CEO's review

A new chapter.

While our results for FY21 reflected sound underlying financial performance, they were offset by significant costs from a number of material legacy issues. The largest of these is the $1.15 billion pre-tax charge included in our FY21 results to provide for potential business interruption claims. The others are an increase in the provision for customer refunds ($238 million); funds to remediate historical payroll underpayments ($51 million); and settlement of the Swann Insurance Class Action ($40 million). Together, these had an almost $1.5 billion pre-tax impact on our results.

These are historical issues we've identified and provisioned for, and which we are fixing. They have been treated as one-offs and have been excluded from the cash earnings measure that determines our dividend.

The issues that the Chairman and I have outlined happened because of organisational and risk management failures in our business.

They are unacceptable, and we are committed to ensuring they do not happen again.

We have already made changes to our technical systems and risk maturity that we believe will prevent a recurrence.

We have made a significant investment to consolidate the multiple systems we inherited as we grew through acquisition to create one single, core insurance platform. Stage one provided us with a single claims platform that can be used across the organisation.

Stage two, now underway, will consolidate and simplify multiple policy and administration systems. When we complete this work, we will be able to provide consistent products and services to customers wherever they are – from wherever our people are.

And there have been major improvements in our risk infrastructure. We have made significant progress in implementing a $100 million program of work to improve fundamental risk practices. After 18 months, this program – which we call Project rQ – is nearly complete and has considerably strengthened risk controls across IAG.

Finally, there have also been some fundamental changes to our organisational structure and leadership, which I describe in more detail below.

IAG's financial performance

Separate from the legacy issues described above, we delivered pleasing underlying financial results in FY21. These reflect the strength of our core insurance business and its market-leading brands.

We achieved gross written premium growth of 3.8% and an underlying insurance margin of 14.7%. Our reported insurance profit of $1,007 million and our reported insurance margin of 13.5% increased from $741 million and 10.1% in FY20 respectively and included:

- Net natural peril claim costs of $742 million, above our original expectations of $658 million;
- Prior period reserve strengthening of $81 million – up from $48 million in FY20 – after adverse developments in commercial long-tail reserves in Australia;
- A positive credit spread impact of $77 million, compared to a negative impact of $46 million last year; and
- A net benefit of around $60-$70 million from COVID-19 effects in the first half of the year.

We delivered a pre-tax return on shareholders' funds portfolio of $306 million, compared to a loss of $181 million in FY20; against that we had the significant one-off corporate expenses which resulted in the reported net loss after tax of $427 million, compared to a net profit after tax of $435 million last year.

When it comes to cash earnings, our standard approach is to identify unusual non-recurring items, record these as net corporate expenses and exclude them when calculating cash earnings. We followed this approach in FY21.

That resulted in cash earnings of $747 million, up from $279 million in FY20, which means we are able to provide shareholders with a final dividend of 13.0 cents per share for FY21.

Our capital position remains strong, with a CET1 ratio of 1.06 at 30 June 2021. This has reduced from 1.19 at 31 December 2020, reflecting the payment of the interim dividend and net profit in the second half.

A new chapter

The Chairman refers to our results as a mixed story. I want to continue with that metaphor by talking about what I believe is a new chapter for our company. As the CEO, I have the great privilege of being in a position to write this chapter, and I have already started.

We have made a number of changes to strengthen the fundamentals of our core insurance business and build a stronger, more resilient IAG.

Our strategy has been reset around four key pillars: customer growth, building better businesses, creating value through digital, and continuing to invest in effective risk management across the group.

We are already seeing results in each of these areas:

- Our objective is to grow with our customers: during the year we increased customer numbers in our Australia and New Zealand direct insurance businesses, and we are expanding our premium NRMA Insurance brand.

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Nick Hawkins

Nick Hawkins
Managing Director and Chief Executive Officer

- Our strategic focus is to build better businesses: this is underpinned by the work we are doing in our Intermediated business, upgrading its risk management and underwriting disciplines and strengthening our relationships with broker partners to improve its profitability.
- Creating value through digital has seen us scale up artificial intelligence and automation in motor claims to deliver better outcomes for customers.
- Actively managing risk is an ongoing priority, with our rQ program already strengthening risk controls across IAG.

We have redesigned our operating model to create three core insurance business divisions: Direct Insurance Australia, Intermediated Insurance Australia, and New Zealand. Each division is aligned to the insurance needs of specific customers, and the way they want to engage with us.

By separating out the Australian Intermediated business, I have set it clearer accountabilities and ensured appropriate executive focus. The fundamental insurance capabilities of this business must be stronger so it can continue to support our partners and brokers. This business has underperformed in recent years, and we've prioritised its improvement as a significant opportunity.

We also have a new executive team. This includes three high quality external appointments: Michelle McPherson as CFO (previously CFO and Deputy CEO of listed Health Insurer nib); Jarrod Hill as Group Executive Intermediated Insurance Australia (previously CEO Chubb Australia); and Tim Plant as Chief Insurance & Strategy Officer (previously CEO Zurich General Insurance Australia). Tim's role is a new one for IAG. In it, he will use his deep insurance experience to improve underwriting discipline across the whole company.

Michelle, Jarrod and Tim complement the existing executive team and will help deliver a stronger, more resilient IAG.

In our new structure, every business executive is responsible for making sure the uplift in capability and control environment we have implemented continues. Each insurance business division has an Executive General Manager with responsibility for Product & Pricing. They and their executive are responsible for end-to-end product and pricing control for each brand and customer offer.

Our work to deliver a simpler IAG more focused on our core insurance businesses in Australia and New Zealand received a boost in July when we signed an Implementation Agreement to sell our Malaysian business. While we expect the sale will lead to a loss of approximately $90 million, it will add around $150 million to our surplus capital. Even allowing for the expected loss, selling all but the final two of our businesses in Asia has given us a net financial gain of over $400 million.

Outlook

On an underlying basis, we delivered an insurance margin of just under 14% in FY21 after excluding the net benefit from COVID-19. I'm confident we will improve as a business and grow our customer base in FY22, and in the years beyond.

My confidence stems from actions we are already taking:

- Driving organic customer growth that at least matches the market in our direct insurance businesses in Australia and New Zealand. We are going to expand our premium NRMA Insurance brand; we are targeting trans-Tasman direct small-to-medium enterprises, by using the benefits of our single technology platform for our personal insurance products and the associated ease of doing business with us.
- Improving the underwriting capability to drive profitability in our Australian Intermediated business. My goal is for this business to deliver an annual insurance result of at least $250 million[1] over the next three to five years. This business is important to us, and it will be a positive contributor to our long-term performance. I have set the new executive of this business specific goals to simplify the business' structure, upgrade its risk and underwriting disciplines, foster relationships with our broker partners, and significantly improve its financial returns.
- Delivering further simplification and efficiencies to reduce the cost structure of the company over the next two to three years. My new organisational structure will help us achieve this outcome by improving clarity and accountability about what we do, and reducing internal complexity allowing us to direct more time and effort on meeting customer needs.

Confidence in our outlook has allowed us to reintroduce guidance[2] of a 13.5-15.5% reported insurance margin for FY22. This aligns to our aspirational goal to achieve a 15-17% insurance margin over the medium term. The FY22 guidance includes an increase in the natural perils allowance from $658 million to $765 million. I will report against this guidance each half year to clearly demonstrate the progress that we are making.

Conclusion

The months since my appointment in November 2020 have provided challenges and rewards, as we operated our business in the uncertain environment created by COVID-19, and addressed several company-specific issues.

We were pleased to continue the COVID-19 customer support measures we introduced in 2020. More than 68,000 policyholders have taken up these measures which include premium reductions and deferrals.

And we were proud to be there for our customers and their communities as they were affected by the high number of extreme weather events that occurred during the year.

I thank our employees who have supported our customers while operating remotely over the last 17 months through COVID-19.

Thank you also to my leadership team for supporting the changes I have already made, and those to come.

And finally, thank you to our Chairman and Directors, for trusting me with this role, at a business I truly am proud to be associated with.

I started working at IAG more than 20 years ago and have always been passionate about the role we play in the community. Our purpose to make the world a safer place guides us to help our customers and make a difference to the communities in which we operate. Our trusted brands and the customer experience they provide are something to be proud of. I am committed to making sure everyone who has a stake in our business shares this sense of pride and I look forward to reporting our progress to you in coming months.

1 The Intermediated Insurance Australia goal is based on the combination of the flow through of operational efficiencies, lower loss ratios driven by a portfolio-led improvement plan and the earn-through of targeted rate increases. The long-tail deterioration experienced in FY21 is expected to improve from FY22 onwards through rate and other initiatives.

2 Full details of the assumptions underlying our guidance are set out in the FY21 investor report, which is available in the Results & Reports area of our website.