FIIG | Factsheet

Insurance Australia Group Ltd

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Sector: Financials
Sub-sector: Insurance
Country: Australia
Ownership: Public

Issuer Outline

Insurance Australia Group Limited (IAG, Group) is the non-operating holding company of the largest general insurance group in Australia and New Zealand with controlled operations across Australia and New Zealand. The Group provides personal and commercial insurance products through leading brands in both Australia (NRMA, CGU, RACV and SGIC, among others) and New Zealand, underwriting ~AUD12.6bn of premium per annum.

Insurance Australia Limited (which accounts for ~three-quarters of gross written premiums) and IAG New Zealand Limited (the residual) represent the two main operating entities for the consolidated group.

The group is one the larger publicly-listed companies on the ASX (ASX: IAG), with a market capitalisation of ~AUD10.5bn.

Key Financials (AUDm)

LTM (30 June)	2021
Gross written premium	12,288
Net earned premium	7,420
Net claims expense	(5,957)
Insurance profit (loss)	(432)
NPAT[1]	(285)
Loss ratio (%)	64.3%
Combined operating ratio (%)	88.4%
PCA multiple (x)	1.86
CET1 ratio (%)	1.06

Source: Company Reports.
[1]Includes AUD1,150m to reflect potential impact of business interruption claims stemming from COVID19

Summary Bond Details

ISIN	Issue Amount	Ranking	Coupon	Coupon Frequency	First Call[1]	Maturity Date
AU3FN0055497	AUD450m	Subordinated Unsecured Tier 2	3M BBSW+2.45%	Quarterly	15 Dec 2026	15 Dec 2036
AU3FN0041687	AUD350m	Subordinated Unsecured Tier 2	3M BBSW+2.10%	Quarterly	15 Jun 2024	15 Jun 2044
AU3FN0047544	AUD450m	Subordinated Unsecured Tier 2	3M BBSW+2.35%	Quarterly	15 Jun 2025	15 Jun 2045

[1]Excludes potential terms that would allow the issuer to redeem prior to the maturity date through a make-whole call

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Tier 2 Structure	
Interest Deferral/Cancellation	Interest will be deferred only in the highly unlikely circumstances that the payment would result in the Group becoming insolvent.
Non-Viability Trigger	Standard Basel III compliant non-viability trigger. If APRA deems a non-viability event will occur the Notes can be converted to common equity, however can also be written off if the issuer is prevented by law or court order from converting the notes within five business days after a trigger event.
Holder Conversion	After the relevant call period has expired, where applicable, Noteholders have the option to convert the subordinated notes into ordinary shares at a 1% discount to the VWAP.

Strengths

- Leading insurance brands in its core markets: One of IAG's key strengths is its portfolio of well-known brands, providing pricing power and the ability to pass on reinsurance costs. Gross written premiums (GWP's) were up ~4% in FY21, with growth driven by increased volumes and margins (increased premiums).

  This strength is augmented by its distribution approach, which provides the Group with increased control over policy pricing and the cost and quality of business underwritten. In FY21, 46% of GWP's were originated through IAG's direct channels.

- Strong capital and earnings profile: As at 30 June 2021, IAG reported a Common Equity Tier One regulatory solvency ratio of 106%, comfortably within IAG's target benchmark of 90% – 110% (and a minimum regulatory requirement of 60%).

  IAG's capital is supported by a strong earnings profile, with underlying insurance margin (insurance profit adjusted for items including net natural peril claims) at ~15.0% in FY21. According to S&P Global Ratings, IAG's operating performance has generally compared favourably with local and regional peers in recent years, particularly in terms of net combined operating ratio and underwriting profits.

  Earnings stability is supported by a relatively low-risk business mix, with ~85% of GWP's in lower-risk short-tail (primarily home, motor and short-tail commercial, with much of the latter concentrated in the SME segment) (short-tail insurance products offer increased visibility about future claims as they are generally known and settled within 12 months). The stability of IAG's earnings profile was also supported by the continued divestment of its remaining Asian operations.

- Sound balance sheet structure and good quality (low-risk) investment portfolio to provide cover for claims: Property and casualty insurers, such as IAG, accumulate substantial funds due to the time gap between the receipt of premiums and the payment of potential claims. To ensure IAG has sufficient liquid funds available to meet payment obligations to policyholders and creditors, the Group maintains a high proportion of high-quality liquid assets. IAG currently applies a 90% probability of adequacy to the outstanding claims liability (regulatory minimum is 75%). In effect this means there is approximately a 1-in-10 chance all future claim payments will exceed the overall reserve held. At June 2021, the Group's investments were AUD12.4bn, of which ~60% were held in technical reserves (which are the investments held to support premium liabilities and outstanding claims reserves) and the remainder in shareholders' funds. Close to 70% of investments are held in fixed interest and cash, of which 86% are rated 'AA' or higher.

  This compares with outstanding claims reserve (a provision for the future liability for claims which have occurred but which have not yet been settled), net of reinsurance and recoveries of AUD7.2bn and unearned premiums (premiums written but not yet earned) of ~AUD6.5bn (the unearned premium reserve is a balance sheet reserve to cover the unearned portion of a policy in the event a policyholder or the insurer decides to cancel the policy during its tenure).

- Reinsurance arrangements provide capital and earnings protection: IAG's reinsurance program is an important part of its approach to capital management. IAG has a philosophy of limiting its main catastrophe retention to a maximum of 4% of gross earned premiums. Current retentions are below this level. As reinsurance costs rise, these additional costs are passed onto policyholders in the form of higher premiums (which is aided by IAG's strong market position).

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Complementing IAG's reinsurance arrangements is a quota shares program with Berkshire Hathaway (20%) and Munich Re, Swiss Re, Hannover Re (12.5%). Quota shares provide the partner entities with a proportion of IAG total revenue (premium) over the life of the contract in return for underwriting a proportion of all claims, operating expenses and commission over the contract period. The benefit of quota shares is that it reduces earnings volatility and reduces the amount of reinsurance required.

Risks

- Material exposure to natural peril events: IAG, as a provider of property and casualty insurance, has a high exposure to natural perils, which are increasing in terms of both frequency and severity. A significant environmental change or external event has the potential to disrupt the general insurance business with the potential for large numbers of insurance claims in the instance of such events. Net claim costs from natural perils have overrun allowances (provisions) for four of the last five years.
- Interest rate risk within investment portfolio: Like all insurance companies, IAG's interest rate risk arises primarily from fluctuations in the valuation of investments in fixed interest-bearing securities (70% of IAG's investment portfolio is held in fixed income and cash). Movements in interest rates can result in material losses (or gains), albeit, generally unrealised (to the extent losses do not need to be crystalised (realised) to support the company's ability to meet its claims, losses should generally unwind).

  For example, IAG reported investment income on technical reserves of AUD139m in FY21 (down ~4%) (Technical reserves are investments held to support premium liabilities and outstanding claims reserves) and a gain of AUD306m within its shareholders funds' (compared to a loss of AUD181m in FY21), reflecting market volatility accompanying the onset of COVID-19 (see financial summary for performance of investment portfolios over last five years). Investment income on shareholders' funds was a profit of AUD306m in FY21, largely due to an unwinding of the events in FY20.

Risks relevant to the Subordinated Unsecured Tier 2 instrument

- Subordinated ranking: Regulatory Tier 2 instruments are unsecured and subordinated instruments, ranking ahead only of ordinary shares and regulatory Additional Tier 1 hybrids. Tier 2 instruments rank behind senior creditors, which includes senior unsecured creditors and policyholders.
- Basel III compliant structural features: The subordinated bonds are Basel III compliant and as such do not include a step-up margin if not called and contain a point of non-viability clause. If APRA, the Australian Prudential Regulator, determines that IAG requires capital support to prevent it becoming non-viable (a 'non-viability event'), IAG may be required to convert some or all of the notes into ordinary shares. The number of shares at time of conversion may be worth significantly less than the face value of the notes and a holder may suffer a loss as a consequence of conversion.

  If the notes required to be converted following a non-viability event are not converted for any reason within 5 business days of the non-viability trigger, then conversion will not occur and the notes will be written off.
- Risks upon conversion: Ordinary shares rank behind the claims of all other securities and debts in a winding-up of IAG. Ordinary Shares trade in a manner that is likely to be more volatile than that of Subordinated Notes and the market price is expected to be more sensitive to changes in the performance and prospects of the business.
- Coupons are deferrable: IAG may elect to defer payment of all or part only of any interest amount payable in respect of the Notes, by giving no less than five business days' notice to noteholders.

  However, any deferred coupon is cumulative and will accrue interest at the applicable Interest Rate until it is paid. In addition to this, IAG is only able to defer a coupon at its own discretion if no distributions have been made on junior ranking instruments or certain equal ranking instruments during the financial year in which such coupon payment date falls, and no dividend on its ordinary shares has been paid in the preceding 12 months.
- Optional call dependent on regulatory approval: The Notes include an early call feature where the face value of the Tier 2 notes may be repaid early in cash. The optional redemption requires regulatory approval, which may not be provided.

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In general, regulators are unlikely to provide approval for a Tier 2 instrument to be called if it results in a reduction in the issuer's capitalisation; regulators are unlikely to provide approval for a redemption or resale unless the issuer has, or is expected to, issue an instrument of similar size to replace the instrument subject to that call. To the extent the optional call was expected not to be exercised, it is likely that the price of the notes will be negatively affected, with this negative price movement being potentially material.

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Financials

The financial summary below represents the consolidated operations of IAG

FYE June 30 (AUDm)	2017	2018	2019	2020	2021
Profit and Loss					
Gross written premium	11,439	11,647	12,005	12,135	12,602
Net earned premium	8,199	7,671	7,238	7,363	**7,473**
Net claims expense	(5,082)	(4,617)	(4,619)	(5,010)	(4,807)
Acquisition and other underwriting costs	(2,079)	(1,877)	(1,716)	(1,757)	(1,798)
Underwriting profit	1,038	1,177	903	596	**868**
Investment income on technical reserves	232	230	321	145	139
Insurance profit	1,270	1,407	1,224	741	**1,007**
Investment income on equity holders' funds	246	165	227	(181)	306
Net profit after tax	929	923	1,076	435	**(427)**
Balance Sheet					
Cash and investments	12,560	11,455	11,222	10,505	12,743
Net premium receivables	3,363	3,589	3,747	3,719	3,873
Reinsurance and other recoveries on outstanding claims	5,258	5,422	5,779	6,069	7,272
Deferred insurance expenses	2,770	3,443	3,451	3,501	3,601
Goodwill and other intangibles	3,332	3,183	3,098	3,134	3,220
Total assets	29,597	29,766	29,286	29,694	**33,449**
Reinsurance premium payable	712	1,157	1,213	1,110	1,194
Outstanding claims liability	11,371	10,410	10,296	10,584	13,312
Unearned premium liability	6,331	6,217	6,334	6,276	6,527
Interest bearing liabilities	1,624	1,960	2,080	1,526	1,987
Total liabilities	22,805	22,825	22,576	23,340	**26,893**
Net assets	6,792	6,941	6,710	6,354	**6,556**
Credit metrics					
Loss ratio	62.0%	60.2%	63.8%	68.0%	64.3%
Combined ratio	87.3%	84.7%	87.5%	91.8%	88.4%
Insurance margin	15.5%	18.3%	16.9%	10.1%	13.5%
Underlying insurance margin*	12.4%	14.1%	16.6%	16.0%	14.7%
Probability of Adequacy (APRA requirement > 75%)	90%	90%	90%	90%	90%
CET1 ratio (APRA requirement > 60%)	109%	126%	131%	123%	123%
PCA multiple	1.70x	2.03x	2.12x	1.97x	1.97x

**Insurance margin adjusted (by management) for natural peril claims (less allowances), reserve releases in excess of 1% of net earned premium; and credit spread movements. Source: IAG*

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