
QBE European Operations plc (formerly QBE International Holdings (UK) plc)

Annual Report

31 December 2011

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Registered Number 02641728

QBE EUROPEAN OPERATIONS PLC

FINANCIAL STATEMENTS

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QBE EUROPEAN OPERATIONS PLC

CHIEF EXECUTIVE OFFICER'S REVIEW

In 2011 QBE EO achieved a pre-tax profit of £83.2 million, an insurance profit margin of 5.3% and a return on allocated capital* of 16.3%

2011 was a challenging year. The London market was heavily exposed to floods in Thailand, the effects of storms in Australia and the US, and earthquakes in New Zealand and Japan, these all had an impact on our reinsurance, marine and direct property lines of business. In addition, there was an abnormally large number of marine and energy risk claims in our onshore and offshore energy portfolios. Our combined operating ratio for 2011 was 96.6%, which is a strong performance considering the market conditions and when compared with the majority of our peers. Our strategy of diversity by product and geographic spread assisted and we also benefited, on a net basis, from extensive reinsurance protection.

Fundamentally, our underlying underwriting margin and profitability remain sound and we maintained our focus on retaining quality clients in what continued to be soft markets, while inadequate pricing in many classes put pressure on the acquisition of new business.

Significant rate increases in energy and catastrophe had an impact on renewals, particularly for Australian and Japanese reinsurance, and worldwide energy clients. In June and July, we also increased rates for US catastrophe reinsurance renewals and for international property business. UK commercial motor rates increased by at least 5% for most clients, in response to poor market results and inflated bodily injury claims, although in other classes – particularly UK and European property and casualty – markets continued to be extremely competitive. Our overall average rate increase in 2011 was around 2%.

Investment market conditions are currently very unsettled, yields are low, and there is no sign of a material increase in interest rates while economies continue to be depressed and the European debt crisis persists.

Acquisition and integration

Our Belgian reinsurer, Secura NV, which was acquired in November 2010 is performing well ahead of expectations. Its integration is beginning to have a significantly beneficial effect on our reinsurance capabilities and on our presence in continental Europe. Its premium income for the year was £203 million. Secura NV had no exposure to the 2011 catastrophes, which demonstrates the benefits of diversification that this acquisition brings to QBE EO.

The European debt crisis has caused significant anxiety and investment market volatility around the world, resulting in an impairment of a number of balance sheets as insurers and banks revalue their investment portfolios and related assets to the lower market value. This unsettled environment has led to an increase in merger and acquisition opportunities, but to date, with the exception of the renewal rights for Brit Insurance UK regional operations, none of them have met our strict criteria. We believe, however, that opportunities in Europe will increase as the full impact of regulatory changes, particularly Solvency II criteria, are better understood and adopted.

Distribution Division restructure

Following a strategic review of the business, we decided to transfer the management of the UK National Distribution channel into the Property, Casualty and Motor Division. This enables us to develop our UK and Ireland regional business by facilitating a common leadership and strategy, by optimising underwriting empowerment and by enabling commercial managers to make full use of their local expertise and relationships.

I am confident that this structural consolidation will help us develop our ability to provide excellent products and services to our brokers and clients in the UK and Ireland, and will provide a strong platform for continued profitable growth.

Patrick Coene's appointment to the new role of Managing Director, European Markets, is expected to create additional market opportunities for QBE EO. Previously Chief Executive Officer of Amlin Corporate Insurance, Patrick brings with him a wealth of underwriting and management experience.

Transformational project

In 2009 we launched a major transformational project to create a market-leading operational support model. This project, which will be completed in Q1 2012, will deliver improved functionality for our underwriters and claims operating staff.

* Return excluding QBE EO's internal reinsurance arrangement with other Divisions within QBE

QBE EUROPEAN OPERATIONS PLC

CHIEF EXECUTIVE OFFICER'S REVIEW (continued)

Solvency II

Solvency II, is a fundamental review of the regulatory requirements for insurance companies across Europe. It will result in a new regulatory regime that is expected to change capital requirements, risk management standards and disclosure requirements for the insurance industry across Europe. It is expected to be implemented on 1 January 2014.

QBE EO has invested significant resources in ensuring that it is prepared to meet the new standards and capital requirements. We participated in all the relevant submissions to Lloyd's and the Association of British Insurers. In October 2011, our syndicates were awarded "green light" status under the Lloyd's traffic light system that is currently being used to measure Solvency II readiness. Similar progress has been made by our regulated companies, although benchmarking is not yet in place for them.

We are confident that our systems and internal processes will comply with the new regulatory requirements and that our insurance carriers will be able to meet the minimum capital requirements when Solvency II is implemented.

Brand development

Building a strong and visible brand is a key component for QBE's development and we have been driving this with our rugby sponsorship. We have been official partners of England Rugby and Premiership Rugby since late 2009, and have been the insurance partner for Glasgow Warriors since 2011.

Most recently, we signed a four season agreement with the RFU to become the title sponsor of the prestigious QBE Internationals, the games which feature England playing against the best of the Southern Hemisphere at Twickenham. This tournament will start in November 2012 and provides us a wider range of brand, business development and employee engagement opportunities.

Employee engagement

Managing our commercial business is, on its own, not enough to create long-term success. The engagement of our people is equally important in achieving our strategic ambition of being recognised as Europe's leading specialist insurer and reinsurer for business. We are committed to developing our employees and improving their performance by understanding what it is that makes them "go the extra mile".

During 2011, we carried out a number of research initiatives and reviews to gain a better understanding of our employees' experience of working with us. As a result, we are now in the process of creating an Engagement Charter.

This will cover

- a definition of engagement for QBE EO,
- our commitment to employee engagement as a top strategic priority, and
- a plan for 2011-2014, that focuses around engaging leadership, managing people effectively, powerful internal communications, and a more cohesive QBE culture.

QBE EO's enduring success is largely the result of its employees' hard work and I thank them all for their endeavours, and the contribution they made during the year.

I am confident that our culture and business model will enable us to continue our proven track record of growth, disciplined underwriting and uncompromising focus on outperformance, and allow us to deliver strong results.

QBE EUROPEAN OPERATIONS PLC

KEY PERFORMANCE INDICATORS

Group operating performance

		2011	2010	Change %
Gross written premium	£'m	3,020	2,695	12.1
Net earned premium	£'m	1,967	1,674	17.5
Underwriting profit	£'m	67	121	(44.6)
Insurance profit	£'m	86	187	(54.0)
Profit for financial year	£'m	95	194	(51.0)
Combined operating ratio (COR)	%	96.6	92.8	3.8
Insurance profit to net earned premium	%	4.4	11.2	(6.8)
Return on allocated capital*	%	16.3	19.7	(3.4)

* Return excluding QBE EO's internal reinsurance arrangement with other Divisions within QBE

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QBE EUROPEAN OPERATIONS PLC

CORPORATE GOVERNANCE

Overview and basis of reporting

QBE EO's board governance structure is shown in the chart opposite. Our key committees and their respective roles and responsibilities are summarised on pages 7 to 8.

The committees all comprise appropriately skilled and experienced members, and operate under formal terms of reference. As an internal holding company of QBE, our board is not bound by the UK Corporate Governance Code but, as a matter of best practice, seeks to comply with it wherever possible.

The financial statements have been prepared in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

The board

The board comprises four executive directors and two QBE executive directors. There was one change to the board during the year. Kathy Lisson stepped down from her role as Chief Operating Officer (COO), effective 15 February 2011, to return to her native Canada. On Kathy's departure, David Winkett was appointed Chief Financial and Operating Officer.

The board meets regularly and is chaired by Frank O'Halloran, Chief Executive Officer of QBE Insurance Group Limited. The role of the Chairman is distinct from that of the CEO and the roles are both clearly established.

The board has an established policy in relation to the provision of non-audit services by the auditors. The objective is to ensure that the provision of such services does not impair the auditor's objectivity.

Key entities

The boards of these entities each have a schedule of matters reserved for their decision and are responsible for the overall management of the companies. This includes strategic matters, approval of financial statements and dividends, appointments and terminations of directors and auditors, delegation of authority, approval of major capital projects, structure and capital changes, and internal controls and risk management.

Our non-executive directors sit on the boards of our regulated entities as well as on the Audit Committee and other key committees as shown in the table on pages 7 to 8. Our non-executive directors are considered by the board to be independent of management and free from any relationship which could materially interfere with the exercise of their independent judgement.

Board performance

Board performance is evaluated on an ongoing basis and governance is reviewed to ensure that its performance meets regulatory, legal and business requirements.

The board's committees

The board has appointed and authorised a number of committees which operate within established terms of reference. QBE EO's key committees comprise:

Executive management committee,

- Audit committee,
- Underwriting and reinsurance review committee,
- Investment committee,
- Reserving committee,
- Internal audit committee, and
- Risk and capital committee.

Further detail on the rules and responsibilities of each of these committees is provided on pages 7 to 8.

QBE EUROPEAN OPERATIONS PLC

CORPORATE GOVERNANCE (continued)

Remuneration and nomination

QBE EO has adopted Group nomination processes, with a moderation panel held at local level and decisions signed off at Group level. Similarly, QBE EO has adopted the Group level remuneration policy, with a moderation panel held at local level and decisions signed off at Group level.

Accountability and internal control

QBE EO's activities expose it to a number of risks that could affect its ability to achieve its business objectives. The board, supported by the risk and capital committee, ensures that an appropriate structure for managing these risks is maintained. Since it is neither realistic nor desirable to eliminate risk entirely, the board seeks to ensure that appropriate controls are in place to manage risk effectively and to an agreed level of tolerance. QBE EO's risk management processes and systems are set out in more detail on pages 9 to 11.

Shareholder communications

As an internal holding company, EO plc does not have external shareholders, shareholder communications are, therefore, dealt with by QBE, which sends a half-yearly report to all shareholders who elect to receive it. Reports are available on QBE's website, www.qbe.com which also contains historical and other details on the Group. Shareholders can discuss their shareholding with the shareholder services department, or the share registrar, both of which are based in Sydney, Australia.

The Group's AGM is held in Sydney each year, usually in April. Shareholders are encouraged to attend the AGM in person, or by proxy. Most resolutions in the notice of meeting have explanatory notes. During the AGM, shareholders may question the Chairman or the external auditor.

Key Committees

Executive committee

Chairman : Steven Burns

Roles and responsibilities

- To formulate strategy for discussion and approval by the board
- The committee comprises all executive directors of the board, together with the Divisional Chief Underwriting Officers

Underwriting and reinsurance review committee

Chairman: Peter Grove

Roles and responsibilities

- To provide assurance that the control framework is appropriate and mitigates underwriting and reinsurance risk
- To review the framework (to ensure that it is consistent with that of QBE), the companies' policies and procedures, and legislative and regulatory requirements
- To contribute to change management projects to ensure that control weaknesses are identified, quantified and managed

Investment committee

Chairman: David Winkett

Roles and responsibilities

- To recommend to the board appropriate investment policies and guidelines for each of the companies' – and subsidiary companies' – funds
- To monitor the agreed investment strategy on a day-to-day basis

CORPORATE GOVERNANCE (continued)

Key Committees (continued)

Audit committee and its sub-committees

Audit committee

Chairman: Brian Pomeroy

Roles and responsibilities

- To assist the boards in discharging their oversight responsibilities
- Principal responsibilities include
 - overseeing the financial reporting process,
 - reviewing the effectiveness of the internal financial control and risk management system, and the internal audit function, and
 - overseeing the independent audit process, including recommending the appointment – and assessing the performance - of the external auditor
- In addition, overseeing the reserving committee, risk and capital committee and internal audit committee

Reserving committee

Chairman: Phil Dodridge

Roles and responsibilities

Undertaking a review of the reserve information in support of the accounts and the calculation of total reserves ensuring consistency with the standards required to attain satisfactory audit and actuarial opinion

Risk and capital committee

Chairman Phil Olsen

Roles and responsibilities

- Ensuring an embedded framework to manage risk and capital is in place
- Oversight of day-to-day activity relating to Solvency II

Internal audit committee

Chairman. Phil Olsen

Roles and responsibilities

- Provide assurance that an appropriate control framework is in place
- Ensure controls are functioning in practice and consistent with QBE and QBE EO procedures, together with legislative and regulatory requirements

QBE EUROPEAN OPERATIONS PLC

RISK MANAGEMENT

Risk management objectives

To create wealth for our shareholders, QBE EO must pursue opportunities that involve risk. Through robust risk management, QBE EO aims to

- achieve competitive advantage by better understanding the risk environments in which it operates
- optimise risk and more effectively allocate capital and resources by assessing the balance of risk and reward, and
- avoid unwelcome surprises by reducing uncertainty and volatility through the identification and management of risks to achieve our strategies and objectives

Strategy

QBE EO's risk management strategy puts structure to the risks that QBE EO is exposed to and defines the framework to manage those risks and meet strategic objectives.

Our defined and robust risk management framework sets out the risks to which we are exposed. In managing those risks to enable us to meet our strategic objectives, the creation of shareholder value is an important consideration. The framework comprises complementary elements that are embedded in our business management cycle and culture.

Risk management is integrated into QBE EO's quality business management process. By this we mean we link business strategy with business planning, and the evaluation and monitoring of performance.

Management culture

QBE maintains a strong risk management culture which, supported by its global risk management framework, protects and advances the interests of shareholders and policyholders.

The OPENUPQBE programme helps QBE achieve its strategic goals by promoting and maintaining a common culture throughout the business. It defines nine Essential Behaviours that involve the careful assessment of risk and reward. Risk management – particularly planning perspective, business acumen and entrepreneurship – is an integral part of Essential Behaviours, which enable opportunities to be identified, QBE EO's business activities to be maximised, and any potential downside to be limited. To be successful, all employees need to follow them.

Appetite

Risk appetite is the level of risk that the board and management are prepared to take in pursuit of the organisation's objectives.

It is managed

- through a set of risk appetite statements and risk tolerances
- through the business plan's capital adequacy objectives, including return on risk-adjusted capital and through detailed risk limits,
- within the delegation of authority from the board to the CEO and onward to the management team, and
- within QBE's policies that cover risk areas

Internal management model

QBE's internal risk management model is at the core of its framework. QBE EO has defined its internal model as an integrated framework to support its objectives by managing risk and capital across the business. The scope of our internal model extends beyond capital modelling to include risk identification, mitigation, assessment and monitoring.

Identification of risks

Risks which could affect QBE EO's ability to achieve its objectives are identified on a continuous basis. We support identification through an emerging risk process, which aims to identify and manage effectively those risks that we perceive as being potentially significant, but which may not yet be fully understood or allowed for in our decision-making activities.

QBE EUROPEAN OPERATIONS PLC

RISK MANAGEMENT (continued)

Internal management model (continued)

Mitigation of risks

Our control framework ensures that risks are managed in accordance with risk appetite. The control registers process ensures that risks have the appropriate controls in place, with the appropriate owners, and are regularly assessed.

Assessment and monitoring of risks

Our committees assess and monitor risk. Risk dashboards, which are used to support assessment decisions, provide information on stress and scenario tests, key risk indicators, control assessments, loss experience, and management action plans.

Exposure to catastrophe losses is assessed by realistic disaster scenarios, commercial catastrophe loss models and in-house catastrophe aggregate management tools.

Capital model

QBE uses a Group-wide economic capital model (ECM) to assess risk and to help determine the level of risk-based capital required for insurance, credit, market, liquidity and operational risks.

Economic capital is defined as the level of capital necessary to ensure that QBE can, with a pre-specified probability, satisfy its obligations on all policies issued before the end of the plan year. It is a measure of risk and is integral to the Group's business management cycle and risk management framework. Its allocation helps to ensure that risks taken by the business are commensurate with required returns and comply with the board's risk appetite. Economic capital enables QBE to make decisions which involve quantitative risk reward trade-offs and underpins the return on capital targets set for members of the Group's bonus schemes.

QBE EO's risk governance

Everyone at QBE EO is responsible for managing risks, as a result, a large number of people are involved in the process. Our risk governance is summarised as follows:

- 1 The board, underwriting Division and corporate services form the top level of our risk governance structure**
They have direct responsibility for risk management and control.
- 2 The risk and capital committee, enterprise risk management (ERM) function and other control functions form the second level of governance**
They are responsible for co-ordinating, facilitating and overseeing the risk framework's effectiveness and integrity. The ERM team's objective is to optimise return from risk by improving decision making, providing the enterprise risk framework, and reviewing and supporting its application, and by offering an independent viewpoint.
- 3 The audit committee, internal audit committee and internal audit function form the third level of governance**
They challenge the integrity and effectiveness of the framework and provide independent assurance, across all our business functions. More than 95% of QBE EO's outstanding claims provision is reviewed annually by independent external actuaries.

Business continuity management

A business continuity management framework ensures that QBE is resilient, and able to respond effectively to incidents that threaten business continuity. It also ensures that the impact of any major disruption is minimised.

The framework includes a set of emergency management plans, department-level business continuity plans and technology recovery plans. It is supported by a range of activities, including staff awareness and testing.

QBE EUROPEAN OPERATIONS PLC

RISK MANAGEMENT (continued)

The risk strategy and framework is applied to the following categories of risk

Strategic risk

QBE EO's strategy is to be recognised as the leading specialist insurer and reinsurer for business in Europe. We manage strategic risk by ensuring that it accords with the Group's targets on premium and profitability growth while, at the same time, maintaining our brand integrity. We manage strategic risks through a robust planning and change process, best practice corporate governance and appropriate safeguards on regulatory capital.

Insurance risk

QBE EO accepts appropriate insurance risk to enable it to meet its objectives. To ensure that we balance insurance risk with reward, all underwriting Divisions are expected to achieve measurable performance targets by operating within the limits and authorities of our risk appetite framework and business plans.

Business plan parameters include a range of limits and authorities, including maximum line size, premium allocation by class, sub-class and geographic spread, underwriting authorities, aggregation limits and reinsurance strategy. Business performance is measured by return on capital, where economic capital is allocated to business areas based on the level of assessed risk. Underwriters use benchmarking models to ensure the appropriate premium is charged for each risk exposure.

Credit risk

A certain amount of credit risk is unavoidable, as it can arise as a result of the inability or slow payment by counterparties. Exposure to credit risk is limited as far as practical and QBE EO has established detailed guidelines, security assessments, limits and monitoring requirements to mitigate credit risk.

Liquidity risk

The objectives with regard to liquidity risk management are to ensure that the business remains solvent by a significant margin, and all funding requirements can be met out of readily available sources of funding. The business maintains a strong liquidity position (by holding its assets in high quality liquid funds) and would meet any major unexpected cash outflow by using its existing resources as well as support provided by other companies within the Group.

Market risk

Exposure to market risk is managed through the investment strategy, which reflects the appetite of the board. The strategy is deliberately conservative in order to eliminate potential volatility from market fluctuations as much as possible whilst still delivering an acceptable absolute return.

Operational risk

The principal objective in managing operational risk is to identify, assess and manage risks, and to reduce any failures or inadequacies in processes, people and systems (including regulatory risk). We mitigate operational risk by ensuring that we have an effective infrastructure, robust systems and controls, and experienced and qualified individuals throughout the organisation.

Group risk

QBE EO derives significant benefits from being part of QBE and part of the Lloyd's Franchise, and primarily manages Group risk through its strong relationships with them. Our business objectives are aligned with QBE's strategy and with Lloyd's Franchise strategic imperatives, where appropriate, the boards follow relevant Group and franchise policies, guidelines and reporting requirements.

QBE EUROPEAN OPERATIONS PLC

DIRECTORS' REPORT

The directors present their report and the audited financial statements for the year ended 31 December 2011

Principal activity

QBE European Operations plc (the Company) is an investment holding company and the principal activity of its subsidiary undertakings continues to be the transaction of insurance and reinsurance business (together the Group). The Company and Group will continue these activities for the foreseeable future.

The Company is wholly owned by QBE Insurance Group Limited (QBE), an Australian listed company that prepares consolidated financial statements in accordance with Australian equivalents to International Financial Reporting Standards. These consolidated financial statements are prepared using UK Generally Accepted Accounting Practice. The Company is the holding company for the European Operations division (QBE EO) of QBE.

Business review and future developments

The results of the Group for the year are set out in the group profit and loss account and the statement of group total recognised gains and losses on pages 17 to 19. The profit for the year was £95,052,000 (2010 £194,159,000). A dividend was paid on the ordinary shares for the year of £596,693,000 (2010 £423,708,000) and a dividend of £3,361,000 was paid on the preference shares (2010 £6,292,000). Details of movements on reserves are set out in note 20.

On 16 May 2011, a Group company lent a further US\$200 million to QBE Investments (North America) Inc, funded by the surplus cash in the Group.

On 24 May 2011, as detailed in Note 24, the Group raised US\$1 billion and £325 million through the issue of 30 year fixed rate subordinated notes.

On 15 December 2011, the Company completed a Court approved capital reduction of £507,110,000 with £23,300,000 was returned to the minority equity shareholder and the remaining £483,810,000 was transferred to the profit and loss account. Detail on the capital reduction is set out in note 20.

On 29 December 2011, the Company changed its name to QBE European Operations plc, from QBE International Holdings (UK) plc, a name that reflects the role of the Company going forward.

On 16 February 2012, the Company paid an interim dividend of £356,700,000 to ordinary shareholders.

Key performance indicators (KPIs)

The directors monitor the progress of the Group by reference to the KPIs tabled on page 4.

Overseas operations

The Group has overseas operations in Australia, Belgium, Bulgaria, Canada, the Czech Republic, Denmark, Estonia, France, Germany, Hungary, Ireland, Italy, Macedonia, Romania, Singapore, Slovakia, Spain, Sweden, Switzerland, Ukraine and the United Arab Emirates.

Directors

Details of the current directors and those that served during the year are shown on page 5.

QBE EUROPEAN OPERATIONS PLC

DIRECTORS' REPORT (continued)

Creditor payment policy

The Company agrees terms with its suppliers when it enters into binding purchase contracts. The Company seeks to abide by the payment terms agreed with suppliers whenever it is satisfied that the supplier has provided the goods or services in accordance with the agreed terms and conditions.

The Group has on average 22 days creditors outstanding at 31 December 2011 (2010 30 days) based on the average daily amount invoiced by suppliers during the year.

Charitable donations

During the year the Group made donations for charitable purposes of £1,019,000 (2010 £40,000).

QBE's new global corporate responsibility initiative, The QBE Foundation, was officially launched in July 2011. The Foundation is a Group-wide initiative that sets out to

- make a difference in key areas that align with QBE's vision and values,
- drive employee engagement by developing networking and a strong team-based culture, and
- maximise the return and impact from any collection, distribution and allocation of philanthropic resources.

In 2011, The Foundation made £868,000 of donations across four key categories of support: matching employee fundraising, matching payroll giving, employee volunteer day, and charitable grants.

Corporate governance

Please refer to Corporate Governance statement on page 6.

Financial risk

Financial risk is dealt with in note 15 to the accounts.

Risk management

Please refer to risk management section on page 9.

Employees – Disabled persons

Applications for employment by disabled persons are always considered, bearing in mind the respective aptitudes and abilities of the applicant concerned. In the event of members of staff becoming disabled, every effort is made to ensure that their employment with the Group continues and the appropriate training is arranged. It is the policy of the Group that the training, career development and promotion of a disabled person should as far as possible, be identical to that of a person who does not suffer from a disability.

Employees – Employee involvement

Communication with all employees continues through internal announcements and distribution of information concerning the performance of the Group, with the aim of ensuring that all employees are aware of the financial and economic performance of their business units and of the Group as a whole.

Involvement in the performance of the Company is encouraged through share schemes and performance related bonus schemes. Employee representatives are consulted to ensure employee views are considered in decision making likely to affect their interests.

QBE EUROPEAN OPERATIONS PLC

DIRECTORS' REPORT (continued)

Statement of directors' responsibilities

The directors are responsible for preparing the Directors' Report and the financial statements in accordance with applicable law and regulations

Company law requires the directors to prepare financial statements for each financial year. Under that law the Directors have elected to prepare the Group and Company financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and the Group and the profit or loss of the Group for that period. In preparing these financial statements, the directors are required to

- Select suitable accounting policies and then apply them consistently,
- Make judgments and accounting estimates that are reasonable and prudent,
- State whether applicable UK accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements, and
- Prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and the Group and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Statement of disclosure of information to auditors

Each person who is a director at the date of this report confirms that

- so far as the Director is aware, there is no relevant audit information of which the auditors are unaware, and
- the Director has taken all the steps that he / she ought to have taken as a director in order to make himself / herself aware of, and to establish that the Company's auditors are aware of, any relevant audit information.

This confirmation is given, and should be interpreted, in accordance with the provisions of s418 of the Companies Act 2006.

By order of the Board



S M Boland
Company Secretary
QBE European Operations plc
Registered Number 02641728
London
4 May 2012

QBE EUROPEAN OPERATIONS PLC

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF QBE EUROPEAN OPERATIONS PLC

We have audited the group and parent company financial statements (the "financial statements") of QBE European Operations plc for the year ended 31 December 2011 which comprise the Group Profit and Loss Account, the Group and Parent Company Balance Sheets, the Statement of Group Total Recognised Gains and Losses, the Reconciliation of Movement in Group Shareholders' Funds and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice), having regard to the statutory requirement for insurance companies to maintain equalisation provisions. The nature of equalisation provisions, the amounts set aside at 31 December 2011, and the effect of the movement in those provisions during the year on the Group's shareholders' funds, the balance on the Group's general business technical account and profit before tax, are disclosed in Accounting policy (d) (vii) and note 21.

Respective responsibilities of directors and auditors

As explained more fully in the Statement of Directors' Responsibilities set out on page 14 the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of whether the accounting policies are appropriate to the group's and parent company's circumstances and have been consistently applied and adequately disclosed, the reasonableness of significant accounting estimates made by the directors, and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the financial statements

- give a true and fair view of the state of the group's and the parent company's affairs as at 31 December 2011 and of the group's profit for the year then ended,
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, and
- have been prepared in accordance with the requirements of the Companies Act 2006

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

QBE EUROPEAN OPERATIONS PLC

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF QBE EUROPEAN OPERATIONS PLC (continued)

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us, or
- the parent company financial statements are not in agreement with the accounting records and returns, or
- certain disclosures of directors' remuneration specified by law are not made, or
- we have not received all the information and explanations we require for our audit

N J D Terry

Nigel Terry (Senior Statutory Auditor)
For and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London

4 May 2012

Note

The maintenance and integrity of the QBE website is the responsibility of the directors, the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website

Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions

QBE EUROPEAN OPERATIONS PLC

GROUP PROFIT AND LOSS ACCOUNT TECHNICAL ACCOUNT – GENERAL BUSINESS

for the year ended 31 December 2011

	Notes	2011 £'000	2010 £'000
Earned premiums, net of reinsurance			
Gross premiums written	2	3,019,592	2,694,964
Outward reinsurance premiums		(987,546)	(960,986)
Net premiums written		2,032,046	1,733,978
Change in the gross provision for unearned premiums		(107,741)	(89,895)
Change in the provision for unearned premiums, reinsurers' share		42,488	29,521
Change in the net provision for unearned premiums		(65,253)	(60,374)
Earned premiums, net of reinsurance		1,966,793	1,673,604
Allocated investment return transferred from the non-technical account		37,902	65,719
Total technical income		2,004,695	1,739,323
Claims incurred, net of reinsurance			
Claims paid			
- Gross amount		(1,625,403)	(1,588,200)
- Reinsurers' share		498,518	598,285
Change in the provision for claims		(1,126,885)	(989,915)
- Gross amount		(412,600)	41,899
- Reinsurers' share		234,629	(49,728)
		(177,971)	(7,829)
Claims incurred, net of reinsurance		(1,304,856)	(997,744)
Net operating expenses	4	(594,875)	(552,130)
Other technical charges, net of reinsurance	13	(2,886)	(2,672)
Change in equalisation provision	21	(16,335)	-
Total technical charges		(1,918,952)	(1,552,546)
Balance on technical account – general business		85,743	186,777

The notes set out on pages 23 to 63 form an integral part of these financial statements

QBE EUROPEAN OPERATIONS PLC

GROUP PROFIT AND LOSS ACCOUNT NON - TECHNICAL ACCOUNT *for the year ended 31 December 2011*

	Notes	2011 £'000	2010 £'000
Balance on technical account – general business		85,743	186,777
Investment income	9(a)	244,138	237,473
Investment expenses and charges	9(b)	(137,679)	(113,332)
Unrealised losses on investments		(58,351)	(19,961)
Allocated investment return transferred to the general business technical account		(37,902)	(65,719)
Other charges		(12,758)	(12,075)
Profit on ordinary activities before tax	2,10	83,191	213,163
Tax on profit on ordinary activities	11	11,926	(19,111)
Profit on ordinary activities after tax		95,117	194,052
Equity minority interests		(65)	107
Profit for the financial year		95,052	194,159

The results above are all derived from continuing operations

Neither gains and losses arising on the holding or disposal of investments, nor the effect of fair value accounting for financial instruments are required to be included in a note of historical profit and losses. There are no other differences between the profit on ordinary activities before tax or the profit for the financial year stated above and their historical cost equivalents.

The notes set out on pages 23 to 63 form an integral part of these financial statements

QBE EUROPEAN OPERATIONS PLC

STATEMENT OF GROUP TOTAL RECOGNISED GAINS AND LOSSES

for the year ended 31 December 2011

	Notes	2011 £'000	2010 £'000
Profit for the financial year	20	95,052	194,159
Actuarial gain / loss recognised in the pension schemes	7,20	3,088	(7,740)
Movement on deferred tax liability relating to pension liability	20	1,266	882
Movement in cash flow hedge		-	3,722
Movement in revaluation reserve	20	(113)	412
Currency translation differences	20	18,186	49,644
Total recognised gains for the year		117,479	241,079

The notes set out on pages 23 to 63 form an integral part of these financial statements

QBE EUROPEAN OPERATIONS PLC

RECONCILIATION OF MOVEMENT IN GROUP SHAREHOLDERS' FUNDS

for the year ended 31 December 2011

	Notes	2011 £'000	2010 £'000
Profit for the financial year	20	95,052	194,159
Other recognised gains	20	22,427	46,920
Dividends	20	(600,054)	(430,000)
Capital reduction	20	(23,300)	-
Issue of ordinary share capital		-	545,490
Net (decrease) / increase in shareholders' funds		(505,875)	356,569
Opening shareholders' funds	20	2,196,978	1,840,409
Closing shareholders' funds	20	1,691,103	2,196,978

The notes set out on pages 23 to 63 form an integral part of these financial statements

QBE EUROPEAN OPERATIONS PLC

BALANCE SHEETS

as at 31 December 2011

Assets	Notes	Group		Company	
		2011 £'000	2010 £'000	2011 £'000	2010 £'000
Intangible assets	13	194,244	209,894	671	806
Investments					
Land and buildings	14(a)	12,094	12,546	-	-
Shares in group undertakings	14(b)	-	-	4,118,930	3,804,748
Other financial investments	14(c)	6,268,289	6,042,620	157,837	34,819
Deposits with ceding undertakings		144,699	149,942	-	-
		6,425,082	6,205,108	4,276,767	3,839,567
Reinsurers' share of technical provisions					
Provision for unearned premiums		423,275	380,188	-	-
Claims outstanding		2,509,964	2,204,901	-	-
		2,933,239	2,585,089	-	-
Debtors					
Debtors arising out of direct insurance operations		994,694	953,576	-	-
Debtors arising out of reinsurance operations		117,371	96,206	-	-
Other debtors including taxation	17	2,646,437	2,120,443	639,882	219,613
		3,758,502	3,170,225	639,882	219,613
Other assets					
Tangible assets	18	85,539	74,621	-	-
Cash at bank and in hand		98,350	182,930	2,951	2,470
		183,889	257,551	2,951	2,470
Prepayments and accrued income					
Accrued interest and rent		34,416	27,416	542	16
Deferred acquisition costs		282,307	255,664	-	-
Other prepayments and accrued income		25,185	35,114	-	-
		341,908	318,194	542	16
Total assets		13,836,864	12,746,061	4,920,813	4,062,472

The notes set out on pages 23 to 63 form an integral part of these financial statements

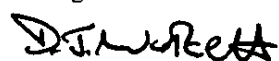
QBE EUROPEAN OPERATIONS PLC

BALANCE SHEETS (continued)

as at 31 December 2011

Equity and Liabilities	Notes	Group		Company	
		2011 £'000	2010 £'000	2011 £'000	2010 £'000
Capital and reserves					
Called up share capital	19,20	2,308,573	2,454,133	2,308,573	2,454,133
Share premium account	20	-	361,550	-	361,550
Revaluation reserve	20	299	412	-	-
Other reserves	20	167,049	148,863	-	-
Profit and loss account	20	(784,818)	(767,980)	600,192	334,073
Total shareholders' funds		1,691,103	2,196,978	2,908,765	3,149,756
Equity minority interests		8,624	8,559	-	-
Total equity		1,699,727	2,205,537	2,908,765	3,149,756
Technical provisions					
Provision for unearned premiums		1,408,459	1,304,970	-	-
Claims outstanding		6,514,462	6,137,377	-	-
		7,922,921	7,442,347	-	-
Provisions for other risks and charges					
Provisions for liabilities and charges	27	1,428	1,534	-	-
Deferred taxation	22	185,630	57,236	-	-
		187,058	58,770	-	-
Deposits received from reinsurers		46,529	49,961	-	-
Creditors					
Creditors arising out of direct insurance operations		126,636	160,509	-	-
Creditors arising out of reinsurance operations		1,295,568	1,197,152	-	-
Amounts owed to credit institutions	23	564,735	546,602	-	-
Other creditors including tax and social security	24	1,944,869	1,032,556	2,012,048	912,286
		3,931,808	2,936,819	2,012,048	912,286
Accruals and deferred income		42,495	40,059	-	430
Total equity and liabilities excluding pension liabilities		13,830,538	12,733,493	4,920,813	4,062,472
Pension liabilities	7(a)	6,326	12,568	-	-
Total equity and liabilities including pension liabilities		13,836,864	12,746,061	4,920,813	4,062,472

These financial statements on pages 17 to 63 were approved by a sub-committee of the board of directors on 4 May 2012 and signed on its behalf by



D J Winkett
Director

The notes set out on pages 23 to 63 form an integral part of these financial statements

QBE EUROPEAN OPERATIONS PLC

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2011

1. Accounting policies

The principal accounting policies adopted in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the years presented unless otherwise stated. The consolidated financial statements incorporate the assets, liabilities, and results of the Company and its subsidiary undertakings, and are drawn up to 31 December each year.

(a) Basis of preparation

These financial statements have been prepared in accordance with the provisions of The Large and Medium-Sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410) relating to insurance groups and applicable accounting standards in the United Kingdom. The Group has adopted the recommendations of the Statement of Recommended Practice on Accounting for Insurance Business issued by the Association of British Insurers in December 2005 (as amended in December 2006).

Compliance with Statement of Standard Accounting Practice (SSAP) 19, "Accounting for Investment Properties" requires departure from the requirements of the Companies Act 2006 relating to depreciation and explanation of the departure is given in Accounting Policy 1(g) below.

(b) Basis of consolidation

The results of subsidiary undertakings acquired or sold during the period are included in the consolidated results from the date of acquisition or up to the date of disposal. On acquisition of a subsidiary undertaking, the Group's share of its assets and liabilities that exist at the date of acquisition are recorded at their fair values reflecting their condition at that date.

(c) Cash flow statement and related party disclosures

The Group and Company is included in the consolidated financial statements of QBE Insurance Group Limited, which are publicly available. Consequently, the Group and Company have taken advantage of the exemption from preparing cash flow statements allowed under Financial Reporting Standard (FRS) 1 (revised 1996). The Group and Company are also exempt under FRS 8 from disclosing related party transactions with other entities that are wholly owned by QBE Insurance Group Limited.

(d) Basis of accounting for insurance

The result is determined on an annual basis whereby the incurred cost of claims, commissions and related expenses are charged against the earned proportion of premiums, net of reinsurance, as described below.

(i) Premiums written

Premiums written comprise premiums on contracts inception during the financial year, together with adjustments made in the year to premiums written in prior years. Premiums are shown gross of commissions payable to intermediaries and exclude taxes and duties levied on them. Estimates are included for premiums due but not yet received or notified, less an allowance for cancellations.

(ii) Unearned premiums

Unearned premiums represent the proportion of premiums written in the year that relate to the unexpired terms of policies in force at the balance sheet date, calculated on the basis of established earnings patterns.

(iii) Acquisition costs

A portion of acquisition costs, which represent commission and other related expenses, is deferred in recognition that it represents a future benefit. Deferred acquisition costs are measured at the lower of cost and recoverable amount and amortised over the period in which the related premiums are earned.

QBE EUROPEAN OPERATIONS PLC

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 31 December 2011

1. Accounting policies (continued)

(d) Basis of accounting for insurance (continued)

(iv) Claims incurred

Claims incurred comprise claims and related expenses paid in the year and changes in provisions for outstanding claims, including provisions for claims incurred but not reported and related expenses, together with any other adjustments to claims from previous years. Where applicable, deductions are made for salvage and other recoveries.

(v) Claims provisions and related reinsurance recoveries

Provision is made at the year end for the estimated cost of claims incurred but not settled at the balance sheet date, including the cost of claims incurred but not yet reported to the Group. The estimated cost of claims includes expenses to be incurred in settling claims and a deduction for the expected value of salvage and other recoveries.

Outstanding claims and reinsurance recoveries are estimated by reviewing individual claims cases and making allowance for claims incurred but not reported, using past experience and trends adjusted for foreseeable events.

Case estimates are set by experienced claims technicians, applying their skill and specialist knowledge to the circumstances of individual claims. The ultimate cost of outstanding claims, including claims incurred but not reported, is estimated by the Group's actuaries who apply recognised actuarial techniques considered appropriate for each portfolio, such as chain ladder and Bornhuetter-Ferguson methods. These methods take into account, amongst other things, statistical analysis of the development of the value and frequency of past claims and the results of analyses undertaken at the point of underwriting. Techniques considered appropriate for specific portfolios include contract by contract analysis, segmentation by subclass, and stochastic analysis. Classes of business are analysed at a level of detail appropriate to their materiality. Allowance is made for changes or uncertainties which may create distortions in the underlying statistics or which might cause the cost of unsettled claims to increase or decrease when compared with the cost of previously settled claims, for example, one-off occurrences and changes in mix of business, policy conditions or the legal environment. The best estimate of reserves for the Group is produced and reviewed by a combination of internal and external actuarial review and is then assessed by QBE management with input from underwriting and claims experts.

As provisions for claims outstanding are based on information which is currently available, the eventual outcome may vary from the original assessment depending on the nature of information received or developments in future periods. For certain classes of business including liability and other long tail classes written by the Group, claims may not be apparent for many years after the event giving rise to the claim has happened. These classes will typically display greater variation between initial estimates and final outcomes. Differences between the estimated cost and subsequent re-estimation or settlement of claims are reflected in the technical account for the year in which these claims are re-estimated or settled.

Provisions are calculated gross of any reinsurance recoveries. A separate estimate is made of the amounts that will be recoverable from reinsurers based upon the gross provisions and having due regard to collectability.

(vi) Unexpired risks provision

Provisions are made for any deficiencies arising when unearned premiums, net of associated acquisition costs, are insufficient to meet expected claims and expenses after taking into account future investment return on the investments supporting the unearned premiums provision and unexpired risks provision. The expected claims are calculated having regard to events that have occurred prior to the balance sheet date.

Unexpired risk surpluses and deficits are offset where business classes are managed together.

(vii) Equalisation provision

Amounts are set aside as equalisation provisions in accordance with the Financial Services Authority Handbook for the purpose of mitigating exceptionally high loss ratios in future years. The amounts provided are not liabilities because they are in addition to the provisions required to meet the anticipated ultimate cost of settlement of outstanding claims at the balance sheet date. Notwithstanding this, they are required by Schedule 3 to SI 2008/410 to be included within technical provisions.

QBE EUROPEAN OPERATIONS PLC

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 31 December 2011

1. Accounting policies (continued)

(d) Basis of accounting for insurance (continued)

(viii) Reinsurance to close (RITC)

Following the end of the third year, the underwriting account of each Lloyd's syndicate is normally closed by reinsurance into the following year of account. The amount of the RITC premium is determined by the managing agent, generally by estimating the cost of claims notified but not settled together with the estimated cost of claims incurred but not reported at that date and claims handling costs.

To the extent that the Group has increased or decreased its participation in a syndicate from one year of account to the next, the RITC paid is treated as a portfolio transfer from the closing year to the receiving year. The share of the RITC receivable is recognised as income in the period that the RITC contract is concluded, together with related claims incurred under the contract.

The payment of an RITC premium does not eliminate the liability of the closed year for outstanding claims. If the reinsuring syndicate was unable to meet its obligations, and other elements of Lloyd's chain of security were to fail, then the closed underwriting account would have to settle the outstanding claims. The Directors consider that the likelihood of such a failure of the RITC is remote, and consequently the RITC has been deemed to settle liabilities outstanding at the closure of an underwriting account.

(ix) Outwards reinsurance

Outwards reinsurance premiums written relate to business ceded during the year, including an estimate of any adjustment premiums payable, together with any differences between estimates in the prior years and that actually ceded. Outwards premiums are recognised as earned over the period of the policy having regard to the incidence of risk. Policies that respond with reference to the attachment point are earned in line with the related inwards written premiums. Policies that respond in relation to the date of loss are earned on a time apportionment basis unless there is a marked unevenness in the incidence of risk over the period of cover, when a basis which reflects the profile of risk is used. The unexpired proportion of the outwards premiums at the balance sheet date is carried forward as reinsurers' share of unearned premiums provision.

(e) Expenses

Acquisition costs, general overheads and other expenses are charged as incurred to the profit and loss technical account, net of the change in deferred acquisition costs. Investment expenses are charged to the profit and loss non-technical account.

(f) Intangible assets

Goodwill represents the excess of the cost of an acquisition over the fair values of Group's share of the net identifiable assets acquired and is capitalised in the balance sheet at cost and amortised through the profit and loss account over 20 years. Carrying values are reviewed regularly for signs of impairment. The gain or loss on any subsequent disposal of subsidiary or associated undertakings will include any attributable unamortised goodwill.

Other goodwill relates to the discounting of technical provisions arising from the fair value exercise carried out following acquisitions. Its amortisation period is based on the class of business, the historic settlement rate and the consideration of whether the historic settlement pattern would be appropriate into the future. The settlement period was estimated by modelling the settlement patterns of the underlying claims and related reinsurance recoveries.

The cost of purchased syndicate participation is amortised over 20 years from the start of the first underwriting year, being management's best estimate of its useful economic life.

The cost of renewal rights are written off over 5 years and other intangible assets over 10 years, from the acquisition date, being management's best estimate of their useful economic life.

Amortisation of other goodwill is included in other technical charges in the technical account. Amortisation of other intangible assets is included in other charges in the non-technical account.

QBE EUROPEAN OPERATIONS PLC

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 31 December 2011

1. Accounting policies (continued)

(g) Tangible assets

Tangible assets are stated at cost less depreciation, with the exception of owner occupied property which is stated at its revalued amount. Cost includes the original purchase price of the asset and the costs attributable to bringing the asset to its working condition for its intended use. Depreciation is provided at rates calculated to write off the cost less estimated residual value in equal amounts over the estimated useful lives of the tangible assets. No depreciation is provided on assets under construction. Each asset's estimated useful life, residual value and method of depreciation are reviewed and adjusted if appropriate at each year end.

The estimated lives are as follows

Office equipment	from three to ten years
Computer equipment	from three to ten years
Motor vehicles	five years
Leasehold improvements	life of lease

A review for impairment of a tangible asset is carried out if events or changes in circumstances indicate that the carrying amount of the tangible asset may not be recoverable. The recoverable amount is the higher of its fair value less costs to sell and its value in use. If the carrying value exceeds the recoverable amount the carrying value is reduced by writing the difference to the profit and loss account in that period.

Investment properties included in land and buildings are valued at open market valuation. Full valuations are made by independent, professional qualified valuers every year. The aggregate surplus or deficit on revaluation is taken to the non-technical account.

In accordance with SSAP 19, no depreciation is provided in respect of freehold investment properties and leasehold investment properties with over 20 years to run. The requirement of the Companies Act 2006 is to depreciate all properties, which conflicts with SSAP 19. The directors consider that, as these properties are held for investments, to depreciate them would not give a true and fair view, hence it is necessary to adopt SSAP 19.

(h) Taxation

The charge for taxation is based on the result for the year adjusted for disallowable items. Deferred taxation is measured on an undiscounted basis at the tax rates that are expected to apply in the periods in which timing differences reverse, based on tax rates and laws enacted or substantively enacted at the balance sheet date. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered.

(i) Investments

Except where noted below, all investments are designated as fair value through profit and loss on initial recognition. They are initially recorded at fair value, being the cost of acquisition excluding transaction costs, and are subsequently remeasured to fair value at each reporting date. Financial assets are managed on a fair value basis in accordance with the Group's documented investment strategy.

Listed investments are stated at fair value on current bid prices quoted by the relevant exchanges. Unlisted investments are carried at the directors' estimate of the current fair value.

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently stated at fair value determined using generally accepted valuation techniques, including the use of forward exchange rates for the valuation of forward foreign exchange contracts.

Loans to group undertakings are stated at amortised cost converted at the relevant exchange rates at balance sheet date.

Financial assets are derecognised when the right to receive future cash flows from the assets has expired, or has been transferred, and the Group has transferred substantively all the risks and rewards of ownership.

QBE EUROPEAN OPERATIONS PLC

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 31 December 2011

1. Accounting policies (continued)

(j) Hedging transactions

Derivatives held for risk management purposes which meet the criteria specified in FRS 26 are accounted for using net investment in foreign operating hedge accounting or cash flow hedge accounting

When a financial instrument is designated as a hedge, the Group formally documents the relationship between the hedging instrument and hedged item as well as its risk management objectives and its strategy for undertaking the various hedging transactions. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the hedging instruments are highly effective in offsetting changes in cash flows of hedged items.

Hedge accounting is discontinued when

- it is determined that a derivative is not, or has ceased to be, highly effective as a hedge,
- the derivative expires, or is sold, terminated or exercised, or
- the hedged item matures, is sold or repaid

For qualifying hedges, the fair value gain or loss associated with the effective portion of the hedge is recognised initially directly in reserves and transferred to the profit and loss account in the period when the hedged item will affect profit or loss. The gain or loss on any ineffective portion of the hedging instrument is recognised in the profit and loss account immediately. When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in reserves and is recognised when the hedged item affects the profit and loss account. When a transaction is no longer expected to occur, the cumulative gain or loss that was recognised in reserves is recognised immediately through the profit and loss account.

(k) Financial liabilities

Creditors are initially recognised at fair value, net of directly attributable transaction costs, and are subsequently stated at amortised cost through the profit and loss account using the effective interest method. The exception being derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently stated at fair value determined using generally accepted valuation techniques, including the use of forward exchange rates for the valuation of forward foreign exchange contracts.

(l) Shares in group undertakings

Shares in group undertakings are included in the Company's balance sheet at cost less any impairment, based on the directors having prudent regard for their likely realisable value. Dividends from group undertakings are taken into account when the right to receive payment is established, for interim dividends, when they are paid and, for final dividends, when they are approved by shareholders.

(m) Investment income

Interest income is recognised on an accruals basis. 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.

A transfer is made from the non-technical account to the technical account of the return on investments supporting the insurance technical provisions.

(n) Realised and unrealised gains and losses

Realised gains and losses on investments carried at fair value through profit and loss are calculated as the difference between net sales proceeds and purchase price.

Unrealised gains and losses represent the difference between the valuation of the investment at the balance sheet date and their purchase price, or if they have been previously valued, their valuation at the last balance sheet date, together with a reversal of unrealised gains and losses recognised in earlier accounting periods in respect of investment disposals in the current year.

QBE EUROPEAN OPERATIONS PLC

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 31 December 2011

1. Accounting policies (continued)

(n) Realised and unrealised gains and losses (continued)

All realised and unrealised gains and losses on investments are initially recorded in the profit and loss non-technical account. A transfer is made from the non-technical account to the technical account of the realised and unrealised gains and losses on investments supporting the insurance technical provisions.

(o) Foreign currency translations

The functional currency of the Company is UK pound sterling (£). The Company and Group present its accounts in thousands of pounds sterling.

Transactions denominated in foreign currencies are translated into sterling at the rates of exchange prevailing at the time of the transactions. Assets and liabilities denominated in foreign currencies are translated into sterling at the rates of exchange prevailing at the balance sheet date, with the exception of non-monetary items which are maintained at historic rates. The results of subsidiary undertakings and branches that have a functional currency different from sterling are translated into sterling at average rates of exchange. The subsidiary undertakings' and branches' assets and liabilities are translated at the balance sheet date rates of exchange. Unclosed foreign exchange derivatives are marked to market at year end date.

Exchange gains or losses are recognised in the profit and loss non-technical account, including gains and losses on foreign exchange derivatives, except those arising upon the revaluation of subsidiary undertakings and branches, which are included in the foreign currency translation reserve and statement of total recognised gains and losses.

(p) Pensions

The Group operates defined contribution pension schemes for certain employees. The pension entitlement of employees is secured through contributions by the Group to a separately administered pension fund. Payments are charged as expense as they fall due.

The Group also operates four defined benefit pension schemes. The costs of the defined benefit pension schemes are determined using the projected unit credit method. Actuarial gains and losses are recognised in the statement of total recognised gains and losses in the year they arise. The retirement benefit obligation recognised in the balance sheet represents the present value of the defined benefit obligation reduced by the fair value of scheme's assets.

A surplus is only recognised if it is either recoverable from reductions in future contributions, or if agreement is in place to recover it from the scheme.

(q) Share based payments

The Group participates in a QBE wide equity settled, share based compensation plan. The fair value of the employee services received in exchange for the grant of those instruments is recognised as an expense. The total amount to be expensed over the vesting period is determined by reference to the fair value of the instruments granted, excluding the impact of any non-market vesting conditions. The fair value at grant date of the options and conditional rights is calculated using a binomial model. The fair value of each instrument is recognised evenly over the service period ending at the vesting date. Non-market vesting conditions are included in assumptions about the number of instruments that are expected to become exercisable.

At each balance sheet date, the Group revises its estimates of the number of options and conditional rights that are expected to become exercisable. The Group recognises the impact of the revision of original estimates, if any, in the profit and loss technical account with a corresponding adjustment to reserves.

(r) Operating leases

Costs in respect of operating leases are charged to the profit and loss technical account on a straight line basis over the lease term.

QBE EUROPEAN OPERATIONS PLC

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 31 December 2011

2. Segmental Analysis

(a) Analysis by geographic area

By origin:

	Gross premiums written		Profit before taxation		Net assets	
	2011	2010	2011	2010	2011	2010
	£'000	£'000	£'000	£'000	£'000	£'000
United Kingdom	2,441,873	2,321,946	49,643	205,789	1,311,581	1,471,244
Other EU member countries	551,756	369,889	31,348	29,933	366,385	411,777
Other countries	25,963	3,129	2,200	(22,559)	21,761	322,516
	3,019,592	2,694,964	83,191	213,163	1,699,727	2,205,537

By destination:

	Gross premiums written	
	2011	2010
	£'000	£'000
United Kingdom	763,278	718,096
Other EU member countries	385,740	421,835
North America	158,709	215,025
Other countries	763,649	571,329
	2,071,376	1,926,285
Reinsurance acceptances	948,216	768,679
	3,019,592	2,694,964

(b) Analysis of gross premiums written, gross premiums earned, gross claims incurred, gross operating expenses and the reinsurance balance

	Gross premiums written	Gross premiums earned	Gross claims incurred	Gross operating expenses	Reinsurance balance
	£'000	£'000	£'000	£'000	£'000
2011					
Direct insurance.					
Accident and health	27,233	29,139	(10,152)	(18,801)	(3,499)
Motor (third party liability)	269,670	270,313	(210,911)	(61,446)	6,131
Marine, aviation and transport	287,402	295,554	(198,963)	(71,583)	(21,375)
Fire and other damage to property	382,483	349,502	(213,680)	(117,075)	(49,037)
Third party liability	883,571	855,331	(506,498)	(269,471)	2,341
Credit and suretyship	20,493	18,476	(375)	(6,115)	(5,268)
Other	105,463	96,582	(43,687)	(31,326)	(12,501)
	1,976,315	1,914,897	(1,184,266)	(575,817)	(83,208)
Reinsurance acceptances	1,043,277	996,954	(870,072)	(112,471)	(38,176)
Total	3,019,592	2,911,851	(2,054,338)	(688,288)	(121,384)

QBE EUROPEAN OPERATIONS PLC

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 31 December 2011

2. Segmental information (continued)

(b) Analysis of gross premiums written, gross premiums earned, gross claims incurred, gross operating expenses and the reinsurance balance (continued)

2010	Gross premiums written £'000	Gross premiums earned £'000	Gross claims incurred £'000	Gross operating expenses £'000	Reinsurance balance £'000
Direct insurance:					
Accident and health	24,174	30,798	(17,396)	(13,223)	(3,886)
Motor (third party liability)	260,300	265,520	(207,033)	(79,449)	(6,838)
Marine, aviation and transport	276,049	269,562	(169,945)	(68,207)	(17,573)
Fire and other damage to property	322,186	328,067	(170,349)	(133,135)	(77,203)
Third party liability	937,420	864,568	(495,139)	(214,146)	(32,590)
Credit and suretyship	20,138	19,822	(108)	(4,665)	(7,858)
Other	86,018	79,729	(40,502)	(2,276)	(17,790)
	1,926,285	1,858,066	(1,100,472)	(515,101)	(163,738)
Reinsurance acceptances	768,679	747,003	(445,829)	(117,866)	(141,005)
Total	2,694,964	2,605,069	(1,546,301)	(632,967)	(304,743)

The reinsurance balance represents the (charge)/credit to the technical account from the aggregate of all items relating to reinsurance outwards

3. Movements in prior years' net claims provisions

During the year a positive/(adverse) run-off development was experienced in respect of the following portfolios

	2011 £'000	2010 £'000
Direct insurance:		
Accident and health	(10)	6,584
Motor (third party liability)	(1,757)	2,799
Marine, aviation and transport	(875)	35,084
Fire and other damage to property	1,344	(16,067)
Third party liability	(17,319)	74,038
Credit and suretyship	9,890	(1,996)
Other	(11,405)	9,284
	(20,132)	109,726
Reinsurance acceptances	50,741	35,005
Total	30,609	144,731

QBE EUROPEAN OPERATIONS PLC

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 31 December 2011

4. Net operating expenses

	2011 £'000	2010 £'000
Acquisition costs	609,675	534,358
Changes in deferred acquisition costs	(10,578)	(1,912)
Administrative expenses	101,982	114,155
	701,079	646,601
Reinsurance commissions and profit participation	(93,413)	(80,837)
Other fee income	(12,791)	(13,634)
	594,875	552,130

5. Employees

The average number of persons (including executive directors) employed by the Group for the year was

	2011 Number	2010 Number
Underwriting	1,098	1,086
Claims	566	552
Administration	1,058	1,097
	2,722	2,735

Total employee costs for the year were

	2011 £'000	2010 £'000
Wages and salaries	172,706	188,352
Social security costs	19,568	20,966
Pension costs	15,265	14,814
	207,539	224,132

6. Directors' emoluments

	2011 £'000	2010 £'000
Aggregate emoluments (excluding pension contributions)	6,091	6,989
Company pension contributions to money purchase schemes	143	256
Compensation for loss of office	11	-
	Number	Number
Number of directors who are members of a money purchase scheme	4	5
	£'000	£'000
Highest paid director		
Aggregate emoluments	2,885	2,991

During the year, nil (2010 seven) directors, including the highest paid director, exercised share options in the ultimate parent company

QBE EUROPEAN OPERATIONS PLC

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 31 December 2011

7. Pension schemes

(a) Defined Benefit Schemes

The Company's subsidiaries operate four defined benefit pension schemes. The Iron Trades scheme relates to former employees of QBE Insurance (Europe) Limited, and the Janson Green scheme relates to former employees of QBE Underwriting Limited. In addition, the QBE (Europe) Reinsurance Ltd Pension & Life Assurance Plan ("QBE Re scheme", relating to employees in Ireland) became part of the Group during 2009, and the Secura NV scheme became part of the Group in 2010 on the acquisition of Secura NV. All four schemes were part of the group for the whole year.

The pension contributions relating to each scheme are assessed in accordance with the advice of independent qualified actuaries so as to spread the cost over the service lives of employees.

Three schemes have been closed to future benefit accruals, the two UK schemes on 31 May 2006, and the Irish scheme on 31 December 2006. The Group retains the risk on employee service in these defined benefit schemes up until those dates. During 2011, full actuarial reviews were performed by independent qualified actuaries of both UK schemes. The reviews found that the Iron Trades scheme was in deficit and the Janson Green scheme in surplus. As a result, the Company agreed to make annual payments of £560,000 to the Iron Trades scheme for the next two years. The actuarial assumptions are stricter than those required to be used for these accounts. In late 2009 an actuarial review on the Irish scheme was performed by independent qualified actuaries and identified the scheme to be in deficit. At the balance sheet date the Group has not agreed to make contributions to the Irish scheme.

At the time of the acquisition of Secura NV their pension scheme was valued as part of the fair value exercise by independent external actuary.

The actuarial valuations were reviewed and updated by independent external actuaries as at 31 December 2011 for the purposes of inclusion in these accounts.

The principal actuarial assumptions used at the year end were

	2011 %	2010 %
Rate of increase to pensions in payment accrued before 1 September 2002 in Janson Green scheme	5.0	5.00
Rate of increase in other pensions in payment	2.95 - 3.05	1.85 - 3.45
Expected return on plan assets	4.14 - 5.50	4.15 - 6.45
Rate of increase in deferred pensions	1.75 - 2.05	1.85 - 3.45
Discount rate	4.00 - 4.70	1.50 - 5.40
Inflation	2.00 - 3.05	2.00 - 3.55

The assumption as to the rate of increase in salaries is no longer applicable, as benefits are no longer based on the final salary.

The valuation of the schemes' liabilities has been determined using the Projected Unit Method.

In addition, an assumption is made as to the life expectancy of members of the schemes. In conjunction with the scheme actuaries, the mortality tables used to calculate the liabilities are the PXA92 Long Cohort tables, projected forward based on the year of birth.

The scheme assets do not include any of the Group's own financial instruments or any property occupied by, or other assets used by, the Group.

QBE EUROPEAN OPERATIONS PLC

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 31 December 2011

7. Pension schemes (continued)

(a) Defined Benefit Schemes (continued)

The following disclosures relate to the four schemes combined

	Market Value 2011 £'000	Market Value 2010 £'000
Equities	67,607	64,603
Bonds	226,350	197,700
Others	10,120	10,453
Total market value of assets	304,077	272,756

The overall expected long term rate of return on fund assets is based on historical and future expectations of returns for each of the major asset classes as well as the expected and actual allocation of scheme assets to these major classes

	2011 £'000	2010 £'000
Analysis of the amount credited to other finance income:		
Expected return on scheme assets	14,407	13,804
Interest on scheme liabilities	(15,085)	(14,316)
Restriction on expected return under FRS 17	(464)	-
Net charge	(1,142)	(512)

	2011 £'000	2010 £'000
Analysis of the amount recognised in the statement of total recognised gains and losses (STRGL)		
Actuarial gains / (losses)	35,370	(7,740)
Restriction on expected return under FRS 17	464	-
Restriction on recognising surplus under FRS 17	(32,746)	-
Gain / (Loss) recognised in the STRGL	3,088	(7,740)

The cumulative amount of actuarial gains and losses recognised in the statement of total recognised gains and losses is a loss of £53,713,000 (2010 £56,801,000)

History of assets and liabilities

	2011 £'000	2010 £'000	2009 £'000	2008 £'000	2007 £'000
Fair value of scheme assets	304,077	272,756	251,433	229,606	242,574
Present value of scheme liabilities	(277,657)	(285,324)	(255,262)	(216,296)	(227,048)
Surplus / (Deficit) at 31 December	26,420	(12,568)	(3,829)	13,310	15,526
Surplus not recognised	(32,746)	-	-	(13,310)	(15,526)
Deficit per balance sheet	(6,326)	(12,568)	(3,829)	-	-
Related deferred tax asset	-	-	223	-	-
Net pension liability	(6,326)	(12,568)	(3,606)	-	-

QBE EUROPEAN OPERATIONS PLC

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 31 December 2011

7. Pension schemes (continued)

(a) Defined Benefit Schemes (continued)

	2011 £'000	2010 £'000
Wholly funded defined benefit obligation at 1 January	(285,324)	(255,262)
Service cost	(345)	(6)
Interest cost	(15,085)	(14,316)
Actuarial gains / (losses)	14,237	(17,464)
Benefits and expenses paid	8,315	10,187
Arising from the transfer in of acquired subsidiaries	-	(8,708)
Foreign exchange	545	245
Wholly funded defined benefit obligation at 31 December	(277,657)	(285,324)
Fair value of scheme assets at 1 January	272,756	251,433
Expected return on scheme assets	14,407	13,804
Actuarial gain on scheme assets	21,133	9,725
Benefits and expenses paid	(8,315)	(10,187)
Employer contributions	4,436	3,415
Arising from the transfer in of acquired subsidiaries	-	4,752
Foreign exchange	(340)	(186)
Fair value of scheme assets at 31 December	304,077	272,756
Net surplus / (deficit) at 31 December	26,420	(12,568)
Surplus not recognised	(32,746)	-
Deficit in the balance sheet at 31 December	(6,326)	(12,568)

History of experience gains and losses

(Excludes restriction on recognising surplus)

	2011 £'000	2010 £'000	2009 £'000	2008 £'000	2007 £'000
Difference between the expected and actual return on scheme assets					
Amount	21,133	9,725	9,502	(21,694)	(1,951)
Percentage of scheme assets	6.9%	3.6%	3.8%	(9.4%)	(0.8%)
Experience gain / (loss) on scheme liabilities					
Amount	14,237	(1,563)	2,820	1,472	(510)
Percentage of the present value of liabilities	4.7%	0.6%	1.1%	0.7%	(0.2%)
Total actuarial gain / (loss) recognised in the STRGL					
Amount	34,906	(7,740)	(17,868)	(6,040)	11,400
Percentage of the present value of liabilities	11.5%	(2.7%)	(7.0%)	(2.8%)	4.8%

(b) Defined Contribution Schemes

For those members of staff who are not members of the defined benefit schemes, the Group operates defined contribution schemes. The pension entitlement of employees is secured through contributions to separately administered pension funds as appropriate. There are no outstanding pension accruals or prepayments for these schemes as at 31 December 2011 (2010 nil). The charge for the year was £14,242,000 (2010 £14,296,000).

The Group has no significant exposure to any other post-retirement benefits obligations other than those disclosed in note 27.

QBE EUROPEAN OPERATIONS PLC

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 31 December 2011

8. Share based payments

(a) Employee share and option plan

The Group's and Company's ultimate parent undertaking and controlling entity, QBE Insurance Group Limited, at its 1981 AGM, approved the issue of shares from time to time under an Employee Share and Option Plan (the Plan), up to 5% of the issued ordinary shares in its capital. Any full-time or part-time employee of the Group who is offered shares or options pursuant to the offer document of the Plan is eligible to participate in the Plan. This includes employees employed by the Group. The Company does not directly employ any staff.

Under the Plan, ordinary shares of QBE Insurance Group Limited are offered at the weighted average market price during the five trading days up to the date of the offer. Likewise, the exercise price for options offered under the Plan is the weighted average market price during the five trading days up to the date of the offer.

In accordance with the terms of the Plan, for awards made up to and including March 2009 interest free loans were granted to employees to subscribe for shares issued under the Plan. Prior to 20 June 2005, the terms of the loans were either personal recourse or non-recourse. With effect from 20 June 2005, only personal recourse loans are granted to employees to subscribe for shares under the Plan. The loans are repayable in certain circumstances as set out in the Plan, such as termination of employment or breach of condition. Except for awards made under the Long-term incentive plan (see note 8(a)(iii)), the award of options and interest free loans was discontinued for awards made after March 2009.

The Group is charged, by QBE Insurance Group Limited, the accounting cost of the options and awards issued to its employees, as calculated using FRS 20, and it is this cost that appears in these financial statements.

Currently these are the following schemes operating within the Plan:

(i) Deferred equity plans

QBE Incentive Scheme

The QBE Incentive Scheme (QIS) is an at-risk structure that comprises cash and deferred equity awards. It came into effect from 1 January 2010 and is applicable to deferred equity awards made in March 2011 and thereafter.

Under the QIS, the directors can issue conditional rights to shares to executives and key senior employees of QBE EO who have already achieved predetermined performance targets. The maximum award restricted to the lesser of 66.67% of the cash award in that year or 100% of base (cash) salary as at 31 December in the financial year prior to the year in which the cash award was paid. The deferred equity award is used as the basis for calculating the number of conditional rights with rights equivalent to 60% of the award converted to shares after three years and 60% after five years.

Further shares are issued in relation to the conditional rights to reflect dividends paid by QBE in the period commencing from the date of the grant of the conditional rights.

The shares issued pursuant to the conditional rights are issued without payment being made by the recipient (i.e. at a nil exercise price).

The shares issued pursuant to the conditional rights will only vest if the individual remains in the Group's service throughout the vesting period. The directors have the discretion to pay cash in lieu of shares in certain circumstances such as death, disability, redundancy or retirement if the individual is not subject to disciplinary proceedings or notice on that date. The ultimate vesting of the conditional rights is also contingent on there being no material deterioration of the relevant entity's return on equity during the vesting period.

QBE EUROPEAN OPERATIONS PLC

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 31 December 2011

8. Share based payments (continued)

(i) Deferred equity plans (continued)

Deferred Compensation Plan – legacy scheme applicable to the 2009 financial year

The terms of the Deferred Compensation Scheme (DCP) applicable for awards in March 2010 was as follows

- The directors and key senior employees of QBE EO were invited to participate in the DCP, under which they received conditional rights to fully paid shares of QBE. The maximum deferred equity award was based on an amount which was the lesser of 66.67% of the STI award earned in the financial year or 100% of base (cash) salary in the financial year immediately prior to the year in which the cash award was paid. The maximum DCP award was used as basis for calculating the number of conditional rights, with rights equivalent to 60% of the award converted to shares after 3 years and 60% after 5 years.

Further shares were issued in relation to the conditional rights to reflect dividends paid by QBE in the period commencing from the date of the grant of the conditional rights.

The shares issued pursuant to the conditional rights will only vest if the individual has remained in the Group's service throughout the vesting period. The directors have the discretion to pay cash in lieu of shares in certain circumstances such as death, disability, redundancy or retirement if the individual is not subject to disciplinary proceedings or notice as of that date.

Deferred Compensation Plan – legacy scheme applicable to the 2008 and prior financial years

Senior management were invited to participate in the DCP. Under the DCP, the directors can issue conditional rights to shares and grant options to senior management who have already achieved predetermined performance criteria. The terms of the DCP may vary to take into account the requirements and market conditions of the locations of senior management, but the general terms of the DCP are set out below.

- The conditional rights entitled relevant employees to receive shares on the third anniversary and the fifth anniversary of the grant of the rights. Further shares are granted in relation to the conditional rights to reflect dividends paid on ordinary shares of QBE in the period commencing from the date of the grant of the conditional rights. The shares issued pursuant to the conditional rights are issued without payment being made by senior management (i.e. at a nil exercise price).
- Any options issued between 2005 and 2008 inclusive will generally be exercisable after five years. They must be exercised within a 12 month period after vesting. Interest free personal recourse loans are granted on the terms permitted by the Plan as described above to persons who hold options to fund the exercise of options.

The shares issued pursuant to the conditional rights and options will only be issued if the individual has remained in the QBE's service throughout the vesting period (unless they leave due to redundancy, retirement through ill health or age, or death) and is not subject to disciplinary proceedings or notice on that date.

QBE EUROPEAN OPERATIONS PLC

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 31 December 2011

8. Share based payments (continued)

(ii) Share incentive plan

Generally, all full-time or part-time employees with a minimum of one year's service are invited to participate in the Share Incentive Plan (the SIP). Under the SIP, directors can provide shares up to A\$1,000 to employees without payment being made by employees. The allocation of shares is based on the period of service. The shares are purchased on market and held in trust for the employee for a minimum of three years or until cessation of employment, whichever is earlier. Further details are provided in note 8(e) below.

(iii) Long-term Incentive (LTI) Plan

The LTI was introduced from 1 January 2010. Only the CEO of QBE EO is invited to participate. The LTI plan comprises an award of conditional rights to fully paid shares of QBE without payment, subject to a five year tenure hurdle with vesting contingent upon the achievement of two future performance hurdles as follows:

- 50% of the award allocation will be contingent on the QBE's average diluted earnings per share increasing by a compound 7.5% per annum over the five year vesting period, and
- 50% of the award allocation will be contingent on the QBE's average return on equity and combined operating ratio being in the top 10% of the top 50 largest global insurers and reinsurers as measured by net earned premium for the five year vesting period.

Further shares will be issued in relation to the conditional rights to reflect dividends paid on ordinary shares of the QBE in the period commencing from the date of the grant of the conditional rights.

The QBE remuneration committee will continue to exercise discretion when determining the vesting of awards under the LTI. The committee has the discretion to allocate a pro-rata amount in cash in lieu of shares in certain circumstances such as death, disability, redundancy or retirement. Then ultimate vesting of the conditional rights is also contingent on there being no material subsequent deterioration of the QBE's return on equity during the vesting period.

QBE EUROPEAN OPERATIONS PLC

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 31 December 2011

8 Share based payments (continued)

(b) Employee options

During the year one qualifying employee of this Group (2010 one) was granted options over ordinary shares of QBE with a total market value of A\$348,000 (2010 A\$410,000), based on the quoted market price at the date the options were granted. The weighted average fair value of options granted during the year ended 31 December 2011 was A\$nil (2010 A\$1.88).

The market value of the options outstanding at the balance sheet date was A\$36,991,000 (2010 A\$78,574,000), calculated by reference to the quoted market value of the underlying shares at that date.

Details of the number of employee options granted, exercised and forfeited or cancelled during the year, including those issued under the DCP, were as follows:

2011

Grant Date	Exercise price A\$	Balance at 1 January 2011	Granted in the year	Exercised in the year	Cancelled/ forfeited in the year	Balance at 31 December 2011
2 March 2006	20.44	939,934	-	(885,657)	(54,277)	-
2 March 2007	32.68	704,534	-	-	(117,104)	587,430
2 March 2007	20.44	20,000	-	(20,000)	-	-
4 March 2008	20.44	20,000	-	(20,000)	-	-
4 March 2008	24.22	1,010,356	-	-	(164,612)	845,744
6 March 2009	17.57	1,586,689	-	-	(221,514)	1,365,175
6 March 2009	20.44	20,000	-	-	-	20,000
5 March 2010	20.44	20,000	-	-	-	20,000
7 March 2011	20.44	-	20,000	-	-	20,000
		4,321,513	20,000	(925,657)	(557,507)	2,858,349
Weighted average exercise price A\$		22.27	20.44	20.44	22.99	22.7

The weighted average share price at the date of exercise of options during the year was A\$18.09 (2010 A\$21.05). The weighted average remaining contractual life of total options outstanding at 31 December 2011 was 2.4 years (2010 4.69 years).

Employee options outstanding at 31 December 2011 were as follows:

Year of expiry	DCP	Other	Total options
2012		60,000	60,000
2013	587,430		587,430
2014	845,744		845,744
2015	1,365,175		1,365,175
	2,798,349	60,000	2,858,349
Vested and exercisable at 31 December 2011	-	-	-

The future performance options have been issued subject to the achievement of specific performance criteria.

QBE EUROPEAN OPERATIONS PLC

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 31 December 2011

8 Share based payments (continued)

(b) Employee options (continued)

Details of the number of options granted, exercised and forfeited or cancelled during the prior year, including those issued under the DCP, were as follows

2010

Grant Date	Exercise price A\$	Balance at 1 January 2010	Granted in the year	Exercised in the year	Cancelled/ forfeited in the year	Balance at 31 December 2010
3 March 2004	11 08	20,000	-	-	(20,000)	-
3 March 2005	8 04	135,583	-	(135,583)	-	-
3 March 2005	11 08	150,310	-	(150,310)	-	-
3 March 2005	14 85	1,162,313	-	(1,072,032)	(90,281)	-
2 March 2006	20 44	1,185,013	-	-	(245,079)	939,934
2 March 2007	32 68	873,920	-	-	(169,386)	704,534
2 March 2007	20 44	20,000	-	-	-	20,000
4 March 2008	20 44	20,000	-	-	-	20,000
4 March 2008	24 22	1,234,479	-	-	(224,123)	1,010,356
6 March 2009	17 57	1,897,597	-	-	(310,908)	1,586,689
6 March 2009	20 44	20,000	-	-	-	20,000
5 March 2010	20 90	-	20,000	-	-	20,000
		6,719,215	20,000	(1,357,925)	(1,059,777)	4,321,513
Weighted average exercise price A\$		20 46	20 90	13 75	21 70	22 27

Employee options outstanding at 31 December 2010 were as follows

Year of expiry	DCP	Other	Total options
2011	7,871	60,000	67,871
2012	936,400	20,000	956,400
2013	711,294	-	711,294
2014	1,023,813	-	1,023,813
2015	1,562,135	-	1,562,135
	4,241,513	80,000	4,321,513
Vested and exercisable at 31 December 2010	-	-	-

QBE EUROPEAN OPERATIONS PLC

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 31 December 2011

8. Share based payments (continued)

(c) Conditional rights

Details of the number of employee entitlements to conditional rights to ordinary shares under the DCP granted, vested and transferred to employees during the year were as follows

2011

Grant Date	Date Exercisable	Fair value per right at grant date A\$	Balance at 1 January 2011	Granted in the year	Dividends attaching in the year	Vested and transferred to employee in the year	Cancelled in the year	Balance at 31 December 2011
4 March 2008	3 March 2011	24 22	705,770	-	750	(647,873)	(58,647)	-
6 March 2009	5 March 2012	17 57	1,057,030	-	75,171	-	(153,726)	978,475
6 March 2010	4 March 2013	20 90	589,086	-	44,907	-	(85,952)	548,041
6 March 2010	4 March 2015	20 90	574,090	-	44,044	-	(82,233)	535,901
7 March 2011	6 March 2014	20 90	-	602,044	49,732	-	(50,491)	601,285
1 July 2011	31 March 2014	17 93	-	593,008	48,937	-	(50,541)	591,404
1 July 2011	31 March 2016	17 48	-	10,000	464	-	-	10,464
			2,925,976	1,205,052	264,005	(647,873)	(481,590)	3,265,570

The weighted average share price at the date of vesting of conditional rights during the year ended 31 December 2011 was A\$17 42 (2010 A\$21 25). The weighted average fair value of conditional rights granted during the year ended 31 December 2011 was A\$17 82 (2010 A\$20 90).

Details of the number of employee entitlements to conditional rights to ordinary shares under the DCP granted, vested and transferred to employees during the prior year were as follows

2010

Grant Date	Date Exercisable	Fair value per right at grant date A\$	Balance at 1 January 2010	Granted in the year	Dividends attaching in the year	Vested and transferred to employee in the year	Cancelled in the year	Balance at 31 December 2010
2 March 2007	1 March 2010	32 68	504,696	-	301	(456,853)	(48,144)	-
4 March 2008	3 March 2011	24 22	855,866	-	-	-	(150,096)	705,770
6 March 2009	5 March 2012	17 57	1,266,475	-	-	-	(209,445)	1,057,030
6 March 2010	4 March 2013	20 90	-	644,695	17,884	-	(73,493)	589,086
6 March 2010	4 March 2015	20 90	-	621,120	17,421	-	(64,451)	574,090
			2,627,037	1,265,815	35,606	(456,853)	(545,629)	2,925,976

QBE EUROPEAN OPERATIONS PLC

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 31 December 2011

8. Share based payments (continued)

(d) Fair value of options and conditional rights

The fair value of both options and conditional rights is determined using a binomial model. The fair value is earned evenly over the period between grant and vesting. For those options and conditional rights granted during the year to 31 December 2011, the following significant assumptions were used:

		Options		Conditional Rights	
		2011	2010	2011	2010
Share price on grant date	A\$	17.41	20.50	13.67 – 19.00	20.50
Fair value of instrument at grant date	A\$	Nil	1.88	14.05 – 18.44	20.90
Risk free interest rate	%	4.75	4.25	4.75	4.25
Expected share price volatility	%	20.0	25.0	20.0	25.0
Expected dividend yield	%	7.0	5.0	7.0	5.0
Expected life of instrument	Years	0.1	1.0	1.2 – 5.0	3.0 – 5.0

Some of the assumptions including expected share price volatility are based on historical data which is not necessarily indicative of future trends. Reasonable changes in these assumptions would not have a material impact on the amounts recognised in the financial statements.

(e) Share incentive plan

The SIP was introduced during 2005 and is a global reward scheme available to eligible permanent employees who have met minimum service conditions at the annual grant date. Under the terms of the SIP, eligible employees may be offered up to A\$1,000 of fully paid ordinary shares in QBE Insurance Group Limited annually for no cash consideration. The market value of shares issued under the terms of the SIP is expensed in the period in which the shares are granted. The total number of shares issued to participating employees in the year was 54,166 (2010 48,278). The weighted average market price on the issue date was A\$13.85 (2010 A\$19.25).

(f) Share based payment expenses

Total expenses arising from share based payment transactions during the year included in expenses were as follows:

	2011	2010
	£'000	£'000
Options provided under the DCP	2,314	2,779
Conditional rights provided under the DCP	10,280	11,973
Shares provided under the SIP	381	489
	12,975	15,241

QBE EUROPEAN OPERATIONS PLC

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 31 December 2011

9. Investment income, expenses and charges

(a) Income from investments other than participating interests

	2011 £'000	2010 £'000
Dividend income	3,936	6,133
Interest receivable		
From group undertakings	92,169	86,391
Other	136,776	115,148
Gains on realisation of investments	-	13,483
Foreign currency exchange gains	9,608	16,318
Other investment income	1,649	
	244,138	237,473

(b) Investment expenses and charges

	2011 £'000	2010 £'000
Investment management expenses	19,608	29,619
Interest payable		
To group undertakings	101,194	57,957
Other	15,055	23,143
Losses on realisation of investments	1,822	2,613
	137,679	113,332

10. Profit on ordinary activities before tax

Profit on ordinary activities before taxation is stated after charging

	2011 £'000	2010 £'000
Auditors' services		
Auditors' remuneration in respect of audit services	141	157
Other services		
Audit of the Company's subsidiaries, pursuant to legislation	1,053	1,019
Other services supplied pursuant to legislation	390	387
Services relating to taxation	197	428
Other services not covered above	727	239
Payments on operating leases – land and buildings	14,011	13,135
Payments on operating leases – other	271	240
Depreciation		
Charge in year	25,831	14,358
Net loss on disposal of fixed assets – other	79	123

QBE EUROPEAN OPERATIONS PLC

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 31 December 2011

11. Tax on profit on ordinary activities

Analysis of (credit) / charge in period	2011 £'000	2010 £'000
<i>Current tax</i>		
UK Corporation Tax	12,643	26,757
Adjustments to tax in respect of prior period	(173,947)	(657)
Double tax relief	-	(1,704)
	(161,304)	24,396
<i>Foreign Tax</i>		
Foreign Tax	20,729	11,074
Adjustments to tax in respect of prior period	(6,640)	382
	14,089	11,456
Total current tax	(147,215)	35,852
<i>Deferred Tax</i>		
Origination and reversal of timing differences	(21,033)	(25,109)
Impact from change in UK tax rate	(17,958)	(2,545)
Adjustments to tax in respect of prior period	174,280	10,913
Total deferred tax	135,289	(16,741)
Tax (credit) / charge on profit on ordinary activities	(11,926)	19,111

Factors affecting tax (credit) / charge for the period

The current year charge for the period is lower (2010 lower) than the standard rate of corporation tax in the UK, 26.5% (2010 28%). The differences are explained below

	2011 £'000	2010 £'000
Profit on ordinary activities before tax	83,191	213,163
Profit on ordinary activities before tax multiplied by standard rate of UK corporation tax of 26.5% (2010 28%)	22,045	59,686
<i>Effects of</i>		
Difference in tax rate	546	209
Expenses not deductible for tax purposes	4,139	615
Income exempt from tax	(20,111)	(23,926)
Tax effect on foreign exchange expense	27,465	(18,491)
Other timing differences	336	25,109
Other permanent differences	4,422	2,948
Overseas tax rate adjustments	(5,470)	(10,023)
Adjustments to tax in respect of prior period	(180,587)	(275)
Current tax (credit)/charge for the year	(147,215)	35,852

The Group's subsidiary undertaking, QBE Corporate Limited, has resubmitted its corporation tax returns for the years ended 31 December 2007, 2008 and 2009 following change in HM Revenue & Customs' guidance. As a result, there are prior period timing adjustments included in the accounts.

During the year, as a result of the changes in the UK main corporation tax rate to 26% that was substantively enacted on 29 March 2011 and that was effective from 1 April 2011 and to 25% that was substantively enacted on 5 July 2011 and that will be effective from 1 April 2012, the relevant deferred tax balances have been re-measured.

QBE EUROPEAN OPERATIONS PLC

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 31 December 2011

11. Tax on profit on ordinary activities (continued)

Factors affecting tax charge for the period (continued)

Further reduction to the UK corporation tax rate were announced in the March 2012 Budget. The changes which are expected to be enacted separately each year, propose to reduce the rate to 22% by 1 April 2014. The changes had not been substantively enacted at the balance sheet date and therefore are not recognised in these financial statements. Had they been substantively enacted they would have reduced the deferred tax liability at the period end by £9.1 million. The impact of these changes in future periods will be dependent on the level of taxable profits in those periods.

12. Profit for the financial year

As permitted by section 408 of the Companies Act 2006, the Company's profit and loss account has not been included in these financial statements. The Company's profit for the financial year was £382,363,000 (2010 £543,925,000).

13. Intangible assets

Group	Goodwill £'000	Intangible £'000	Renewal rights £'000	Other goodwill £'000	Purchased syndicate participation £'000	Total 2011 £'000	Total 2010 £'000
Cost							
At 1 January	167,960	1,300	3,308	179,098	59,716	411,382	365,894
Purchases during the year	-	-	-	-	-	-	46,944
Adjustment during the year	-	-	-	-	-	-	(1,456)
At 31 December	167,960	1,300	3,308	179,098	59,716	411,382	411,382
Amortisation							
At 1 January	(46,602)	(494)	(1,654)	(126,763)	(25,975)	(201,488)	(186,729)
Amortisation during the year	(8,630)	(135)	(827)	(2,886)	(3,172)	(15,650)	(14,759)
At 31 December	(55,232)	(629)	(2,481)	(129,649)	(29,147)	(217,138)	(201,488)
Net book value at 31 December	112,728	671	827	49,449	30,569	194,244	209,894

Goodwill represents the difference between the cost of the acquired entity and the aggregate of the fair values of that entity's identifiable assets and liabilities. An element of this balance (described as 'other goodwill' above) relates to the discounting of certain technical provisions arising from the fair value exercises carried out following the acquisitions of QBE Reinsurance (UK) Limited in 1996, QBE Holdings (Europe) Limited in 2000, QBE Insurance Company (UK) Limited in 2000, QBE Reinsurance (Europe) Limited in 2009 and Secura NV in 2010. These technical provisions were discounted solely to satisfy the requirements of FRS 7 "Fair Values in Acquisition Accounting". The criteria adopted for estimating the period that will elapse before the claims are settled were based on the class of business, the historic settlement rate and the consideration of whether the historic settlement pattern would be appropriate into the future. The period of time which will elapse before the technical provisions are settled was estimated by modelling the settlement patterns of the underlying claims and related reinsurance recoveries.

Details of the purchase of Secura NV is in note 14(b).

QBE EUROPEAN OPERATIONS PLC

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 31 December 2011

13. Intangible assets (continued)

	Total 2011 £'000	Total 2010 £'000
Company – Intangible		
Cost		
At 1 January / 31 December	1,300	1,300
Amortisation		
At 1 January	(494)	(366)
Amortisation during the year	(135)	(128)
At 31 December	(629)	(494)
Amortised cost at 31 December	671	806

On 28 February 2007, the Company purchased intellectual property, business information and a business database relating to the motor underwriting market, for total consideration of £1,300,000. The full purchase price has been treated as an intangible asset.

14. Investments

(a) Land and buildings

	Group 2011 £'000	2010 £'000
Cost or Valuation		
As at 1 January	12,546	11,102
Surplus on revaluation	(300)	219
Purchase	-	1,225
Exchange difference	(152)	-
As at 31 December	12,094	12,546

If the investment properties had not been re-valued, they would have been included at the following amounts

	Group 2011 £'000	2010 £'000
Cost	12,187	12,187
Aggregate depreciation based on cost	(283)	(223)
Net book value	11,904	11,964

Land and buildings were valued in October 2011 on an open market basis by independent surveyors, Cushman & Wakefield LLP and DCE Daniela Ilieska.

(b) Shares in group undertakings

	Company 2011 £'000	2010 £'000
At 1 January	3,804,748	3,496,954
Dissolution of Ensign Holdings Limited	(412)	-
Liquidation of HP Jenni & Partner AG	(1,122)	-
Purchase of Secura NV	-	275,891
Purchase of additional shares in QBE Holdings (EO) Limited	122,860	265,490
Dissolution of QBE Funding Limited, QBE Funding II Limited, QBE Funding III Limited and QBE Funding IV Limited	-	(691)
Write down reversal / (charge) of QBE Holdings (EO) Limited	192,856	(192,856)
Write down of QBE Management Services (UK) Limited	-	(40,040)
At 31 December	4,118,930	3,804,748

QBE EUROPEAN OPERATIONS PLC

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 31 December 2011

14 Investments (continued)

(b) Shares in group undertakings (continued)

There were no acquisitions in 2011. The Company's subsidiary, MBP Holdings Limited, was dissolved in February 2012.

Purchases

2010

On 2 November 2010 the Company completed the purchase of the entire shareholding in Secura NV, a Belgian based specialist reinsurer. The purchase has been accounted for as an acquisition.

Book value and fair value of net assets on acquisition	Book value of Secura NV £'000	Fair value adjustments £'000	Fair value of Secura NV £'000
Cash and investments	777,355	36,616	813,971
Fixed Assets	255	-	255
Reinsurers' share of technical provisions	98,851	(6,113)	92,738
Debtors	217,663	1,150	218,813
Technical provisions	(812,816)	53,057	(759,759)
Creditors and accruals	(76,604)	(13,523)	(90,127)
Net assets acquired	204,704	71,187	275,891
Cost of acquisition			275,891
Goodwill arising on acquisition			-

The fair value adjustments consist of valuation of certain investments that were carried at amortised cost, discounting of net technical provisions and the corresponding tax effects. The discounting of net technical provision of £46,944,000 was recognised as other goodwill on acquisition (see note 13).

Secura NV made a profit of €28,914,000 in the period before purchase in 2010.

Disposals

2011

The Company's subsidiaries, Ensign Holdings Limited, was dissolved in April 2011 and HP Jenni & Partner AG, was liquidated in August 2011.

2010

The Company's subsidiaries, QBE Funding Limited, QBE Funding II Limited, QBE Funding III Limited and QBE Funding IV Limited, were dissolved in October 2010.

During the year, the Company sold its investment in QBE Pl Sp z o o, which was dormant, with no gains or losses from this disposal.

QBE EUROPEAN OPERATIONS PLC

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 31 December 2011

14. Investments (continued)

(b) Shares in group undertakings (continued)

Held by Company	Country of Incorporation	Equity Holdings %	Principal activity
Anex Jenni & Partner AG	Switzerland	100	Underwriting agency
Greenhill International Insurance Holdings Limited	United Kingdom	100	Holding company
Lifeco s r o	Czech Republic	100	Underwriting agency
MBP Holdings Limited	United Kingdom	100	Dissolved on 7 February 2012
QBE Investment Management (UK) Limited	United Kingdom	100	Investment management company
QBE Holdings (EO) Limited	United Kingdom	100	Holding company
QBE Management Services (UK) Limited	United Kingdom	100	Service company
Secura NV	Belgium	100	Reinsurance company
Standfast Corporate Underwriters Limited	United Kingdom	100	Corporate member of Lloyd's

Held by subsidiaries	Country of Incorporation	Equity Holdings %	Principal activity
Atlasz Real Estate and Management Company Limited	Hungary	100	Property holding company
Aviabel CIE Belge d'Assurances Aviation SA	Belgium	19 14	Insurance
British Marine Managers Limited	United Kingdom	100	Non-operating
Greenhill BAIA Underwriting GmbH	Germany	100	Insurance intermediary
Greenhill Sturge Underwriting Limited	United Kingdom	100	Insurance intermediary
Greenhill Underwriting Espana Limited	United Kingdom	100	Insurance intermediary
Iron Trades Management Services Limited	United Kingdom	100	Dissolved on 31 January 2012
Lifeco Re Limited	United Kingdom	100	Non-operating
Limit (No 2) Limited	United Kingdom	100	Corporate member of Lloyd's
Limit (No 7) Limited	United Kingdom	100	Corporate member of Lloyd's
Limit (No 10) Limited	United Kingdom	100	Corporate member of Lloyd's
Limit Corporate Members Limited	United Kingdom	100	Holding company
Limit Holdings Limited	United Kingdom	100	Holding company
QBE Atlaz Ingatlankezelő zrt	Hungary	100	Non-operating
QBE Corporate Limited	United Kingdom	100	Corporate member of Lloyd's
QBE Europe Holding Services Agent de Asigurare	Romania	100	Non-operating
QBE European Services Limited	United Kingdom	100	Insurance intermediary
QBE European Underwriting Services (Australia) Pty Limited	Australia	100	Service company
QBE Funding V Limited	Jersey	100	Issuer of zero coupon bonds
QBE Funding Trust V	Jersey	100	Special purpose entity
QBE Holdings (Europe) Limited	United Kingdom	100	Holding company
QBE Hu kft	Hungary	100	Underwriting agency
QBE Insurance Company (UK) Limited	United Kingdom	100	Non-operating
QBE Insurance (Europe) Limited	United Kingdom	100	Insurance and reinsurance company
QBE Investments (Australia) Pty Limited	Australia	100	Investment holding company
Stock Company for Insurance and Reinsurance "QBE Makedonja" - Skopje	Macedonia	65 23	Insurance company
QBE Management (Ireland) Limited	Ireland	100	Service company
QBE Marine and Energy Services Pte Limited	Singapore	100	Service company
QBE Denmark A/S	Denmark	100	Insurance company
QBE Reinsurance (Europe) Limited	Ireland	100	Reinsurance company
QBE Reinsurance (UK) Limited	United Kingdom	100	Non-operating
QBE Services Inc	Canada	100	Service company
QBE Sk, s r o	Slovakia	100	Underwriting agency

QBE EUROPEAN OPERATIONS PLC

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 31 December 2011

14. Investments (continued)

(b) Shares in group undertakings (continued)

Held by subsidiaries (continued)	Country of Incorporation	Equity Holdings %	Principal activity
QBE s r o	Czech Republic	100	Underwriting agency
QBE UK Finance III Limited	United Kingdom	100	Investment company
QBE UK Finance IV Limited	United Kingdom	100	Investment company
PrJSCIC "QBE Ukraine"	Ukraine	49	Insurance business
QBE Underwriting Limited	United Kingdom	100	Lloyd's managing agent
QBE Underwriting Services Limited	United Kingdom	100	Service company
QBE Underwriting Services (Ireland) Limited	Ireland	100	Service company
QBE Underwriting Services (UK) Limited	United Kingdom	100	Service company
Ridgwell Fox & Partners (Underwriting Management) Limited	United Kingdom	100	Underwriting management for a reinsurance pool
Standfast Holdings Limited	United Kingdom	23 34	Dissolved on 25 February 2012
Strakh-Consult	Ukraine	100	Holding company
The Minibus & Coach Club Limited	United Kingdom	100	Insurance intermediary
Visionex 2000 Limited	United Kingdom	100	Dissolved on 31 January 2012

Included in the above listing is investment in participating interest, being Standfast Holdings Limited

QBE Ukraine is a subsidiary as the Group has management control in addition to its 49% shareholding

In the opinion of the directors, the aggregate value of the assets of the Company consisting of shares in, or amounts owing (whether on account of a loan or otherwise) from the Company's subsidiary undertakings, is not less than the aggregate of the amounts at which these assets are stated in the Company's balance sheet

In accordance with the requirements of FRS 5 "Reporting the substance of transactions" – special purpose entity, QBE Funding Trust V, as a quasi-subsiidiary, has been included in the consolidated financial statements

(c) Other financial investments

Group	Cost 2011 £'000	Carrying value 2011 £'000	Cost 2010 £'000	Carrying value 2010 £'000
Shares – listed	24,399	24,963	71,851	50,868
Shares – unlisted	15,011	14,670	15,568	15,528
Other variable yield securities	382,886	382,886	426,025	426,025
Debt securities and other fixed income – listed	5,786,255	5,753,516	5,338,905	5,361,631
Deposits with credit institutions	56,180	56,180	150,399	150,399
Derivatives	-	36,074	-	38,169
	6,264,731	6,268,289	6,002,748	6,042,620

Company	Cost 2011 £'000	Carrying value 2011 £'000	Cost 2010 £'000	Carrying value 2010 £'000
Other variable yield securities	3,177	3,177	18,137	18,137
Debt securities and other fixed income – listed	140,247	138,559	-	-
Derivatives	-	16,100	-	16,682
	143,424	157,836	18,137	34,819

QBE EUROPEAN OPERATIONS PLC

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 31 December 2011

14. Investments (continued)

(d) Derivative financial instruments

Fair Value	Group		Company	
	2011 £'000	2010 £'000	2011 £'000	2010 £'000
Foreign currency derivatives				
Other financial investments – derivatives (note 14(c))	35,826	38,169	16,100	16,682
Other creditors (note 24)	(37,076)	(65,440)	(859)	(12,291)
Equity derivatives				
Shares – listed	248	-	-	-

Foreign currency derivatives

The Group uses forward foreign exchange derivatives in order to hedge its exposure to foreign currencies. These are valued using the underlying foreign exchange rates at the year end. Contractual amounts for foreign currency exchange derivatives outstanding at the balance sheet date include foreign exchange contracts to transact the net equivalent of £1,119,799,000 (2010 £2,115,718,000), as broken down by local currency in the following table

	2011		2010	
	Local Currency '000 Purchase	Sell	Local Currency '000 Purchase	Sell
Australian dollar	-	(19,175)	-	(552,515)
Brazilian real	3,600	-	3,600	-
Bulgarian lev	7,900	-	8,688	-
Canadian dollar	-	(356,158)	-	(308,981)
Colombian peso	1,664,600	-	-	(241,900)
Czech koruna	164,400	-	88,400	-
European euro	-	(263,149)	-	(226,807)
Hong Kong dollar	23,000	-	36,200	-
Hungarian forint	1,326,800	-	-	-
Great British Pound	-	(104,300)	-	-
Indian rupee	269,000	-	287,900	-
Indonesian rupiah	-	-	7,532,700	-
Japanese yen	4,977,800	-	151,500	-
Malaysian ringgit	-	-	-	(1,600)
New Zealand dollar	104,900	-	-	(800)
Norwegian Krone	7,000	-	-	-
Romanian leu	-	(4,800)	-	(2,900)
Singapore dollar	-	(3,800)	-	-
South African rand	101,857	-	75,527	-
Swedish kroner	-	(4,600)	-	(6,400)
Swiss franc	-	(10,500)	-	(2,100)
Ukraine hryvnia	-	-	28,916	-
US dollar	-	(301,733)	-	(2,249,449)

The net Sterling position of the above transaction is a buy position of £1,121,049,000

The forward foreign exchange derivatives outstanding at year end expired in January 2012 (2010 January 2011)

During the year a profit of £14,048,000 (2010 loss of £17,133,000) relating to such contracts was recognised. This is included in the net foreign exchange gain of £9,608,000 (2010 gain £16,318,000) in the profit and loss non-technical account

QBE EUROPEAN OPERATIONS PLC

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 31 December 2011

14. Investments (continued)

(d) Derivative financial instruments (continued)

Equity derivatives

The Group entered into equity derivative contracts in order to protect the equity portfolios within the Group from the risk of downside movements in the share markets. The derivatives outstanding at the balance sheet date relate only to option contracts.

During the year a loss of £1,095,000 (2010 loss £2,195,000) was included in the profit and loss non-technical account relating to these derivatives.

(e) Valuation hierarchy

The following table presents the Group's assets measured at fair value at 31 December 2011 in a three level hierarchy.

2011 Group	Level 1 £'000	Level 2 £'000	Level 3 £'000	Total £'000
Equity Shares	24,963	-	14,670	39,633
Other variable yield securities	56,099	326,787	-	382,886
Debt securities and other fixed income securities	318,933	5,434,583	-	5,753,516
Derivatives	248	35,826	-	36,074
	400,243	5,797,196	14,670	6,212,109

2010 Group	Level 1 £'000	Level 2 £'000	Level 3 £'000	Total £'000
Equity Shares	50,868	-	15,528	66,396
Other variable yield securities	147,509	278,516	-	426,025
Debt securities and other fixed income securities	312,895	5,048,736	-	5,361,631
Derivatives	-	38,169	-	38,169
	511,272	5,365,421	15,528	5,892,221

2011 Company	Level 1 £'000	Level 2 £'000	Level 3 £'000	Total £'000
Other variable yield securities	3,177	-	-	3,177
Debt securities and other fixed income securities	-	138,559	-	138,559
Derivatives	-	16,100	-	16,100
	3,177	154,659	-	157,836

2010 Company	Level 1 £'000	Level 2 £'000	Level 3 £'000	Total £'000
Other variable yield securities	18,137	-	-	18,137
Derivatives	-	16,682	-	16,682
	18,137	16,682	-	34,819

QBE EUROPEAN OPERATIONS PLC

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 31 December 2011

14. Investments (continued)

(e) Valuation hierarchy (continued)

The investments included in Level 3 have one or more inputs that are not based on observable market data. These instruments are valued using cost or stale prices, where alternative inputs are not available. The following table presents the movements of level three investments during the year.

	2011 £'000	2010 £'000
Balance at 1 January	15,528	4,277
Transfer out from Level 3	(124)	(4,188)
Unrealised losses in profit and loss statement	(302)	(73)
Purchases	-	15,528
Foreign exchange	(432)	(16)
Balance at 31 December	14,670	15,528

Notes:

- Level 1 Valued using unadjusted quoted prices in active markets for identical financial instruments. This category includes listed equity shares, certain exchange-traded derivatives, G10 government securities and certain US agency securities.
- Level 2 Valued using techniques based significantly on observable market data. Instruments in this category are valued using:
- (a) quoted prices for similar instruments or identical instruments in markets which are not considered to be active, or
 - (b) valuation techniques where all the inputs that have a significant effect on the valuation are directly or indirectly based on observable market data.
- Level 3 Valued using techniques where at least one input (which could have a significant effect on the instrument's valuation) is not based on observable market data.

QBE EUROPEAN OPERATIONS PLC

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 31 December 2011

15. Financial Risk

The activities of the Group expose it to financial risks such as market risk, credit risk and liquidity risk. The Group's risk management framework recognises the unpredictability of financial markets and seeks to minimise potential adverse effects on its financial performance.

The key objectives of the Group's asset and liability management strategy are to ensure sufficient liquidity is maintained at all times to meet the Group's obligations, including its settlement of insurance liabilities and, within these parameters, to optimise investment returns for the Group.

(i) Market Risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market factors. Market risk comprises three types of risk: currency risk (due to fluctuations in foreign exchange rates), interest rate risk (due to fluctuations in market interest rates) and price risk (due to fluctuations in market prices).

Currency risk

The Group is exposed to foreign currency risk in respect of its foreign currency exposures and forward foreign exchange derivatives are used to protect the currency positions.

The risk management process covering forward foreign exchange derivatives involves close senior management scrutiny, including regular board and other management reporting. All forward foreign exchange derivatives are subject to delegated authority levels provided to management, and levels of exposure are reviewed on an ongoing basis.

The table below shows the impact on profit after income tax and equity of changes in foreign currency exchange rates against the UK pound sterling on our major operational currency exposures.

	Movement in variable %	2011		2010	
		Profit / (loss) £'000	Equity £'000	Profit / (loss) £'000	Equity £'000
Australian dollar	+10	(75)	(75)	(572)	(1,167)
	-10	75	75	572	1,167
Canadian dollar	+10	1,511	1,511	(1,306)	(1,306)
	-10	(1,511)	(1,511)	1,306	1,306
Euro	+10	(288)	(435)	1,570	861
	-10	288	435	(1,570)	(861)
US dollar	+10	7,736	6,979	(4,522)	(5,733)
	-10	(7,736)	(6,979)	4,522	5,733

The above is shown net of taxation at the standard rate of 26% (2010 28%)

QBE EUROPEAN OPERATIONS PLC

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 31 December 2011

15. Financial Risk (continued)

(i) Market Risk (continued)

Interest rate risk

The Group is exposed to interest rate risk arising on interest bearing assets. Assets with floating interest rates expose the Group to cash flow interest rate risk. Fixed interest rate assets expose the Group to fair value interest rate risk. The Group's strategy is to invest in high quality, liquid fixed interest securities and cash and to actively manage duration. The investment portfolios are actively managed to achieve a balance between cash flow interest rate risk and fair value interest rate risk bearing in mind the need to meet the liquidity requirements of the business.

The Group's exposure to interest rate risk for each significant class of interest bearing financial assets and liabilities is as follows:

2011	Floating interest rate £'000	Fixed interest rate maturing in 1 year or less £'000	1 to 2 years £'000	2 to 3 years £'000	Over 3 years £'000	Total £'000
Interest bearing securities	3,041,201	2,204,456	223,651	401,925	419,699	6,290,932
Financial liabilities	-	-	(564,735)	-	(1,632,465)	(2,197,200)
Net interest bearing financial assets / (liabilities)	3,041,201	2,204,456	(341,084)	401,925	(1,212,766)	4,093,732

2010	Floating interest rate £'000	Fixed interest rate maturing in 1 year or less £'000	1 to 2 years £'000	2 to 3 years £'000	Over 3 years £'000	Total £'000
Interest bearing securities	2,656,620	2,169,221	232,674	527,852	534,618	6,120,985
Financial liabilities	-	-	-	(546,602)	(675,892)	(1,222,494)
Net interest bearing financial assets / (liabilities)	2,656,620	2,169,221	232,674	(18,750)	(141,274)	4,898,491

The Group's sensitivity to movements in interest rates in relation to the value of fixed interest securities is shown in the table below. This sensitivity analysis is presented gross of any inter-dependencies between financial assets and liabilities.

	Movement in variable %	2011 Profit / (loss) £'000	2010 Profit / (loss) £'000
Interest rate movement – fixed	+1.5	28,958	43,305
interest securities	-1.5	(28,958)	(43,305)

The above is shown net of taxation at the standard rate of 26% (2010 28%)

QBE EUROPEAN OPERATIONS PLC

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 31 December 2011

15. Financial Risk (continued)

(i) Market Risk (continued)

Price risk

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 Group is exposed to price or market value risk on its investment in equities and fixed interest securities and uses derivatives to manage the equity exposure. The risk management processes over these forward contracts and options are the same as those explained under currency risk.

The potential impact of movements in the market value of equities on the profit and loss account and balance sheet is shown in the sensitivity analysis below. The price risk in relation to unlisted securities is immaterial in terms of the possible impact on profit and loss and has not been included in the sensitivity analysis.

The impact has been shown on the basis that equity funds are fully exposed to market price fluctuations. Equity portfolios are from time to time hedged in order to manage this exposure. Exchange traded futures contracts used to provide the hedges are not perfectly correlated to the composition of the underlying equity fund.

	Movement in variable %	Financial impact	
		2011 Profit / (loss) and equity £'000	2010 Profit / (loss) and equity £'000
ASX 100	+20	-	6,073
	-20	-	(6,073)
FTSE 100	+20	2,165	1,169
	-20	(2,165)	(1,169)
EUR – DJ EURO STOXX	+20	3,591	5
	-20	(3,591)	(5)

The above are shown net of taxation at the standard rate of 26% (2010 28%)

QBE EUROPEAN OPERATIONS PLC

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 31 December 2011

15. Financial Risk (continued)

(ii) Credit risk

Credit risk is the risk that one party to a financial instrument will cause financial loss to the other party by failing to discharge an obligation

Credit risk exposures are calculated regularly and compared with authorised credit limits before further transactions are undertaken with counterparties 94% (2010 94%) of total fixed interest and cash investments are with counterparties having a Moody's rating of A or better The Group does not expect any investment counterparties to fail to meet their obligations given their strong credit ratings The Group only uses derivatives in highly liquid markets

The reinsurers' share of claims outstanding is also exposed to credit risk 53% (2010 44%) of the reinsurers' share of claims outstanding is with fellow group undertakings 91% (2010 94%) of the remaining balance is with reinsurers with S&P rating of A- or greater

The following table provides information regarding the carrying value of the Group's financial assets, excluding amounts in respect of insurance contracts All amounts are neither past due nor impaired at the balance sheet date

	2011 £'000	2010 £'000
Cash	98,350	182,930
Interest bearing investments	6,192,582	5,938,055
Derivative financial instruments	36,074	38,169
Amounts owed by group undertakings	2,370,272	1,945,946
Other receivables	131,320	117,828

(iii) Liquidity risk

In addition to treasury cash held for working capital requirements, a minimum percentage of the Group's total financial assets is held in liquid, short-term money market securities to ensure there are sufficient liquid funds available to meet insurance and investment obligations

At 31 December 2011, the average duration of cash and fixed interest securities was 0.45 years (2010 0.7 years)

The table below summarises the maturity profile of all financial liabilities based on the remaining contractual obligations

	2011			2010		
Non-derivatives	Within 1 year £'000	Between 1 and 5 years £'000	Over 5 years £'000	Within 1 year £'000	Between 1 and 5 years £'000	Over 5 years £'000
Trade and other payables	(317,823)	-	-	(261,126)	-	-
Borrowings	-	(564,735)	(1,632,465)	-	(546,602)	(675,892)
Derivatives	(37,076)	-	-	(65,440)	-	-

The Company has no significant concentration of liquidity risk

16. Capital

Each registered insurance company regulated by the Financial Services Authority (FSA), Central Bank of Ireland (CBI), National Bank of Belgium (NBB) in Belgium, Insurance Supervision Agency in Macedonia (ISAM), The State Commission for Regulation of Financial Services Markets of Ukraine (SCRFSM) and each syndicate in Lloyd's is required to carry out a self assessment of the capital it requires, the Individual Capital Assessment (ICA) This is required to reflect the level of capital needed to ensure that the entity will remain solvent for the next twelve months in 99.5% of future foreseeable scenarios

QBE EUROPEAN OPERATIONS PLC

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 31 December 2011

16. Capital (continued)

The Group has developed a sophisticated stochastic risk-based capital model, which incorporates the key risks being faced by each of the legal entities. The output from this model, which is tailored to the Group's risk profile, is reported to the Risk and Capital Committee, which in turn recommends it to the relevant boards for adoption. The ICAs have been reviewed by the FSA, CBI and Lloyd's, and form the basis of the minimum capital required by each registered insurance company and syndicate.

Lloyd's corporate members are required to hold capital, Funds at Lloyd's (FAL), in a trust at Lloyd's. These funds are intended to cover circumstances where syndicate assets prove insufficient to meet their liabilities. The level of FAL is dependent on corporate member's participations on syndicates and the level of the syndicate ICAs after they have been reviewed and accepted by Lloyd's.

The Group's capital model has been embedded in the business, and as well as assessing minimum capital requirements for group undertakings, it has also been used to

- allocate capital to class of business for business planning and performance monitoring
- assess the effectiveness of existing reinsurance protections and new reinsurance strategies
- consider the implications of Solvency II on the business

17. Other debtors including taxation

	Group		Company	
	2011	2010	2011	2010
	£'000	£'000	£'000	£'000
Corporation tax	179,261	84,085	89,650	23,778
Amounts owed by group undertakings	2,370,272	1,945,946	518,624	194,539
Deferred taxation (note 22)	-	-	30,728	-
Other	96,904	90,412	880	1,296
	2,646,437	2,120,443	639,882	219,613

Two subsidiary undertakings have made long-term loans to a fellow QBE company, QBE Investments (North America) Inc. The first loan amounts to US\$1,840,027,537 and was made on 5 June 2009. This loan is split into 4 Tranches: A US\$500,000,000, B US\$500,000,000, C US\$500,000,000, D US\$340,027,537. QBE Investments (North America) Inc. pays interest on the Tranche Loans at the base rate of USD 6 Month LIBOR plus 5.29% for Tranche A, 5.25% for Tranche B, 5.43% for Tranche C, and 5.58% for Tranche D. The actual repayment of interest takes place every 31 May and 30 November, with the first payment made on 30 November 2009. The total US\$1,840,027,537 is to be repaid on 31 May 2019.

The second loan amounts to US\$286,000,000 and was made on 30 November 2009. QBE Investments (North America) Inc. pays interest on this loan which is calculated using USD 6 Month LIBOR plus 4.25%. Interest payment dates and LIBOR reset dates are identical to the first loan with the first payment made on 31 May 2010. The US\$286,000,000 is to be repaid on 30 November 2019.

The third loan amounts to US\$400,000,000 and was made on 30 June 2010. QBE Investments (North America) Inc. pays interest on this loan which is calculated using USD 6 Month LIBOR plus 3.85%. Interest payment dates and LIBOR reset dates are identical to the first loan with the first payment made on 30 November 2010. The US\$400,000,000 is to be repaid on 31 May 2020.

The fourth loan amounts to US\$200,000,000 and was made on 16 May 2011. QBE Investments (North America) Inc. pays interest on this loan which is calculated using USD 6 Month LIBOR plus 2.25%. Interest payment dates and LIBOR reset dates are identical to the first loan with the first payment made on 31 May 2011. The US\$200,000,000 is to be repaid on 15 May 2021.

The carrying value of these loans is deemed to be the fair value at 31 December 2011.

QBE EUROPEAN OPERATIONS PLC

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 31 December 2011

18. Tangible assets – Group

	Motor vehicles £'000	Computer equipment £'000	Office equipment £'000	Assets in the course of construction £'000	Leasehold improvements £'000	Owner Occupied Property £'000	Total £'000
Cost or revaluation							
At 1 January 2011	2,312	97,083	17,369	21,821	19,042	7,272	164,899
Exchange adjustments	(49)	(119)	(85)	-	(119)	(430)	(802)
Transfer	-	14,728	-	(14,728)	-	-	-
Revaluation	-	-	-	-	-	(113)	(113)
Additions	316	1,686	2,320	38,631	352	64	56,169
Disposals	(674)	(3,152)	(882)	(3,370)	(435)	(110)	(21,423)
At 31 December 2011	1,905	110,226	18,722	42,354	18,840	6,683	198,730
Cumulative depreciation							
At 1 January 2011	(1,114)	(65,037)	(11,576)	-	(12,551)	-	(90,278)
Exchange adjustments	-	74	12	-	21	-	107
Charge for year	(373)	(21,029)	(2,271)	-	(2,158)	-	(25,831)
Disposals	444	1,142	812	-	413	-	2,811
At 31 December 2011	(1,043)	(84,850)	(13,023)	-	(14,275)	-	(113,191)
Net book value at 31 December 2011	862	25,376	5,699	42,354	4,565	6,683	85,539
Net book value at 31 December 2010	1,198	32,046	5,793	21,821	6,491	7,272	74,621

19. Share capital

	2011 £'000	2010 £'000
Called up, allotted and fully paid		
“A” Ordinary Shares – 330,000,000 shares of £1 each	330,000	330,000
“B” Ordinary Shares – 1,978,572,962 shares of £1 each	1,978,573	1,978,573
Non-Voting Ordinary Shares – 23,300,000 shares of £1 each	-	23,300
Floating Rate Non-Voting Preference Shares – 122,260,000 shares of £1 each	-	122,260
	2,308,573	2,454,133

On 15 December 2011, the Company completed a Court approved capital reduction by reducing 122,260,000 and 23,300,000 of Floating Rate Non-Voting Preference Shares and Non-Voting Ordinary Shares respectively. Detail on the capital reduction is set out in note 20.

During 2010, the Company issued at par 545,489,545 “B” Ordinary Shares of £1 each.

There are no differences in rights and rank between the holders of “A” Ordinary Shares and holders of “B” Ordinary Shares.

The holders of the Non-Voting Ordinary Shares had the following restrictions on their rights:

- (i) They had the right to participate in any dividend or other distribution of profits of the Company if and to the extent resolved by the directors of the Company in their absolute discretion.
- (ii) They had no rights to vote at general meetings of the Company.

QBE EUROPEAN OPERATIONS PLC

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 31 December 2011

19. Share capital (continued)

The holders of the Floating Rate Non-Voting Preference Shares had the following restrictions on their rights

- (i) They had no rights to vote at general meetings of the Company
- (ii) They were entitled to receive, out of profits legally available for that purpose if and when declared by the directors of the Company, preferential cumulative dividends that accrue rateably on a daily basis and are payable in cash, semi-annually in arrears
- (iii) They were not entitled to any dividends in excess of the full non-cumulative dividends declared on the Floating Rate Non-Voting Preference Shares
- (iv) On a return of capital on winding-up (other than on redemption or purchase of shares) or otherwise, they were entitled to any payment in priority to the holders of any other class of shares
- (v) They would not share in the balance of assets remaining after the payments due in (iv) above

20. Reconciliation of movements in reserves and shareholders' funds

2011 Group	Called up share capital £'000	Share premium reserve £'000	Foreign currency translation reserve £'000	Revaluation reserve £'000	Profit and loss reserve £'000	Total £'000
At 1 January 2011	2,454,133	361,550	148,863	412	(767,980)	2,196,978
Profit for the year	-	-	-	-	95,052	95,052
Capital reduction	(145,560)	(361,550)	-	-	483,810	(23,300)
Currency translation differences	-	-	18,186	-	-	18,186
Actuarial gain recognised in the pension schemes	-	-	-	-	3,088	3,088
Movement on deferred tax relating to pension liability	-	-	-	-	1,266	1,266
Revaluation	-	-	-	(113)	-	(113)
Dividend	-	-	-	-	(600,054)	(600,054)
At 31 December 2011	2,308,573	-	167,049	299	(784,818)	1,691,103

2010 Group	Called up share capital £'000	Share premium reserve £'000	Foreign currency translation reserve £'000	Revaluation reserve £'000	Cash flow hedge £'000	Profit and loss reserve £'000	Total £'000
At 1 January 2010	1,908,643	361,550	99,219	-	(3,722)	(525,281)	1,840,409
Profit for the year	-	-	-	-	-	194,159	194,159
Issuance of share capital	545,490	-	-	-	-	-	545,490
Movement on cash flow hedge	-	-	-	-	3,722	-	3,722
Currency translation differences	-	-	49,644	-	-	-	49,644
Actuarial loss recognised in the pension schemes	-	-	-	-	-	(7,740)	(7,740)
Movement on deferred tax relating to pension liability	-	-	-	-	-	882	882
Revaluation	-	-	-	412	-	-	412
Dividend	-	-	-	-	-	(430,000)	(430,000)
At 31 December 2010	2,454,133	361,550	148,863	412	-	(767,980)	2,196,978

QBE EUROPEAN OPERATIONS PLC

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 31 December 2011

20. Reconciliation of movements in reserves and shareholders' funds (continued)

2011 Company	Called up share capital £'000	Share premium reserve £'000	Profit and loss reserve £'000	Total £'000
At 1 January 2011	2,454,133	361,550	334,073	3,149,756
Profit for the year (note 12)	-	-	382,363	382,363
Capital reduction	(145,560)	(361,550)	483,810	(23,300)
Dividend	-	-	(600,054)	(600,054)
At 31 December 2011	2,308,573	-	600,192	2,908,765

2010 Company	Called up share capital £'000	Share premium reserve £'000	Cash flow hedge £'000	Profit and loss reserve £'000	Total £'000
At 1 January 2010	1,908,643	361,550	(3,722)	220,148	2,486,619
Profit for the year (note 12)	-	-	-	543,925	543,925
Issuance of share capital	545,490	-	-	-	545,490
Movement on cash flow hedge	-	-	3,722	-	3,722
Dividend	-	-	-	(430,000)	(430,000)
At 31 December 2010	2,454,133	361,550	-	334,073	3,149,756

On 15 December 2011, the Company completed a Court approved capital reduction of £507,110,000 with £23,300,000 was returned to the minority equity shareholder and the remaining £483,810,000 was transferred to the profit and loss account. The total amounts of capital reduction of £507,110,000 comprises of £122,260, £23,300,000 and £361,550,000 of Floating Rate Non-Voting Preference Shares, Non-Voting Ordinary Shares respectively and of share premium reserve respectively.

During the year the Company declared and paid an interim dividend of £596,692,842 (2010 £423,708,000) and a dividend of £3,361,614 (2010 £6,292,000) to ordinary shareholders and preference shareholder respectively.

On 30 June 2010, as part of the refinancing of QBE the Americas via QBE European operations, the Company issued at par 265,489,545 "B" Class Ordinary Shares of £1 each to its immediate parent entity QBE Insurance Group Limited and in turn on lent funds to QBE Investments (North America) Inc.

On 2 November 2010, the Company completed the purchase of the entire issued share capital of Secura NV, a Belgian based specialist reinsurer. This acquisition was funded by issuance of 280 million "B" Class ordinary shares of £1 each to its immediate parent entity QBE Insurance Group Limited. Full details can be found in note 14(b).

21. Equalisation provision

The equalisation provision required to be made by the Group in accordance with the FSA Handbook is as follows

	2011 £'000	2010 £'000
At 1 January	-	-
Transfers in	16,335	-
At 31 December	16,335	-

As explained in accounting policy (d) (vii), an equalisation provision is established in the Group financial statements. The effect of this provision is to reduce the Group's shareholders' funds by £16.3 million (2010 £nil). The increase in the provision during the year has the effect of reducing the balance on the technical account for general business and decreasing the profit on ordinary activities before taxation by £16.3 million (2010 £nil).

QBE EUROPEAN OPERATIONS PLC

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 31 December 2011

22. Deferred tax

	Group		Company	
	2011	2010	2011	2010
	£'000	£'000	£'000	£'000
Movements in deferred tax are made up as follows:				
Deferred tax liability at start of period	(57,236)	(64,171)	-	-
Deferred tax (charge)/credit in profit and loss account	(135,289)	16,741	30,728	-
Movement in provisions – acquisitions/disposals	61	(8,950)	-	-
Movement in provisions – other	6,834	(856)	-	-
Deferred tax liability at end of period	(185,630)	(57,236)	30,728	-
The elements of deferred tax are made up as follows:				
Accelerated capital allowances	977	(97)	-	-
Short-term timing differences	(191,447)	(62,999)	30,728	-
Employee compensation and benefits	4,840	5,860	-	-
Liability / Asset in balance sheet	(185,630)	(57,236)	30,728	-

23. Amounts owed to credit institutions

	Group	
	2011	2010
	£'000	£'000
Amounts due in more than one year		
QBE Funding Trust V	564,735	546,602

On 12 May 2010, the Group raised US\$850m through the issue of 20 year hybrid securities. Interest accumulates at 2.5% per annum (compounding semi-annually). In the event of conversion, QBE Insurance Group Limited, the Group's ultimate parent company, will issue a fixed number of its shares to the security holders. The conversion rate may be adjusted in certain circumstances to take account of dividends paid on that company's ordinary shares. In the event of redemption, repurchase or maturity, QBE Insurance Group Limited can elect to repay the principal and accreted interest in either cash or the equivalent value in shares of the company, or a combination of both. Investors can request repurchase at the end of three, five, seven, 10 or 15 years from the date of issue. QBE Insurance Group Limited can redeem the securities at any time on or after three years from the date of issue. Investors have the option to convert the security if

- the market value of the security is less than the US dollar equivalent of the market value of the underlying shares in QBE Insurance Group Limited for five consecutive trading days,
- the securities are called for redemption, or
- on certain corporate transactions occurring (e.g. change in control)

The hybrid securities are guaranteed by the QBE Insurance Group Limited

The fair value of the hybrid securities at 31 December 2011 is £565,559,000 (2010: £548,877,000)

QBE EUROPEAN OPERATIONS PLC

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 31 December 2011

24. Other creditors including tax and social security

	Group		Company	
	2011	2010	2011	2010
	£'000	£'000	£'000	£'000
Corporation tax	-	70,157	-	-
Amounts due to fellow QBE Insurance Group Limited subsidiaries	160,898	117,262	376,773	233,770
Amounts due to fellow QBE Insurance Group Limited subsidiaries (i)	307,890	307,561	307,890	307,561
Amounts due to fellow QBE Insurance Group Limited subsidiaries (ii)	354,588	352,614	354,588	352,614
Amounts due to fellow QBE Insurance Group Limited subsidiaries (iii)	644,675	-	644,675	-
Amounts due to fellow QBE Insurance Group Limited subsidiaries (iv)	325,312	-	325,312	-
Derivative financial liabilities (note 14(d))	37,076	65,440	859	12,291
Other creditors	114,430	119,522	1,951	6,050
	1,944,869	1,032,556	2,012,048	912,286

- (i) In 2006, the Company issued £300,000,000 of capital securities to a fellow QBE Insurance Group Limited subsidiary. The securities have no fixed redemption date and may not be called for redemption or conversion by the investors. The securities are subordinated. Distributions are deferrable and not cumulative. However, if a distribution or principal amount is not paid by the Company and the guarantor does not pay the amount under the guarantee, then the capital securities are to be redeemed for QBE Insurance Group Limited preference shares. QBE Insurance Group Limited has fully and unconditionally guaranteed the Group's obligations under the capital securities. The fair value of the capital securities at 31 December 2011 is £210,750,000 (2010 £216,750,000).
- (ii) In 2007, the Company issued US\$550,000,000 of capital securities to a fellow QBE Insurance Group Limited subsidiary. The securities have no fixed redemption date and may not be called for redemption or conversion by the investors. The securities are subordinated. Distributions are deferrable and not cumulative. However, if a distribution or principal amount is not paid by the Company and the guarantor does not pay the amount under the guarantee, then the capital securities are to be redeemed for QBE Insurance Group Limited preference shares. QBE Insurance Group Limited has fully and unconditionally guaranteed the Group's obligations under the capital securities. The fair value of the capital securities at 31 December 2011 is £303,693,000 (2010 £296,113,000).
- (iii) In May 2011, the Company issued US\$1,000,000,000 of Fixed Rate Reset Subordinated Callable Notes due 2041 to a fellow QBE Insurance Group Limited subsidiary. The securities may not be called for redemption by the investors. The securities are subordinated. Interest payments are deferrable, and no payments are due unless the Group satisfies certain solvency conditions. These notes are non-current liabilities. The fair value of the subordinated notes at 31 December 2011 is £601,036,000.
- (iv) In May 2011, the Company issued £325,000,000 of Fixed Rate Reset Subordinated Callable Notes due 2041 to a fellow QBE Insurance Group Limited subsidiary. The securities may not be called for redemption by the investors. The securities are subordinated. Interest payments are deferrable, and no payments are due unless the Group satisfies certain solvency conditions. These notes are non-current liabilities. The fair value of the subordinated notes at 31 December 2011 is £296,998,000.

QBE EUROPEAN OPERATIONS PLC

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 31 December 2011

25 Operating lease commitments

Land and Buildings	Group		Company	
	2011 £'000	2010 £'000	2011 £'000	2010 £'000
Annual commitments under operating leases are				
Leases which expire within one year	938	377	-	-
Leases which expire between one and five years	1,751	1,497	-	-
Leases which expire after five years	15,442	11,892	-	-
	18,131	13,766	-	-
<hr/>				
Other	Group		Company	
	2011 £'000	2010 £'000	2011 £'000	2010 £'000
Annual commitments under operating leases are				
Leases which expire within one year	11	55	-	-
Leases which expire between one and five years	153	118	-	-
	164	173	-	-

26. Guarantees and Contingencies

Of the total assets disclosed on the Group's balance sheet £2,294,371,000 (2010 £2,379,073,000) are subject to Lloyd's Premium Trust Funds, or will become subject to them on realisation, of which £2,232,177,000 (2010 £2,256,411,000) are investments

The Group has liabilities covered by the deposit of certain investments and cash, in respect of undrawn letters of credit amounting to

	2011		2010	
	Original currency '000	Reporting currency £'000	Original currency '000	Reporting currency £'000
United States dollar	30,366	19,544	42,044	26,930
Euro	13,336	11,108	29,151	24,983
Canadian dollar	111	70	209	135
Pound sterling	35,132	35,132	46,381	46,381
		65,854		98,429

Additionally there are charges over fixed income securities of US\$14,732,635 (£9,482,284) (2010 US\$17,020,060 (£10,901,896)) backing the Group's Excess and Surplus lines business in the USA, which are required by the US insurance regulatory authorities

QBE EUROPEAN OPERATIONS PLC

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 31 December 2011

27. Provisions for liabilities and charges

	2011 £'000	2010 £'000
1 January 2011	1,534	4,275
Utilised during year	(106)	(2,741)
31 December 2011	1,428	1,534

The current year provision is in relation to the voluntary pension provision. On 1 January 2006, Limit Holdings Limited, a fellow QBE undertaking, transferred at book value to the Company a voluntary pension provision. Details of the voluntary pension arrangement are as follows:

The Company operates an arrangement under which former employees of QBE Underwriting Limited (previously Janson Green Limited) receive retirement benefits, including enhanced pension payments and medical insurance, provided by the Company on an ex-gratia basis. The payments are adjusted for inflation on an annual basis. The costs are paid by the Company as they fall due and hence the arrangement is unfunded.

Since the commitments under the arrangement relate to past service the liability is provided for in full at the Directors' estimate of the ultimate cost based on mortality tables. The provision assumes that future inflation in pension payments is offset by similar changes in the discount rate used to calculate the present value of such obligations. All adjustments to the provision are dealt with in the profit or loss account.

The restructuring provision booked in 2009 was fully utilised in 2010 upon the completion of the exercise.

28. Funds at Lloyd's ("FAL")

FAL are those of the Group's funds which are subject to the terms of the Lloyd's Deposit Trust Deed and which are used to support the underwriting of the Group's corporate member subsidiary. Under Lloyd's regulations, the amounts of FAL required to support underwriting for the following year and open years of account are determined at the 'coming-into-line' date as prescribed by Lloyd's each year. At 31 December 2011, these amounted to £1,068,481,000 (2010 £897,004,000). This requirement was satisfied as follows:

	2011 £'000	2010 £'000
Letters of credit guaranteed by the ultimate holding company	908,844	688,764
Interim profits	47,537	76,051
General deposit	28,318	64,469
Reserve margins	83,782	67,720
	1,068,481	897,004

29. Parent Undertaking

The Company's ultimate controlling entity is QBE Insurance Group Limited, which is incorporated in Australia. The consolidated accounts for QBE Insurance Group Limited are available from the Company's registered office at Plantation Place, 30 Fenchurch Street, London, EC3M 3BD.

The Company's immediate parent company is QBE Insurance Holdings Pty Limited, which is incorporated in Australia.

30. Capital Commitments

The Group's capital commitments authorised and contracted for but not provided for in the accounts amount to £1.1 million (2010 £5.8 million).

31. Post balance sheet event

On 16 February 2012, the Company paid an interim dividend of £356,700,000 to ordinary shareholders.