CFO's review

This year, we maintained our disciplined and active approach to the way we manage and allocate your capital.

Nick Hawkins
Chief Financial Officer

We made further improvements to our capital efficiency and reduced earnings volatility

In December 2017, we announced three agreements to quota share a combined 12.5% of our consolidated business, further improving our capital mix by increasing our use of more efficient reinsurance capital.

The agreements, with reinsurers Munich Re, Swiss Re and Hannover Re, came into effect on 1 January 2018. They provide the reinsurers with a combined 12.5% of our consolidated gross earned premium, and they are responsible for 12.5% of our claims and expenses.

As part of the agreements, we also receive an exchange commission payment from the reinsurers, which recognises the value to them of accessing our strong core franchise.

These agreements build on the 10-year, 20% whole-of-account quota share arrangement with Berkshire Hathaway which has been in place for over three years.

All the quota share agreements deliver similar benefits in terms of:

- reduced earnings volatility, as we effectively exchange insurance risk for a more stable fee income stream;
- lower requirement for catastrophe reinsurance and reduced exposure to volatility in associated premium rates; and
- reduction in the amount of regulatory capital we are required to hold.

Sale of Asia businesses

We have progressed a strategic review of our Asia businesses, with the outcomes including sale agreements for our operations in Thailand, Indonesia and Vietnam.

We expect the sale of these businesses to realise an after tax profit of at least $200 million, which we will recognise in the 2019 financial year. The vast majority of expected proceeds relate to the sale of the business in Thailand, and we anticipate settlement by 31 August 2018.

We continue to hold the minority interests in Malaysia and India.

Our capital position is strong

Our key capital measure is our Common Equity Tier 1 (CET1) ratio, and we have a benchmark target range of 0.9 to 1.1 times the Prescribed Capital Amount, which is higher than the regulatory minimum of 0.6 times.

At 30 June 2018, we had regulatory capital of $5.0 billion, resulting in a CET1 ratio of 1.26, significantly higher than our benchmark and the regulatory requirement. Over the longer term, we are committed to managing our CET1 capital broadly in line with our targeted benchmark.

Returning capital to our shareholders

We have long maintained that we think the best place for surplus capital is with shareholders.

The combination of the quota share arrangements releasing capital, and the sale of the Asia businesses, means that we now have a considerable amount of surplus capital.

Given that we have no material operational demands for capital, we have announced a $592 million capital management initiative that will amount to 25 cents per ordinary share and is expected to be made up of:

- a capital return of 19.5 cents;
- a fully franked special dividend of 5.5 cents; and
- a share consolidation which is expected to reduce IAG's ordinary shares on issue by approximately 2.4% and preserve consistency of earnings per share calculation. After the consolidation, each shareholder's proportionate interest in IAG will be unchanged.

The capital return and share consolidation components are subject to shareholder approval, which will be sought at our Annual General Meeting on 26 October 2018. Payment of the special dividend is conditional on this approval. If approved, payment will occur on or around 26 November 2018. Further details of the initiative will be included in the notice of meeting which will be distributed from 10 September 2018.

Dividends and future franking credits

As advised by the Chairman in her review, shareholders will receive a fully franked final dividend of 20.0 cents per ordinary share, taking the full year payout to 34.0 cents per share, a cash payout ratio of 77.9%.

One result of the capital management measures undertaken in recent years – including the special dividend component of the planned November 2018 return – is that we may not be in a position to fully frank dividends from the second half of calendar 2019 onwards. Franking from that date is expected to be in the range of 70% to 100%.