Climate-related disclosure

2019

Contents

Since 2018, IAG commenced the expansion of our climate change-related disclosure to facilitate the phased introduction of the recommendation of the Taskforce on Climate-related Financial Disclosures (TCFD).

Introduction

Climate change is one of the world's most pressing issues. Consistent with the scientific reports of the Intergovernmental Panel on Climate Change, global temperatures have the potential to increase between 1.5 and 3.0 degrees Celsius (°C) by 2050. In 2002 IAG launched *The Impact of Climate Change on Insurance against Catastrophes*, an Australian first report, and since then, in line with its purpose to make the world a safer place, IAG has led initiatives aimed at addressing the opportunities and risks associated with climate change and taken practical steps to minimise its own environmental impact.

IAG has been making climate change related disclosures for many years and commenced disclosure aligned with the recommendations of the Taskforce on Climate-related Financial Disclosures (TCFD) in FY18. This climate-related disclosure addresses how IAG is managing climate risks and opportunities through Governance; Strategy; Risk Management; and Metrics and Targets.

Through its work with the United Nations Environment Programme Finance Initiative (UNEP FI) and a range of cross-sector stakeholders, IAG is contributing to the development of sustainable finance roadmaps for Australia and New Zealand. This work will lead to the creation of sustainable finance solutions that support progress against the United Nations' Sustainable Development Goals (SDGs) and achieving the Paris Climate Agreement to limit climate change to below 2°C. IAG has contributed to the UNEP FI Principles for Sustainable Insurance TCFD pilot and will continue to participate with other global insurers in FY20. This will enable industry benchmarking and inform IAG's ongoing approach to risk assessments, scenario analysis and climate-related disclosure.

Governance

The Board Charter of Insurance Australia Group Limited (IAG) articulates that the Board has responsibilities to:

- Review and monitor implementation of IAG's shared value and sustainability strategy, including climate change;
- Monitor the performance of shared value initiatives to create safer, stronger and more confident communities, as well as sustainability aspects under the areas of customer, workforce, community and environment; and
- Review external reporting on shared value and sustainability strategies and initiatives, specifically within the 2019 annual report and the 2019 annual review and safer communities report.

Board Committees of IAG include the Risk Committee (where climate change is considered as part of IAG's Enterprise Risk Profile), Audit Committee (with consideration of climate related disclosures), People and Remuneration Committee and Nomination Committee (with consideration of the safer communities, including climate change, approach and activity). Committee responsibilities are set out in Committee Charters, that are available in the About Us section of this website.

IAG's sustainability performance is managed within a Safer Communities framework and is supported by a number of policies and position statements including IAG's Social and Environmental Policy, Public Policy Position on Climate Change and Climate Action Plan. Progress against IAG's Climate Action Plan is reported to the IAG Board annually.

IAG's Chief Executive Officer (CEO) has management accountability for the implementation, performance and external disclosure of IAG's safer communities' activities, which includes climate change and the Climate Action Plan. The Group Executive People Performance and Reputation has accountability for oversight of climate change activity and the Climate Action Plan, with accountability for key objectives and programs outlined in the Plan owned by relevant IAG Group Leadership Team (GLT) members. Progress against IAG's Climate Action Plan is reported to the IAG GLT at least every six months.

The IAG Climate Risk & Opportunity Steering Committee comprises five IAG GLT members and senior leaders from across the business. It provides guidance on the strategic direction, risk management, ongoing implementation and development of business opportunities relating to IAG's position on climate change.

IAG's Social and Environmental Policy provides a framework for identifying and managing IAG's direct and indirect social and environmental impacts, outlines IAG's commitments to action, and defines IAG's approach to continuous improvement in its social and environmental performance, including climate change.

IAG's Public Policy Position on Climate Change outlines IAG's commitment to the Paris Agreement and to continuing to work constructively with government, industry, non-profit groups and local communities to limit carbon emissions, increase resilience and address the risks posed by the changing climate and to continue to incorporate climate considerations into IAG's Investment Policy and approach.

IAG's Climate Action Plan is a three-year plan that sets out the framework, commitment and steps to address the effects of climate change. IAG discloses publicly on its Climate Action Plan every six months, showing visibility and accountability for its commitments. Visit the Safer Communities section to read IAG's latest Climate Action Plan Scorecard update.

Strategy

IAG Enterprise strategy

IAG has identified three key strategic priorities, supported by organisational capabilities, to deliver its strategy: Customer (world-leading customer experiences); Simplification (simplified, modular and lower cost operating model); and Agility (an agile organisation distinguished by innovation, speed and execution skills). Climate change is a key consideration in IAG's strategy-setting process. While resilient to short term risks through the use of risk-based pricing, reinsurance and annual premium adjustment, IAG recognises longer term considerations such as the increasing frequency and severity of natural peril events. IAG continues to investigate product and service opportunities that support adaptation and emission reductions.

IAG's strategic commitments are outlined in its Climate Action Plan, which has five areas of focus:

- Think big – ensuring IAG leads on the right issues and builds the right relationships to achieve its ambitions.
- Prepare our people – to apply the depth of experience of people from across IAG's business.
- Reduce our emissions – to practice what IAG preaches.
- Invest responsibly – to ensure our investment activity aligns to IAG's purpose.
- Rethink risk – to ensure IAG's products, systems and partnerships help customers, business and communities to make a smooth transition to what the future brings.

Contributing to improvements in the broader systems that enable climate change management

IAG demonstrates leadership in disaster risk reduction and climate change through its role as a founding member of the Australian Business Roundtable for Disaster Resilience & Safer Communities, working collaboratively with governments to effect change in public policy, increase investment aimed at building safer and more resilient communities and working to improve the capacity of people and businesses to better withstand future natural disasters. IAG has also been invited by the Federal Governments in Australia and New Zealand to play a role in climate change management, including active engagement and contribution to the National Resilience Taskforce in Australia. In New Zealand, IAG is working through the Climate Leaders Coalition to ensure businesses are actively adapting and building resilience to climate impacts. IAG also works in collaboration with communities and partners to build resilience and support community and business outcomes. This includes working with the Australian and New Zealand Red Cross and the State Emergency Service in New South Wales and Queensland.

Using research and modelling to support a strategic response

IAG manages climate change risks and its impacts on IAG's strategy and business through the development and utilisation of models which map the possible outcomes of natural peril events. The impacts of climate change to IAG's strategy are managed through IAG's established risk management frameworks (see Risk section for additional information). The models inform IAG's risk-based pricing and reinsurance requirements, with the ability to adjust premiums annually, ensuring IAG's strategy and business is resilient in the short term.

In FY18, IAG collaborated with NCAR in a research project to determine the most up to date science to inform natural peril modelling for the current climate and three potential future temperature scenarios (+1.5°C, +2°C and +3°C). This research was developed to better understand the climate related risks and opportunities to IAG, particularly over the medium and long term. Although the research project draws on the most up-to-date science and expert opinion, there remains considerable uncertainty in the modelling due to gaps in climate

science as well as limitations in the natural peril models that are used for climate scenario modelling. A key finding from this work was that natural peril events will occur in an increasingly non-uniform way across Australia, which may lead to disproportionate impacts to some communities. There are also varying levels of the capabilities of communities and individuals to adapt to the impacts of climate change.

IAG's future climate temperature modelling informs the management of these impacts in the medium to long term. The application of these scenarios to IAG's natural peril models has enabled an assessment of the potential impacts on premiums over time. IAG understands that the frequency and severity of perils is projected to increase in the medium to long term and, exacerbated by urbanisation and population concentration, this will drive increasing claims to property, motor and business policies and affect IAG's ability to deliver on its purpose. Without commensurate risk reduction initiatives, it is expected to put upward pressure on IAG's overall risk pool and therefore the total market premium, though the impact over the next twenty years is not expected to be as marked or material as for the thirty years to 2069.

An illustration of this variability is the potential worsening risk of tropical cyclones impacting South East Queensland which could double at 2°C warming by as early as 2035 and triple at 3°C warming by as early as 2050. Further still, impacts at property level can vary significantly due to additional compounding effects of changes to flood risk, storm surge risk and sea level rise. The table below provides an example of such an effect for three nearby properties within a suburb of South East Queensland, with sea level impacts modelled to occur at a slightly delayed time period of 2050 to 2070:

Property	Property Characteristics	Change in peril risk for +2°C scenario	Change in peril risk for +3°C scenario
A	Not in flood plain or storm surge zones	+33%	+83%
B	Within flood plain whereby flood risk is affected by sea level	+50%	+250%
C	Within flood plain and affected by storm surge and sea level rise	+100%	+317%

The modelling indicates a likely increase to the climate related component of gross written premiums due to rising natural perils costs in the medium to long term. There may be some reduction in the total market premium if climate change impacts start to render existing housing stock uninsurable, or force the creation of a government administered scheme outside of the open market.

A temperature increase above 2°C could result in significant access and affordability issues. The increasing frequency and or severity of weather events, coupled with compounding effects of perils (as described above), may push some areas beyond affordability or indeed habitability. There may also be an increase in under-insurance and self-insurance. The severity of any future access and affordability risks will, additionally to climate change, also be impacted by government and industry approaches to land planning and building codes. IAG is committed to continue to partner with other businesses, community and governments to play a meaningful role in addressing the implementation of these broader mitigation measures. This can create a more resilient built environment and limit the cost implications for the final risk transfer that insurance provides.

To manage the medium-term impacts, IAG utilises a "quota share approach", to better manage its capital risks and to mitigate the increasing costs of reinsurance.

Reducing carbon intensity through our underwriting practice

IAG has a focus on managing climate risk and opportunities through the underwriting of assets. To demonstrate this, IAG is committed to ceasing underwriting entities predominately in the business of extracting fossil fuels and power generation using fossil fuels by 2023. In alignment with our purpose to make your world a safer place we have committed to underwrite workers compensation irrespective of the climate intensity of the industry they work in because everyone needs to be protected at work. Our current exposure is included in the Metrics section of this disclosure.

Carbon considerations in investments

IAG invests responsibly, integrating Environmental, Social and Governance (ESG) criteria across its equity portfolio to proactively support a just transition to a low-carbon economy. IAG utilises a third-party controversy screening module, to review its investment exposure, to assess the carbon intensity and exposure to high risk investments and to inform divestment decisions (a detailed outline of our approach and current performance is included in the Metrics section of this disclosure).

Using scenario analysis to inform strategy and business planning

In order to better understand the most significant impacts of climate change to IAG's business, a series of cross-functional workshops were held involving IAG leaders and external stakeholders. The workshops were designed to determine the most significant political, economic, social, technological, environmental and legal factors impacted by a +2°C temperature increase by 2030, while considering physical, transition and liability risk. Trust in governments and institutions, regulatory intervention and the impacts of inequality were found to be the most impactful factors to the IAG strategy. As a result, four "plausible scenarios" were developed to input into product development and pricing strategies in the short term and assess the resilience of IAG's strategy in the medium and long term. These scenarios will be used in strategy and business planning across FY20.

Risk management

Integration with Enterprise wide risk management processes

The Enterprise Risk Profile (ERP) is IAG's framework to identify risks inherent in IAG's strategy, which may inhibit meeting or achieving its strategic objectives. IAG manages risks through its ERP process, with the impacts of climate change being identified and managed as a high-risk event.

IAG manages its inherently high risks through cause and effect analysis, known as IAG's bow-tie analysis, which seeks to identify key causes and consequences attached to risks and identifies controls and mitigating strategies from climate change. The bow-tie analysis is embedded within IAG's Risk Response Plan which is integrated with IAG's Risk Management System, Risk Appetite Statement and Risk Management Strategy. These risk management tools inform the implementation of IAG's strategy and safer communities activities.

Assessing the physical, transitional and liability risks of climate change

IAG considers climate change risk across physical, transition and liability risk. Physical risk is the physical impacts of climate change to IAG's business and will typically include the increased frequency and cost of claims. IAG's established natural peril modelling informs risk-based pricing, reinsurance and the ability to price annually. Transition risk is the risk associated with the transition to a low-carbon economy. Liability risk refers to the litigation or legal risk resulting from both physical impacts of climate change and the transition to a low carbon economy through the introduction of new legislation.

Decarbonisation has the potential to affect the scale and opportunity for our insurance business, the risk profile of our investments, and our future claims costs. The risks and opportunities associated with climate change transition could vary depending on the future decarbonisation pathway that Australia, New Zealand and the world follows. IAG will focus on implications for the business to 2030 and 2050 utilising scenarios with an ambition consistent to limiting long-term global warming in alignment with the Paris Agreement.

IAG is using a +1.5°C "stretch" scenario for Australia; and "balanced/central" and "delayed action/shock" scenarios aligned to a +2°C temperature increase for Australia and New Zealand. This is to further understand how economies could change in response to different long-term climate objectives, including behavioural and lifestyle changes. The "balanced/central" scenario is illustrative of the implications of pursuing a managed policy response to climate change versus a "delayed action/shock" scenario assuming climate-driven policy changes are abruptly forced on the economy following a period of business as usual. These scenario approaches align with our ongoing physical climate risk analysis, allowing a more comprehensive view of the risks and potential opportunities IAG may face from climate change.

Metrics and targets

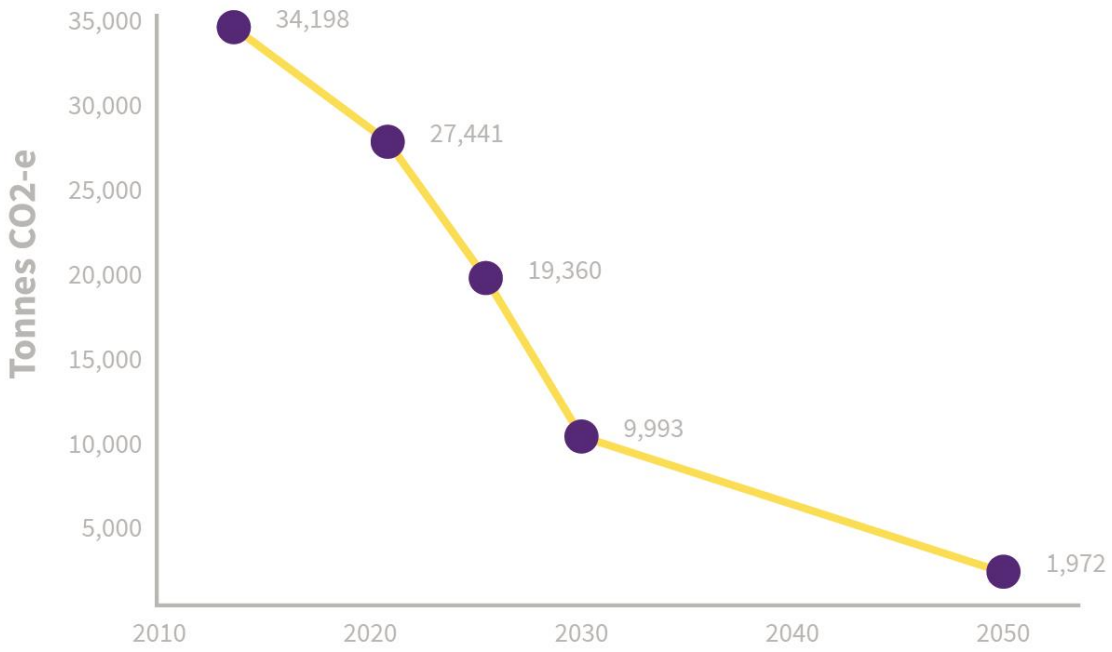
IAG Carbon Management – Climate neutrality and Science Based Targets

IAG has been carbon neutral across scope 1, 2 & 3 emissions since 2012. IAG has set science-based absolute emission targets for scope 1 & 2 emissions to meet its Paris Agreement commitments to keep climate change below 2°C. Using FY18 as its baseline the science-based absolute emission target for scope 1 & 2 is a 20% reduction by 2020, 43% reduction by 2025, 71% reduction by 2030 and a 95% reduction by 2050. IAG has continued its focus to "reduce our emissions" outlined in IAG's Climate Action Plan and Scorecard. The following graph outlines IAG's Scope 1 & 2 Science Based Target to 2050.

IAG Greenhouse Gas Emissions

In FY19 IAG reduced Scope 1 and 2 greenhouse gas emissions to 26,457. This was achieved through a combination of a reduction in emissions from electricity, a reduction from transport-related activity, including vehicles and travel, and a reduction in the size of IAG's Asia based business. IAG is on track to achieve its FY20 science-based emission reduction target. The following graph outlines IAG's performance over the past five years:

IAG SCIENCE BASED TARGET



IAG underwriting

As at 30th June 2019, the current Gross Written Premium (GWP) written relating to all mining, and fossil fuel power generation is less than $10m which equates to less than 0.1% of the total GWP written by the group in FY19. IAG's key parameters for defining this exposure include:

- Fossil fuel extraction including any hydrocarbon fuels, where extraction makes up over 30% of all the entity's activities;
- Power generation using fossil fuels, where thermal coal makes up over 30% of the electricity generated; and
- Exclude:
  - small and medium enterprises with turnover less than $100M, where the primary industry classification of the business is not related to any mining or power generation but may have greater than 30% of turnover through engagement in these industries; and
  - legacy portfolios in run-off for businesses that IAG have divested, including accident and health insurance, surety bonds and trade credit insurance where the liability for future claims against some of the policies will exist until expiry of the policy.

Investment Portfolio

IAG's investment philosophy is to manage technical reserves (assets backing our policyholder claims - $6 billion) and shareholders' funds ($4.7 billion) separately. For technical reserves, wherever possible, we invest in securities with interest rate sensitivities that align to the underlying insurance liabilities. Shareholders' funds are invested to maximise return on risk-based capital consistent with IAG's risk appetite and flexibility requirements. IAG's assets are invested so that the contribution of investment risk to earnings volatility should not dominate the contribution from insurance risk.

IAG's overall investment allocation is conservatively positioned, with nearly 80% of total investments in fixed interest and cash as at 30th June 2019. Technical reserves were 100% invested in fixed interest and cash. Shareholders' fund investments included fixed interest and cash (57.9%), Australian and international equities (19.5%) and alternatives (22.6%).

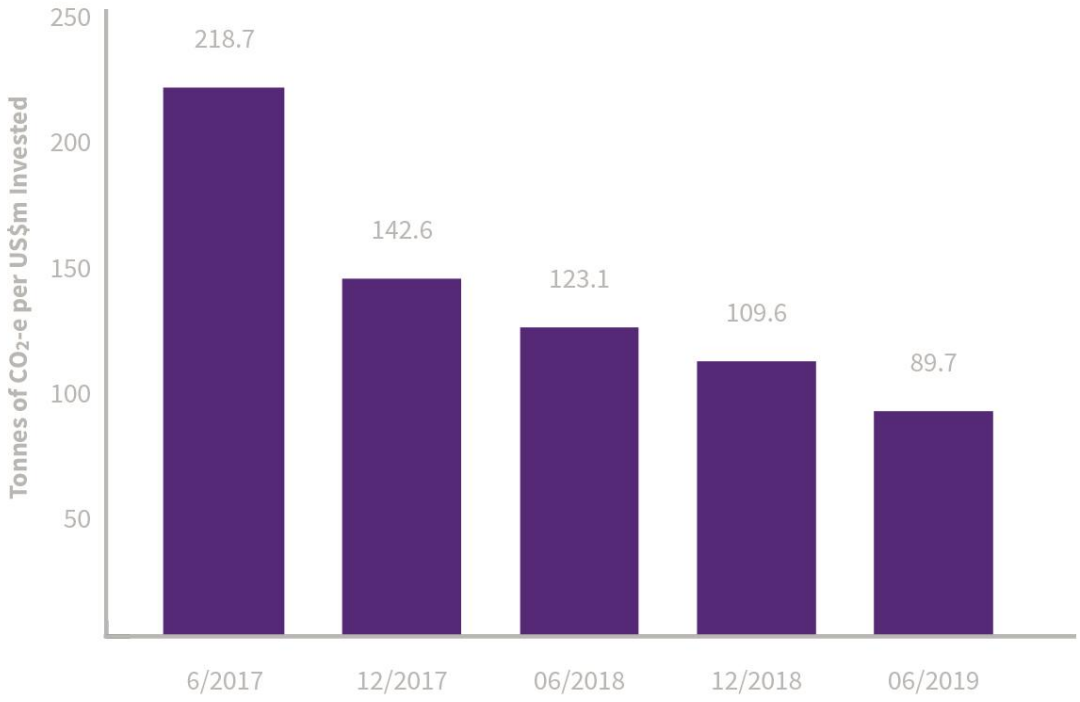
IAG's Climate Action plan outlines our responsible investment objectives and activities in relation to climate risks, which are to:

- Shift investments to companies that have a lower exposure to climate-related risks or a forward-looking strategy to manage these risks.
- Actively support action on climate change and a net-zero future.
- Measure carbon intensity and include climate related risks in the (ESG) risk management of our investments.

Normalised Carbon Footprint Equity Portfolio

The following graph reflects IAG's investment portfolio carbon exposure through listed equities (Australian and international). This demonstrates how IAG's approach to invest responsibly has achieved a reduction in normalised carbon footprint of equity portfolio through a shift in investments to companies that have a lower exposure to climate-related risks or a forward-looking strategy to manage these risks since 2017.

NORMALISED CARBON FOOTPRINT OF LISTED EQUITY PORTFOLIO



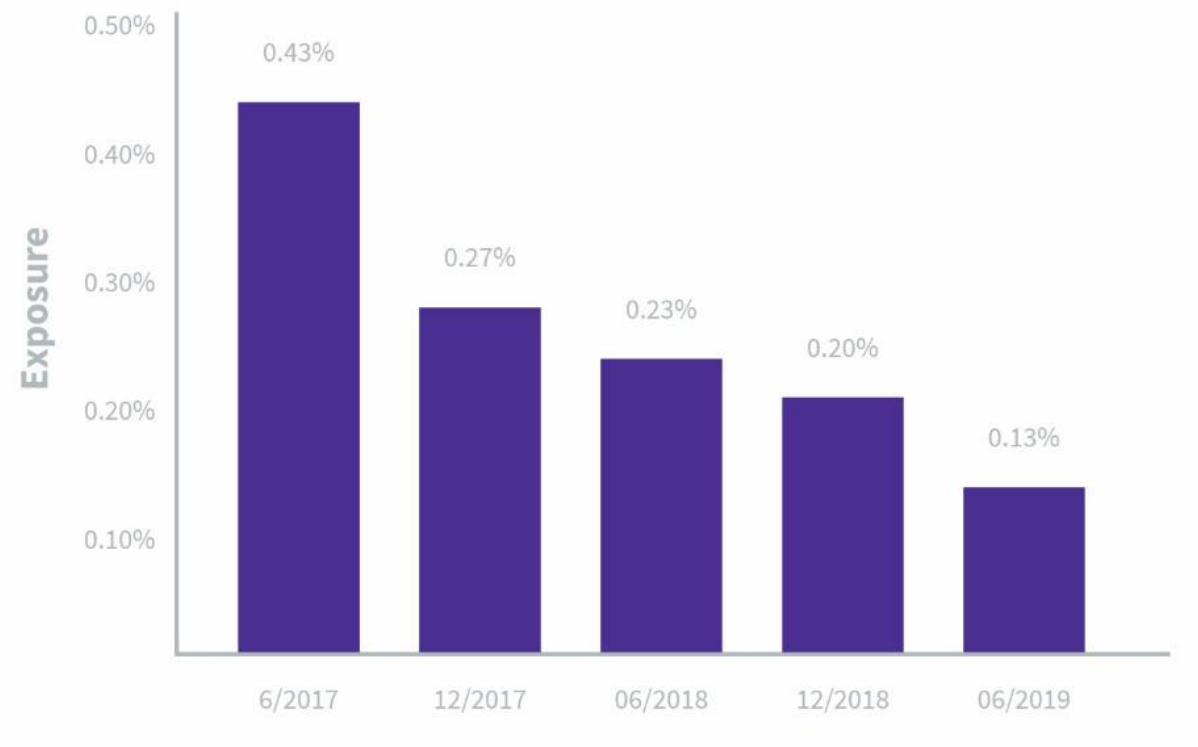
Where reported data is not available, Scope 1 & 2 carbon emissions are estimated using MSCI's proprietary carbon estimation model. Scope 1 emissions are direct emissions from sources owned or controlled by a company. Some examples include emissions from fossil fuels burned on site, and emissions from entity-owned or leased vehicles. Scope 2 emissions are indirect emissions from consumption of purchased electricity, heat, or steam, and the transmission and distribution losses associated with some purchased utilities.

Investment Portfolio Exposure to Higher Risk Companies

The following graph demonstrates IAG Asset Management's reduced exposure to higher risk companies through its approach to invest responsibly, with an overall portfolio shift taking place since 2017. Higher risk companies are identified using MSCI's Low Carbon Reduction criteria. This identifies companies with the largest contributions to climate change:

- Largest owners of fossil fuel reserves
- Those with the largest carbon footprint
- Those with the highest carbon intensity

EXPOSURE TO HIGHER RISK COMPANIES



Update to IAG climate-related disclosure (13 November 2019)

Following the recent commentary at the IAG AGM regarding the identification of "higher risk companies" with the largest contributions to climate change, IAG confirms the criteria as being:

- Largest owners of fossil fuel reserves (more than 1% of remaining global carbon budget), or
- Those with the largest carbon footprint (carbon footprint greater than 0.33% of the annual global carbon emissions), or
- Those with the highest carbon intensity (carbon intensity that exceeds 3,000 tCO2/m USD revenues).