006.

### Key ratios – the Americas

| **for the half year ended 30 June** | | **2006** | **2005** |
|---|---|---|---|
| Gross written premium | $M | **983** | 710 |
| Gross earned premium | $M | **903** | 631 |
| Net earned premium | $M | **546** | 355 |
| Claims ratio | % | **57.8** | 62.0 |
| Commission ratio | % | **24.2** | 24.2 |
| Expense ratio | % | **9.0** | 7.0 |
| Combined operating ratio | % | **91.0** | 93.2 |
| Insurance profit to net earned premium | % | **12.5** | 10.1 |

### Portfolio mix – the Americas

| **Gross earned premium for the half year ended 30 June** | **2006 %** | **2005 %** |
|---|---|---|
| Property | **38.3** | 35.9 |
| Casualty | **22.5** | 27.7 |
| Motor and motor casualty | **16.3** | 13.3 |
| Accident and health | **13.0** | 17.5 |
| Workers' compensation | **3.0** | 2.7 |
| Other | **6.9** | 2.9 |

# Investments

Gross investment income for the half year was $403 million compared with $409 million for the same period last year. The gross yield was 4.5% compared with 5.3%. The current gross yield is below our full year target of 5.0% mainly due to lower gains on our equity portfolio. Gross investment income includes net realised and unrealised gains and losses on equities. Realised and unrealised gains on equities before tax were $15 million compared with gains of $55 million for the same period last year. Investment income has been assisted by higher interest rates, our short duration fixed income strategy and the active management of fixed interest portfolios. Interest income was up 21% to $340 million.

Net investment income before tax for the half year, which is net of borrowing costs, exchange gains and losses and investment expenses was slightly down from $337 million to $331 million. The lower gains on equities compared with the same period last year held back the growth in investment income.

Cash flow for the six months and exchange rate movements resulted in net invested funds increasing to $16.0 billion at 30 June 2006 compared with $15.5 billion at 31 December 2005. We continue to maintain a policy of matching liabilities with assets of the same currency and managing all "tradeable" overseas shareholders' funds back into Australian dollars.

We outperformed the cash and fixed interest markets due to our short duration strategy, however, we underperformed on equities because of our strategy to remain under-invested for the majority of the half year. We increased our exposure to equities from 3.8% of our total investment portfolio at 31 December 2005 to 8.0% at 30 June 2006. During the period, a substantial portion of our equity portfolio was protected against upward and downward movements of the major stock exchange indices by derivatives.

Our low risk absolute return strategy remains in place. In the current environment, this means a relatively short duration fixed income portfolio of 0.8 years, and gradually, on a selected basis, rebuilding our equity portfolio held mainly to support our shareholders' funds to no more than 10% of total investments and cash.

The recent increases in interest rates on our substantial US, UK and Australian cash and fixed interest portfolios will assist investment income in the next six months. We will continue to actively manage our investment portfolio in line with our low risk absolute return strategy. Subject to there being no material fall in equity markets, we are confident of a further improvement in overall investment yields and investment income in the second half of 2006.

## Investment income

| **for the half year ended 30 June** | **2006 $M** | **2005 $M** |
|---|---|---|
| Dividends | **22** | 25 |
| Interest | **340** | 281 |
| Other income | **7** | 9 |
| | **369** | 315 |
| Realised gains on fixed interest securities | **32** | 17 |
| Realised gains on equities | **26** | 38 |
| Unrealised (losses) gains on fixed interest securities | **(13)** | 22 |
| Unrealised (losses) gains on equities | **(11)** | 17 |
| Net fair value gains on financial assets | **34** | 94 |
| Gross investment income | **403** | 409 |

## Total investments and cash

| | **30 June 2006 $M** | **30 June 2006 %** | **31 December 2005 $M** | **31 December 2005 %** |
|---|---|---|---|---|
| Cash and cash equivalents | **1,752** | **9.6** | 1,061 | 6.0 |
| Short term money | **7,172** | **39.5** | 8,292 | 47.1 |
| Fixed interest securities and other | **7,746** | **42.7** | 7,537 | 42.9 |
| Equities | **1,461** | **8.0** | 674 | 3.8 |
| Investment properties | **34** | **0.2** | 33 | 0.2 |
| Total investments and cash | **18,165** | **100.0** | 17,597 | 100.0 |

## Market value of equities

| **as at 30 June** | **2006 %** | **2005 %** |
|---|---|---|
| Australian dollar | **40** | 34 |
| US dollar | **18** | 27 |
| Sterling | **32** | 27 |
| Other | **10** | 12 |

## Market value of total investments and cash

| **as at 30 June** | **2006 %** | **2005 %** |
|---|---|---|
| Australian dollar | **28** | 30 |
| US dollar | **26** | 22 |
| Sterling | **34** | 35 |
| Other | **12** | 13 |

# Directors' report

for the half year ended 30 June 2006

Your directors present their report on the consolidated entity consisting of QBE Insurance Group Limited and the entities it controlled at the end of or during the half year ended 30 June 2006.

## Directors

The following directors held office during the half year and up to the date of this report:
EJ Cloney (chairman)
LF Bleasel AM
The Hon NF Greiner AC
IF Hudson
BJ Hutchinson
CLA Irby
IYL Lee
FM O'Halloran

## Consolidated results

| **for the half year ended 30 June** | **2006 $M** | **2005 $M** |
|---|---|---|
| REVENUE | | |
| Premium revenue | **4,932** | 4,331 |
| Other revenue | **1,018** | 780 |
| Net fair value gains on financial assets | **34** | 94 |
| Investment income – ABC financial assets pledged for funds at Lloyd's | **88** | 60 |
| | **6,072** | 5,265 |
| EXPENSES | | |
| Outward reinsurance premium expense | **934** | 825 |
| Gross claims incurred | **2,968** | 2,606 |
| Other expenses | **1,205** | 1,046 |
| Expenses – ABC securities for funds at Lloyd's | **99** | 67 |
| Finance costs | **57** | 46 |
| **Profit before income tax** | **809** | 675 |
| Income tax expense | **214** | 181 |
| **Profit after income tax** | **595** | 494 |
| Net profit attributable to minority interest | **4** | 3 |
| **Net profit after income tax attributable to members of the company** | **591** | 491 |

## Profit

The directors are pleased to announce a 20% increase in net profit after income tax to $591 million for the half year ended 30 June 2006 compared with $491 million for the same period last year. The significant increase in profit reflects the benefit of the Group's geographic spread, product diversification, premium growth from acquisitions and improved insurance margins.

## Dividends

The directors are also pleased to announce a 21% increase in the interim dividend to 40.0 cents per share, 60% franked. The interim dividend for the same period last year was 33.0 cents per share, 50% franked. The dividend payout will be $322 million compared with $254 million for the same period last year. The Dividend Election Plan and the Dividend Reinvestment Plan have been suspended due to our strong capital adequacy.

## Shareholders' funds

Shareholders' funds increased from $5,093 million at 31 December 2005 to $5,565 million at 30 June 2006. The number of shares advised to the Australian Stock Exchange increased from 794 million at 31 December 2005 to 804 million at 30 June 2006 mainly due to the reinvestment of dividends and the issue of shares under staff incentive plans.

## Review of operations

Gross earned premium was $4,932 million, an increase of 14% over the same period last year. Premium growth was assisted by the acquisitions made in 2005, improved customer retention and an overall increase in premium rates ahead of expectations. Net earned premium increased 14% to $3,998 million. Reinsurance costs reduced to just less than 19% of gross earned premium even though we incurred higher reinsurance costs to protect our inwards reinsurance business and to slightly reduce our maximum event retention as a percentage of net earned premium compared with 2005 levels.

The ratio of claims, commissions and expenses to net earned premium (combined operating ratio) was 87.9% compared with 90.3% for the same period last year. The net claims ratio was 58.3% compared with 61.0% for the same period last year. The improvement in the net claims ratio was assisted by overall increases in premium rates and the continued low frequency of claims. The commission ratio increased from 17.0% to 17.6%, reflecting a change in the mix of business. The expense ratio was 12.0%, down from 12.3% for the same period last year. The reduction reflects further synergies from acquisitions and restructures, partly offset by increased costs of implementing new systems in many of our operations.

**Australia Pacific Asia Central Europe**

Australian general insurance combined operating ratio was 82.7% compared with 86.2% for the same period last year. The result benefited from a continued focus on insurance profitability, risk selection and the control of attritional loss ratios. Net earned premium of $1,031 million was up 3% from the same period last year. Increased customer retention and organic growth were partly offset by an overall reduction in premium rates to reflect our lower claims costs and competition. The claims ratio decreased from 59.1% to 55.2%. The commission ratio decreased from 14.3% to 13.1% mainly due to benefits from the acquisition of underwriting agencies in 2004 and 2005. The expense ratio increased from 12.8% to 14.4% due to merging IT systems and the expenses of the new agencies.

Pacific Asia Central Europe combined operating ratio was 83.0% compared with 88.8% for the same period last year. Net earned premium increased by 2% to $265 million, and was affected by increased competition, particularly in Asia and New Zealand. The claims ratio decreased from 44.6% to 40.8% reflecting our focus on controlling attritional loss ratios. The commission ratio increased slightly from 19.2% to 19.6% due to higher agency commissions and the expense ratio reduced from 25.0% to 22.6%. Expenses benefited from business improvement efficiencies, partly offset by higher costs of the initial implementation of new IT systems in the majority of countries in which we operate.

**European operations**

This division comprises our company operations, QBE Insurance (Europe), and our Lloyd's business.

QBE Insurance (Europe), which has operations in the UK, Ireland, France, Germany, Italy, Luxembourg and Spain, reported net earned premium growth of 11% to $1,081 million mainly due to acquisitions in 2005. The division produced a combined operating ratio of 90.8% compared with 90.2% for the same period last year. The slight deterioration reflects casualty premium rate reductions, two large property risk losses and additional risk margins in outstanding claims. The net claims ratio was 63.1%, up slightly from the same period last year. The commission ratio increased slightly from 15.6% to 15.8% from a change in the mix of business, and the expense ratio was unchanged at 11.9%. Savings in expenses from the synergies following the restructures in 2004 and 2005 were offset by the cost of implementing new IT systems and the rationalisation of premises.

Lloyd's division combined operating ratio was 90.3% compared with 96.2% for the same period last year. Net earned premium increased 12% to $877 million, assisted by increases in premium rates for catastrophe exposed property, marine and energy risks and the transfer of reinsurance business from QBE Insurance (Europe). The claims ratio reduced from 64.8% to 58.9% reflecting the continued low level of attritional claims, a relatively low level of catastrophes in the half year and the absence of upgrades of old US casualty claims provisions in runoff syndicates. The commission ratio increased to 21.0% from 19.2% due to a slight change in the mix of business. The expense ratio decreased from 12.2% for the same period last year to 10.4%, reflecting savings from the management restructures in 2004 and 2005.

**the Americas**

This division reported net earned premium growth of 54% to $546 million due to acquisitions made in 2005 and the increase in premium rates, partly offset by increased competition in some portfolios. The combined operating ratio was 91.0% compared with 93.2% for the same period last year, reflecting careful risk selection and a continued low frequency of claims. The net claims ratio reduced from 62.0% to 57.8%. The commission ratio was unchanged at 24.2%. The expense ratio increased from 7.0% to 9.0% mainly due to the higher proportion of general insurance business following the acquisitions in 2005.

# Directors' report continued

for the half year ended 30 June 2006

The provision for **outstanding claims** is determined after consultation with internal and external actuaries. The outstanding claims assessment takes into account the statistical analysis of past claims, allowance for claims incurred but not reported, recoveries and future interest and inflation factors. The Australian Prudential Regulation Authority ("APRA") prudential standards provide that, for our Australian licensed insurers, outstanding claims should be set at a level that provides a probability of at least 75% that the provision for outstanding claims will be adequate to settle claims as they become payable in the future. As in previous years, the directors consider that risk margins are required in addition to APRA's minimum requirements to cover uncertainties such as latency claims, changes in interest rates and superimposed inflation. The directors have satisfied themselves that the Group's outstanding claims provision substantially exceeds APRA's minimum requirement.

**Net investment income** fell 2% to $331 million. The lower gains on equities compared with the same period last year held back growth. The result includes net fair value gains before tax on equities of $15 million ($55 million gain for the same period last year) and foreign exchange gains of $14 million ($9 million loss for the same period last year). The gross investment yield before borrowing costs, exchange gains and losses and investment expenses was 4.5% compared with 5.3% for the same period last year.

**Income tax** expense for the period reduced slightly to 26.5% of profit before tax, primarily due to profits in lower tax paying countries.

## Auditor's independence declaration

A copy of the auditor's independence declaration as required under section 307C of the *Corporations Act 2001* is set out on page 17.

## Rounding of amounts

The company is of a kind referred to in the Australian Securities and Investments Commission class order 98/0100 dated 10 July 1998 (as amended by class order 04/667 dated 15 July 2004) relating to the "rounding off" of amounts in the consolidated financial statements and in the directors' report. Amounts have been rounded off in the financial report and the directors' report to the nearest million dollars in accordance with that class order.

Signed in SYDNEY this 16th day of August 2006 in accordance with a resolution of the directors.

EJ Cloney
Director

FM O'Halloran
Director

## Auditor's independence declaration

As lead auditor for the review of QBE Insurance Group Limited for the half year ended 30 June 2006, I declare that, to the best of my knowledge and belief, there have been:

(a) no contraventions of the auditor independence requirements of the *Corporations Act 2001* in relation to the review; and

(b) no contraventions of any applicable code of professional conduct in relation to the review.

This declaration is in respect of QBE Insurance Group Limited and the entities it controlled during the period.

PricewaterhouseCoopers

RD Deutsch
Partner

Sydney, 16 August 2006

Liability limited by a scheme approved under Professional Standards Legislation

# Consolidated income statement

for the half year ended 30 June 2006

| | Note | 2006 $M | 2005 $M |
|---|---|---|---|
| REVENUE | | | |
| Premium revenue | | **4,932** | 4,331 |
| Other revenue | | **1,018** | 780 |
| Net fair value gains on financial assets | | **34** | 94 |
| Investment income – ABC financial assets pledged for funds at Lloyd's | | **88** | 60 |
| | 2 | **6,072** | 5,265 |
| EXPENSES | | | |
| Outward reinsurance premium expense | | **934** | 825 |
| Gross claims incurred | | **2,968** | 2,606 |
| Other expenses | | **1,205** | 1,046 |
| Expenses – ABC securities for funds at Lloyd's | | **99** | 67 |
| Finance costs | | **57** | 46 |
| **Profit before income tax** | 3 | **809** | 675 |
| Income tax expense | | **214** | 181 |
| **Profit after income tax** | | **595** | 494 |
| Net profit attributable to minority interest | | **4** | 3 |
| **Net profit after income tax attributable to members of the company** | | **591** | 491 |

| | Note | Cents | Cents |
|---|---|---|---|
| Basic earnings per share | 4 | **74.6** | 65.4 |
| Diluted earnings per share | 4 | **71.0** | 60.8 |

The above consolidated income statement should be read in conjunction with the accompanying notes.

# Consolidated balance sheet

as at 30 June 2006

| | Note | 30 June 2006 $M | 31 December 2005 $M | 30 June 2005 $M |
|---|---|---|---|---|
| CURRENT ASSETS | | | | |
| Cash and cash equivalents | | **1,752** | 1,061 | 1,492 |
| Receivables | | **4,966** | 3,607 | 4,210 |
| Reinsurance and other recoveries on outstanding claims | | **1,396** | 1,357 | 868 |
| Deferred insurance costs | | **1,651** | 1,446 | 1,674 |
| Financial assets at fair value through the income statement | | **8,233** | 9,411 | 6,226 |
| Derivative financial instruments | | **65** | 82 | 102 |
| Current tax assets | | **6** | – | 7 |
| Other current assets | | **3** | 4 | 1 |
| **Total current assets** | | **18,072** | 16,968 | 14,580 |
| NON-CURRENT ASSETS | | | | |
| Reinsurance and other recoveries on outstanding claims | | **2,823** | 2,856 | 2,369 |
| Financial assets at fair value through the income statement | | **8,146** | 7,092 | 7,972 |
| Investment properties | | **34** | 33 | 31 |
| ABC financial assets pledged for funds at Lloyd's | | **1,040** | 1,032 | 1,005 |
| Property, plant and equipment | | **247** | 232 | 200 |
| Intangible assets | | **1,389** | 1,382 | 1,056 |
| Deferred tax assets | | **52** | 67 | 120 |
| Defined benefit retirement surplus | | **16** | 2 | 3 |
| Other non-current assets | | **38** | 1 | 29 |
| **Total non-current assets** | | **13,785** | 12,697 | 12,785 |
| **Total assets** | | **31,857** | 29,665 | 27,365 |
| CURRENT LIABILITIES | | | | |
| Trade and other payables | | **1,585** | 1,282 | 1,469 |
| Outstanding claims | | **5,168** | 4,904 | 3,862 |
| Unearned premium | | **5,135** | 4,287 | 4,740 |
| Interest bearing liabilities | | **400** | 400 | – |
| Derivative financial instruments | | **75** | 35 | 30 |
| Current tax liabilities | | **189** | 162 | 128 |
| Provisions | | **2** | 2 | – |
| **Total current liabilities** | | **12,554** | 11,072 | 10,229 |
| NON-CURRENT LIABILITIES | | | | |
| Outstanding claims | | **10,546** | 10,179 | 9,373 |
| Interest bearing liabilities | | **1,763** | 1,730 | 1,742 |
| Swaps relating to ABC securities | | **63** | 29 | 13 |
| ABC securities for funds at Lloyd's | | **994** | 1,015 | 992 |
| Deferred tax liabilities | | **245** | 251 | 193 |
| Provisions | | **51** | 62 | 55 |
| Defined benefit retirement obligations | | **14** | 168 | 222 |
| **Total non-current liabilities** | | **13,676** | 13,434 | 12,590 |
| **Total liabilities** | | **26,230** | 24,506 | 22,819 |
| **Net assets** | | **5,627** | 5,159 | 4,546 |
| EQUITY | | | | |
| Share capital | 5 | **3,335** | 3,195 | 2,965 |
| Equity component of hybrid securities | | **108** | 108 | 108 |
| Reserves | | **(5)** | (20) | (35) |
| Retained profits | | **2,127** | 1,810 | 1,448 |
| **Shareholders' funds** | | **5,565** | 5,093 | 4,486 |
| Minority interest | | **62** | 66 | 60 |
| **Total equity** | | **5,627** | 5,159 | 4,546 |

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

# Consolidated statement of recognised income and expense

for the half year ended 30 June 2006

| | 2006 $M | 2005 $M |
|---|---|---|
| AMOUNTS RECOGNISED IN EQUITY | | |
| Net increase (decrease) in foreign currency translation reserve | **8** | (17) |
| Actuarial gains (losses) on defined benefit retirement obligations, net of tax | **18** | (20) |
| Cash flow hedges, net of tax | **7** | (3) |
| Employee share options, net of tax | **–** | 14 |
| Net income (expense) recognised directly in equity | **33** | (26) |
| AMOUNTS RECOGNISED IN INCOME STATEMENT | | |
| Profit after income tax | **595** | 494 |
| **Total recognised income and expense for the period** | **628** | 468 |
| Attributable to: | | |
| Equity holders | **624** | 465 |
| Minority interest | **4** | 3 |
| | **628** | 468 |

The above consolidated statement of recognised income and expense should be read in conjunction with the accompanying notes.

# Consolidated statement of cash flows

for the half year ended 30 June 2006

| | 2006 $M | 2005 $M |
|---|---|---|
| OPERATING ACTIVITIES | | |
| Premium received | **4,918** | 4,338 |
| Reinsurance and other recoveries received | **762** | 427 |
| Outwards reinsurance paid | **(885)** | (781) |
| Claims paid | **(3,000)** | (2,206) |
| Insurance costs paid | **(1,034)** | (876) |
| Other underwriting costs | **(412)** | (292) |
| Interest received | **318** | 276 |
| Dividends received | **19** | 21 |
| Other operating income | **9** | 1 |
| Other operating payments[1] | **(147)** | (95) |
| Interest paid | **(35)** | (40) |
| Income taxes paid | **(191)** | (101) |
| **Net cash flows from operating activities** | **322** | 672 |
| INVESTING ACTIVITIES | | |
| Proceeds on sale of equity investments | **1,684** | 393 |
| Proceeds on sale of investment property | **–** | 1 |
| Proceeds on sale of property, plant and equipment | **–** | 1 |
| Payments for purchase of equity investments | **(2,431)** | (311) |
| (Payments for) proceeds from foreign exchange transactions | **(45)** | 126 |
| Proceeds from (payments for) purchase of other financial assets | **1,376** | (359) |
| Purchase of controlled entities (net of cash acquired) | **(13)** | (42) |
| Proceeds on disposal of controlled entities | **4** | – |
| Payments for purchase of investment property | **(1)** | – |
| Payments for purchase of property, plant and equipment | **(29)** | (36) |
| **Net cash flows from investing activities** | **545** | (227) |
| FINANCING ACTIVITIES | | |
| Proceeds from issue of shares under staff share scheme | **34** | 19 |
| Share issue expenses | **(3)** | – |
| Dividends paid | **(175)** | (107) |
| **Net cash flows from financing activities** | **(144)** | (88) |
| NET INCREASE IN CASH AND CASH EQUIVALENTS HELD | **723** | 357 |
| Cash and cash equivalents at the beginning of the half year | **1,061** | 1,121 |
| Effect of exchange rate changes on opening cash and cash equivalents | **(32)** | 14 |
| **Cash and cash equivalents at the end of the half year** | **1,752** | 1,492 |

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

[1] Current year includes payments of $128 million to fund defined benefit retirement obligations.

# Notes to the consolidated financial statements
for the half year ended 30 June 2006

## 1. Basis of preparation of half year financial report

This general purpose consolidated financial report for the half year ended 30 June 2006 has been prepared in accordance with Accounting Standard AASB 134: Interim Financial Reporting and the *Corporations Act 2001*.

The financial report for the half year ended 30 June 2006 does not include all the notes normally included in an annual financial report. Accordingly, it is recommended that this report be read in conjunction with the annual report for the financial year ended 31 December 2005 and any public announcements made by QBE Insurance Group Limited and its controlled entities ("the consolidated entity") during the half year in accordance with any continuous disclosure obligations arising under the *Corporations Act 2001*.

The accounting policies adopted are consistent with those of the previous financial year and corresponding interim reporting period.

### (A) Australian accounting standards issued but not yet effective

| Title | | Operative date |
|---|---|---|
| 2005-10 | Amendments to Australian Accounting Standards (AASB 132, AASB 101, AASB 114, AASB 117, AASB 133, AASB 139, AASB 1, AASB 4, AASB 1023 and AASB 1038) | 1 January 2007 |
| AASB 7 | Financial Instruments: Disclosures | 1 January 2007 |

These amendments are not effective for the year ended 31 December 2006 and have not been applied in preparing the consolidated entity's financial statements. The impact of the application of these standards is disclosure only.

The consolidated entity will apply these standards for the annual reporting periods beginning on or after the operative dates set out above.

## 2. Revenue

| | 2006 $M | 2005 $M |
|---|---|---|
| **Revenue from ordinary activities** | | |
| Direct | **3,766** | 3,437 |
| Inward reinsurance | **1,166** | 894 |
| | **4,932** | 4,331 |
| **Other revenue** | | |
| Reinsurance and other recoveries | **635** | 465 |
| Interest and dividend income | **369** | 315 |
| Foreign exchange gains | **14** | – |
| | **1,018** | 780 |
| Net fair value gains on financial assets[1] | **34** | 94 |
| Investment income – ABC financial assets pledged for funds at Lloyd's | **88** | 60 |
| **Revenue** | **6,072** | 5,265 |

[1] Includes realised gains of $58 million (2005 $55 million).

## 3. Profit before income tax

| | 2006 $M | 2005 $M |
|---|---|---|
| Gross written premium | **5,656** | 5,123 |
| Unearned premium movement | **(724)** | (792) |
| Gross earned premium | **4,932** | 4,331 |
| Outward reinsurance premium | **(1,083)** | (968) |
| Deferred reinsurance premium movement | **149** | 143 |
| Outward reinsurance premium expense | **(934)** | (825) |
| Net earned premium | **3,998** | 3,506 |
| Gross claims incurred | **(2,968)** | (2,606) |
| Reinsurance and other recoveries | **635** | 465 |
| Net claims incurred | **(2,333)** | (2,141) |
| Net commission | **(702)** | (596) |
| Other acquisition costs | **(259)** | (225) |
| Underwriting and other expenses | **(222)** | (205) |
| | **(3,516)** | (3,167) |
| **Underwriting profit** | **482** | 339 |
| Investment income on policyholders' funds | **266** | 214 |
| **Insurance profit** | **748** | 553 |
| Investment income on shareholders' funds | **65** | 123 |
| Amortisation of intangibles and impairment of goodwill/intangibles | **(4)** | (1) |
| **Profit before income tax** | **809** | 675 |

## 4. Earnings per share

| | 2006 Cents | 2005 Cents |
|---|---|---|
| Basic earnings per share | **74.6** | 65.4 |
| Diluted earnings per share | **71.0** | 60.8 |

| | $M | $M |
|---|---|---|
| **Reconciliation of earnings used in calculating earnings per share** | | |
| Net profit after income tax attributable to members of the company used in calculating basic earnings per share | **591** | 491 |
| Add: finance costs of hybrid securities | **1** | 3 |
| Earnings used in calculating diluted earnings per share | **592** | 494 |

| | Millions | Millions |
|---|---|---|
| Weighted average number of ordinary shares used as the denominator in calculating: | | |
| Basic earnings per share | **791** | 750 |
| Diluted earnings per share | **834** | 812 |

Hybrid securities have been treated as dilutive if the contingent conversion conditions are met at the balance date. If all hybrid securities had been considered dilutive at 30 June 2006, and applying issued share capital notified to the ASX, diluted earnings per share would have been 69.1 cents (2005 59.2 cents).

Weighted average number of ordinary shares reflects shares adjusted: (a) to derecognise shares issued under the Employee Share and Option Plan ("the Plan"); and (b) to reflect the elimination of own shares. Basic earnings per share calculated with reference to issued share capital notified to the ASX would have been 73.9 cents (2005 64.6 cents). Refer to note 5.

## 5. Share capital

| | 2006 $M | 2005 $M |
|---|---|---|
| Issued ordinary shares, fully paid | **3,353** | 2,965 |
| Own shares[1] | **(18)** | – |
| | **3,335** | 2,965 |

| | Number of shares 000 | $M |
|---|---|---|
| **Issued and fully paid at 1 January 2005** | 734,609 | 2,780 |
| Shares issued under the Employee Share and Option Plan | 2,257 | 19 |
| Vendor options exercised | 865 | – |
| Shares issued under Dividend Reinvestment Plan | 6,639 | 97 |
| Shares issued under Dividend Election Plan | 1,610 | – |
| Shares issued to holders of hybrid securities | 12,324 | 69 |
| Shares issued under the long term incentive scheme on vesting of conditional rights | 356 | – |
| **Issued and fully paid at 30 June 2005** | 758,660 | 2,965 |
| | | |
| **Issued and fully paid at 1 January 2006** | **785,294** | **3,195** |
| Shares issued under the Employee Share and Option Plan | **1,021** | **7** |
| Employee options exercised | **3,379** | **30** |
| Vendor options exercised | **332** | **7** |
| Shares issued under Dividend Reinvestment Plan | **5,741** | **117** |
| Shares issued under Dividend Election Plan | **473** | **–** |
| Shares issued to holders of hybrid securities | **55** | **–** |
| Shares issued under the long term incentive scheme on vesting of conditional rights | **238** | **–** |
| Share issue expenses | **–** | **(3)** |
| Bonus shares | **2** | **–** |
| **Issued and fully paid at 30 June 2006** | **796,535** | **3,353** |
| Shares notified to the Australian Stock Exchange | **803,730** | **3,414** |
| Less: Plan shares subject to non-recourse loans, derecognised under Australian GAAP | **(7,195)** | **(61)** |
| **Issued and fully paid at 30 June 2006** | **796,535** | **3,353** |

[1] Own shares represents shares purchased by the consolidated entity to meet obligations under share incentive plans. Issued ordinary shares are reduced by these shares on consolidation.

## 6. Dividends

| | 2006 $M | 2005 $M |
|---|---|---|
| Final dividend paid on ordinary shares | | |
| Franked at 50% – 19.0 cents (2005 15.0 cents) | **151** | 114 |
| Unfranked – 19.0 cents (2005 15.0 cents) | **151** | 114 |
| | **302** | 228 |
| Dividend reinvested under the Dividend Election Plan | **(10)** | (24) |
| **Total dividend paid** | **292** | 204 |

The final dividend of $302 million for 2005 was paid on 29 March 2006. On 16 August 2006 the directors declared a 60% franked interim dividend of 40.0 cents per share (2005 33.0 cents per share, 50% franked). The interim dividend is $322 million (2005 $254 million), payable on 14 September 2006.

The company has a Dividend Reinvestment Plan ("DRP") and a Dividend Election Plan ("DEP"). The directors suspended the 2.5% discount on shares issued under these plans in August 2005. The directors have now suspended the DRP and the DEP due to the consolidated entity's strong capital adequacy.

## 7. Contingent liabilities

| | 30 June 2006 $M | 31 December 2005 $M |
|---|---|---|
| Letters of credit issued in support of the consolidated entity's participation in Lloyd's of London | **373** | 235 |

A controlled entity has entered into a number of deeds of covenant in respect of its controlled entities to meet part of their obligations to Lloyd's of London. The total guarantee given under these deeds of covenant is $415 million ($316 million at 31 December 2005). The obligations under the deeds of covenant are secured by a fixed and floating charge over certain investments and other assets in favour of Lloyd's of London.

## 8. Segment information

| | Revenue | | Profit before income tax | |
|---|---|---|---|---|
| | 2006 $M | 2005 $M | 2006 $M | 2005 $M |
| Australia Pacific Asia Central Europe | **1,772** | 1,782 | **313** | 279 |
| European operations | **3,181** | 2,670 | **379** | 328 |
| the Americas | **1,117** | 808 | **70** | 42 |
| Equator Re | **274** | 148 | **47** | 26 |
| Elimination – internal reinsurance | **(272)** | (143) | **–** | – |
| **Total** | **6,072** | 5,265 | **809** | 675 |

## 9. Events occurring after the balance sheet date

In July 2006, the consolidated entity raised £300 million through the issue of non-voting, non-cumulative perpetual preferred securities ("capital securities"). The capital securities will generally entitle holders to receive semi-annual, non-cumulative preferential cash distributions at a fixed rate of 6.9% per annum until July 2016, and thereafter quarterly distributions at a floating rate of 2.9% above the London interbank offered rate for three month sterling deposits.

# Directors' declaration

The directors declare that the financial statements and notes set out on pages 18 to 25:

(a) comply with Accounting Standards, the Corporations Regulations 2001 and other mandatory professional reporting requirements; and

(b) give a true and fair view of the consolidated entity's financial position as at 30 June 2006 and of its performance, as represented by the results of its operations and its cash flows, for the half year ended on that date.

In the directors' opinion, the financial statements and notes are in accordance with the *Corporations Act 2001*, including sections 304 (compliance with accounting standards) and 305 (true and fair view) and there are reasonable grounds to believe that QBE Insurance Group Limited will be able to pay its debts as and when they become due and payable.

Signed in SYDNEY this 16th day of August 2006 in accordance with a resolution of the directors.

EJ Cloney
Director

FM O'Halloran
Director

# Independent review report

to the members of QBE Insurance Group Limited

## Statement

Based on our review, which is not an audit, we have not become aware of any matter that makes us believe that the financial report of QBE Insurance Group Limited:

- does not give a true and fair view, as required by the *Corporations Act 2001* in Australia, of the financial position of the QBE Insurance Group (defined below) as at 30 June 2006 and of its performance for the half year ended on that date; and
- is not presented in accordance with the *Corporations Act 2001*, Accounting Standard AASB 134: Interim Financial Reporting and other mandatory financial reporting requirements in Australia, and the Corporations Regulations 2001.

This statement must be read in conjunction with the rest of our review report.

## Scope

### The financial report and directors' responsibility

The financial report comprises the balance sheet, income statement, statement of recognised income and expense, statement of cash flows, accompanying notes to the financial statements, and the directors' declaration for the QBE Insurance Group ("the consolidated entity"), for the half year ended 30 June 2006. The consolidated entity comprises both QBE Insurance Group Limited ("the company") and the entities it controlled during that half year.

The directors of the company are responsible for the preparation and true and fair presentation of the financial report in accordance with the *Corporations Act 2001*. This includes responsibility for the maintenance of adequate accounting records and internal controls that are designed to prevent and detect fraud and error, and for the accounting policies and accounting estimates inherent in the financial report.

### Review approach

We conducted an independent review in order for the company to lodge the financial report with the Australian Securities and Investments Commission. Our review was conducted in accordance with Australian Auditing Standards applicable to review engagements. For further explanation of a review, visit our website http://www.pwc.com/au/financialstatementaudit.

We performed procedures in order to state whether, on the basis of the procedures described, anything has come to our attention that would indicate that the financial report does not present fairly, in accordance with the *Corporations Act 2001*, Accounting Standard AASB 134: Interim Financial Reporting and other mandatory financial reporting requirements in Australia, a view which is consistent with our understanding of the consolidated entity's financial position, and its performance as represented by the results of its operations and cash flows.

We formed our statement on the basis of the review procedures performed, which included:

- inquiries of company personnel; and
- analytical procedures applied to financial data.

Our procedures include reading the other information included with the financial report to determine whether it contains any material inconsistencies with the financial report.

These procedures do not provide all the evidence that would be required in an audit, thus the level of assurance provided is less than that given in an audit. We have not performed an audit, and accordingly, we do not express an audit opinion.

While we considered the effectiveness of management's internal controls over financial reporting when determining the nature and extent of our procedures, our review was not designed to provide assurance on internal controls.

Our review did not involve an analysis of the prudence of business decisions made by directors or management.

## Independence

In conducting our review, we followed applicable independence requirements of Australian professional ethical pronouncements and the *Corporations Act 2001*.

PricewaterhouseCoopers

PricewaterhouseCoopers

RD Deutsch
Partner

Sydney, 16 August 2006

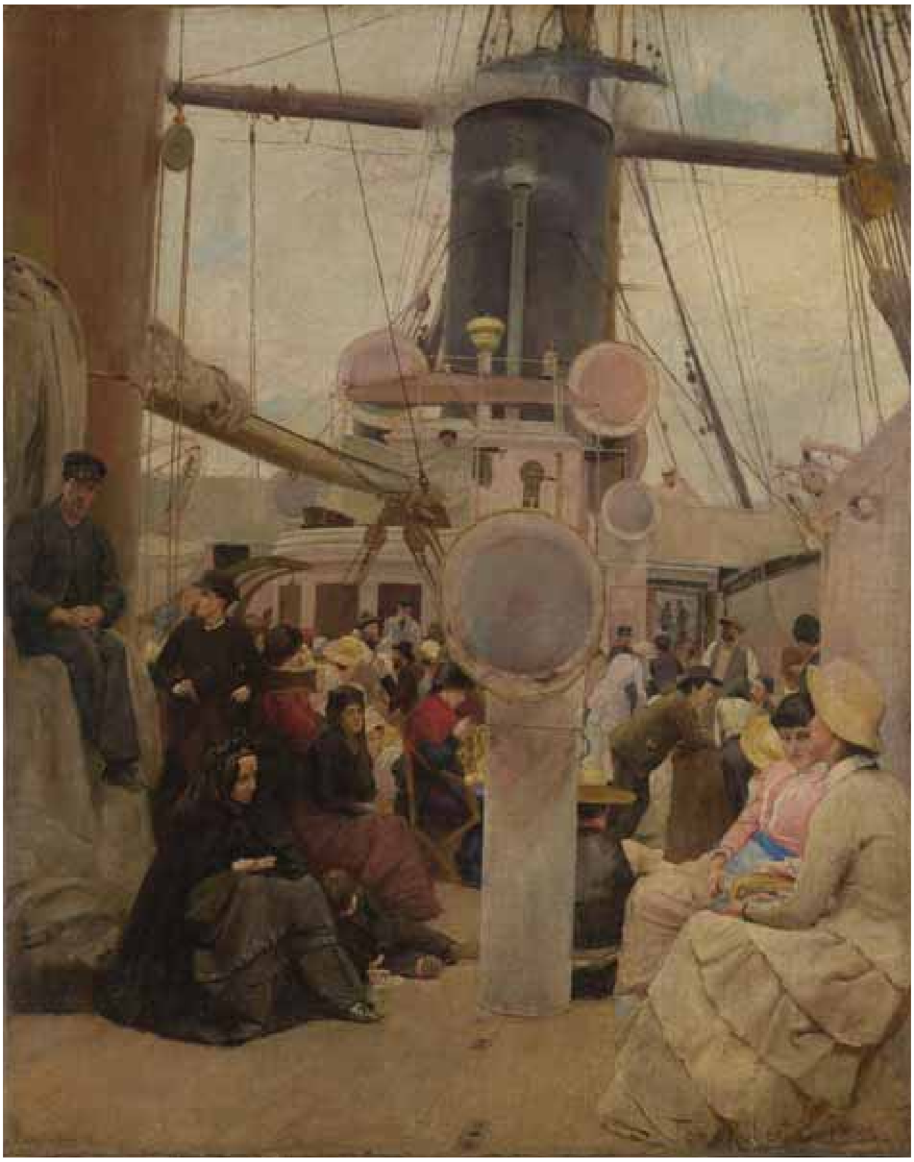
Liability limited by a scheme approved under Professional Standards Legislation

For further information
please refer to our website
www.qbe.com

## In 2006, QBE celebrates the 120th anniversary of the formation of its founding company, The North Queensland Insurance Company Limited.

In 1883, James Burns, the founder of Burns, Philp & Co Limited, established a fleet of ships operating out of Townsville, a harbour in the far north of Australia, servicing shipping and trading on the Australian east coast and neighbouring islands. Together with an agency for the Australian United Steam Navigation Co, James Burns shrewdly capitalised on the growth in trade and marine transport in the region. Out of this business was born The North Queensland Insurance Company Limited, formed in 1886 and providing marine insurance cover for the extensive Burns Philp fleet and commercial interests.

The famous Australian artist Tom Roberts travelled aboard the SS *Lusitania* in 1885 when he returned to Australia after four years in Europe. His sketches of the crowded deck provided the basis for the painting below which was completed in 1886, and captures the type of vessel and passengers typical of voyages up and down the Australian coast from the far North Queensland ports to Brisbane and Sydney.



Tom Roberts *Born England 1856, arrived Australia 1869, lived in Europe 1881–85 and 1903–19, died 1931.*

*Coming South* 1886 oil on canvas, 63.5 x 52.2 cm

*Gift of Colonel Aubrey H. L. Gibson in memory of John and Anne Gibson, settlers (1887), 1967*
*National Gallery of Victoria, Melbourne.*

QBE Insurance Group Limited

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