Chairman's review

A mixed story.

Introduction

IAG's results for FY21 present a mixed story.

The businesses at the heart of IAG remain strong. Overall, the continuing hard work of our people to support Australian and New Zealand communities throughout a very challenging year, both as a result of COVID-19 and a series of natural disasters, has strengthened the company's underlying competitive position.

Over the last year, brand strength, customer numbers, customer satisfaction and digital take-up have all improved. Two of our three business units have done well, delivering an insurance profit (excluding unusual items) of around $1 billion. Our people's commitment has remained strong, as has our capital position. We have a new CEO, leading to renewal and strengthening of the management team. As a result, IAG is well-placed to meet the challenges of the coming years.

Despite this, the company has reported a net loss.

Both the Board and management are extremely disappointed at this outcome and we have made very significant changes to the organisation to deal with it.

In this report, while once again re-affirming the underlying competitive strength of the company, I want to clearly outline the underlying causes of the statutory loss, the work which has already taken place to build a stronger governance platform, and recent changes to revitalise the company.

Shareholders should be in no doubt of the commitment of Board and management to return IAG to the high levels of performance we all expect.

Results, drivers and causes

In FY21 IAG made a net loss after tax of $427 million. This compares with a net profit after tax of $435 million for FY20. Our result for FY19 of a net profit after tax of $1,076 million was a good one, with most aspects of the business tracking well and including over $200 million profit on the sale of the Thailand business that year. It much better reflects the potential of the company.

Our result in FY21 was materially affected by a pre-tax provision of $1.15 billion for potential Business Interruption claims associated with the COVID-19 pandemic. In addition, the result contains further increased pre-tax provisions for customer refunds of $238 million arising from past pricing issues, $40 million from settlement of the Swann Insurance Class Action, and $51 million relating to payroll compliance. These events alone have cost the company approximately $1.5 billion.

These issues arose because of organisational and risk management failures within the company. In particular, the COVID-19 crisis exposed a potential shortcoming in contractual exclusions for pandemics in some business interruption policies, resulting from a failure to update references to legislation.

In relation to the other issues, the largest arises from multi-year pricing issues identified by IAG where discounts were not always applied in full to premiums for all customers who may have been eligible. The wording of our promises to our customers did not accurately reflect our complex, model-based pricing algorithms. Actuarially-based pricing is arguably inherently complex, but that is not an excuse in a customer-focused company.

Let me take this opportunity to apologise to all our shareholders for these management and operational issues and the impact they have had on IAG's returns.

Each of these failings was costly and unacceptable. However, we are now at the point where all of the issues identified are well understood and being properly managed and accounted for. The systematic way in which management has identified and remediated them, and rebuilt the control systems around them, should give us confidence they will not occur again.

Further details of our results are provided by the CEO in his report to shareholders on the following pages and in the details of the accounts.

Board focus

Strengthening risk management has been a major area of focus and investment for IAG over the past several years. The Board has been instrumental in identifying the need for significant uplift in our risk management systems and personnel and has been driving this change agenda. A new Chief Risk Officer, David Watts, was appointed in 2018 and a $100 million program to upgrade operational risk capabilities within the company is nearing completion.

Hand-in-hand with the upgrade in risk management, the Board has prioritised investments to simplify and upgrade our Information Technology (IT) systems, to both improve control and increase productivity and to enable us to provide the digital services required by our customers. Over the last three years $150 – 200 million each year has been committed to this task, under the leadership of a new Chief Operating Officer, Neil Morgan.

In addition, the Board has progressively set higher standards for executive accountability, annually reviewing risk management failings and identifying accountabilities. Over the last two years the Board has held a number of individuals (including both current and former executives) directly to account for the issues described, and made significant downward adjustments to their remuneration, including to that which was deferred from prior years. These adjustments total $6.9 million to date, including $3.5 million relating to decisions made by the Board in August 2020.

We are a well-capitalised and skilled insurer, with leading shares in all our major markets, strong links to major reinsurance providers, some of the most recognised and trusted brands in Australia and New Zealand, and a strong purpose-led culture that ensures we are ready to respond when our customers need us most.

Elizabeth Bryan AM
Chairman

The Board did not award a Short Term Incentive to any executive in the company in relation to FY20. Further, a portion of Long Term Incentives did not vest last year, and some will not vest this year. The total potential remuneration forgone by executives as a result of all these actions was approximately $13 million.

Now, the good news

It is unusual for a Chairman to lead her report to shareholders by focusing on the bad news in a company. But my message is that the Board fully understands what needs to be done to prevent future shocks to the business from failures in our control systems and recognises how important it is to do this. This work is well advanced.

Let me reassure you that the enormous underlying strengths of IAG remain. We are a well-capitalised and skilled insurer, with leading shares in all our major markets, strong links to major reinsurance providers, some of the most recognised and trusted brands in Australia and New Zealand, and a strong purpose-led culture that ensures we are ready to respond when our customers need us most.

Evidence of the power of these characteristics is shown in the insurance metrics for this year. Our gross written premium of $12,602 million grew by 3.8%, our insurance profit was $1,007 million, representing a reported insurance margin of 13.5%, an increase of $266 million over last year, and our cash earnings were $747 million.

These results have allowed the company to declare a final dividend of 13.0 cents per share. The dividend will be paid on 22 September 2021 to shareholders registered at 18 August 2021.

The Board was very pleased to appoint Nick Hawkins as IAG's new CEO this financial year. Nick has been the company's Chief Financial Officer since 2008, after joining in 2001, and has been able to move quickly to make important changes in the company. He has both simplified the organisational structure and brought a number of new executives into his leadership team. He is committed to completing the remediation of risk and controls in IAG and the upgrade of our IT systems.

In addition, Nick has implemented a growth path for the company and taken on the turn-around of the Intermediated business. This business has been a long term under-performer for IAG and previous endeavours to improve its profitability have not been successful. The Board therefore welcomes Nick's decision to report on this business separately and to recruit into IAG a new experienced and highly regarded executive, Jarrod Hill, to lead it.

While I have focused, to some extent, on recent events, Nick, in his report, will focus strongly on the future and what he and his team plan to deliver to customers and shareholders.

Board renewal

The Board is undergoing a continued renewal process.

We have been fortunate to be able to add to the IAG Board two very experienced international insurance executives, George Sartorel and Scott Pickering who will considerably strengthen its insurance expertise.

George has had a long and distinguished career with Allianz Group and was most recently Regional Chief Executive, Asia Pacific. He has returned home to Australia and brings with him experience in creating and leading large, innovative insurance companies with digital business models.

Scott is a New Zealander who also returned home after a successful international career as a global insurance executive. He recently retired from the role of CEO of the NZ Accident Compensation Corporation.

The third new director, David Armstrong, will become the Chairman of the Audit Committee after this year's Annual General Meeting. David is a well-known and highly-respected company director. He is a former partner with PwC specialising in financial services and brings deep knowledge of audit and risk control and experience with Australian public companies.

As announced recently, Duncan Boyle, will retire from IAG's Board on 22 October 2021. Duncan has served on the Board for five years, including three years as Chairman of the Risk Committee and I acknowledge his bringing his long experience of the global insurance industry to the Board's deliberations.

Our announcement also included the news that I will not stand for re-election at IAG's Annual General Meeting this year. I have completed six years as Chairman and reached an age milestone that indicates retirement to be the better choice. It is my great pleasure to hand over the Chairmanship of this very special company to my long-term colleague on this Board, Tom Pockett.

Tom has expertly led the Audit Committee through the past years of change and remediation in IAG. He is well-positioned to complete this job and – with a strong Board, new CEO and skilled executive team – lead IAG into a successful future.

I will miss IAG. It is a company I have been very honoured to be associated with. Nothing makes me prouder than when I witness the people and capital of IAG mobilising at short notice to help those affected by the many natural disasters we experience in this country and in New Zealand. This is the heart and soul of IAG and the reason most of its people work here. Through its various businesses, IAG has been meeting this need for over 160 years and is a vital part of both Australia's and New Zealand's financial and social infrastructure.

Despite the last two difficult years I am confident the company will complete the actions in train to renew itself and that IAG will continue to play a strong role in the service of all its stakeholders.