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# Suncorp Group Limited

23 February 2023

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

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## Issuer Outline

Suncorp Group Limited is a non-operating holding company ("NOHC") and the ultimate parent company of Suncorp Group (Suncorp, Group), which is listed on the ASX with a market capitalisation of AUD16.1bn as at 23 February 2023.

Suncorp provides insurance, banking and wealth solutions services across Australia and New Zealand, through three segments: Insurance Australia, Banking, and Suncorp New Zealand.

AAI Limited is the main operating general insurance company for Suncorp. AAI underwrites and distributes personal and commercial general insurance products across Australia through direct and intermediated channels under several leading brands which include AAMI, GIO, Suncorp, Vero, and APIA, as well as a number of niche brands including Bingle.

Suncorp Metway Limited is the main operating entity for Suncorp's banking products, which primarily involve the provision of retail and small business banking in Australia. The recent announcement of the sale Suncorp's banking operations to ANZ is expected to be completed in end-2023.

## Key Financials (AUDm)

| LTM (30 Jun) | 2022 |
|---|---|
| Gross written premium[1] | 11,382 |
| Insurance profit[1] | 329 |
| Loss ratio (%)[1] | 65.7 |
| Net interest income[2] | 1,245 |
| Net interest margin (%)[2] | 1.93 |
| Credit loss (%)[2] | (0.04) |
| NPAT | 681 |
| CET1 multiple[1] | 1.22x |
| CET1 ratio (%)[2] | 9.08 |

*[1]General Insurance, [2]Bank*
*Source: S&P Capital, FIIG Securities, Company*

## Summary Bond Details

| ISIN | Issue Amount | Ranking | Coupon | Coupon Frequency | First Call[1] | Maturity Date |
|---|---|---|---|---|---|---|
| AU3FN0044251 | AUD 600m | Sub. Unsec. Tier 2 | 3M BBSW + 2.15% | Quarterly | 5 Dec 2023 | 5 Dec 2028 |
| AU3FN0055802 | USD 250m | Sub. Unsec. Tier 2 | 3M BBSW + 2.25% | Quarterly | 1 Dec 2025 | 1 Dec 2035 |
| AU3CB0239267[2] | AUD 600m | Senior Unsecured | 3.25% | Semi-Annual | N/A | 24 Aug 2026 |
| AU3FN0067906 | AUD 290m | Sub. Unsec. Tier 2 | 3M BBSW + 2.30% | Quarterly | 1 Jun 2027 | 1 Jun 2037 |
| AU3FN0075644 | AUD 250m | Sub. Unsec. Tier 2 | 3M BBSW + 2.65% | Quarterly | 1 Dec 2028[3] | 1 Dec 2038 |

*[1] Excludes potential terms that would allow the issuer to redeem prior to the maturity date through a make-whole call.*
*[2] Issued by Suncorp Metway Limited – covered bond. [3]Discrete call, with the next call date on 1 March 2031 and quarterly thereafter.*

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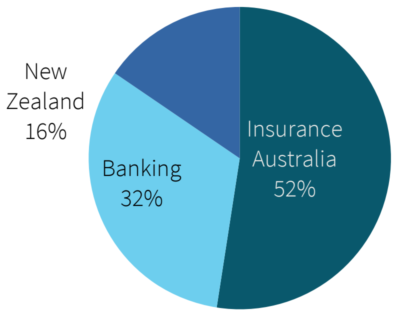
| Tier 2 Structure | |
|---|---|
| Interest Deferral/Cancellation | Interest is deferrable and cumulative if, prior to the payment of interest, the issuer is not solvent or would not be solvent after payment. |
| Non-Viability Trigger | Yes, standard Basel III compliant non-viability trigger. If APRA determines the issuer is at risk of becoming non-viable, the terms of the notes indicate that the primary method of loss absorption will be via conversion of the subordinated notes into equity, in-part or in full. |
| Holder Conversion | The December 2038 Tier 2 notes include a right for holders to require the conversion of their notes in December 2030 at a 1% discount to the volume-weighted average price of the Suncorp shares during the 20 business days prior to the conversion date. |

## Strengths

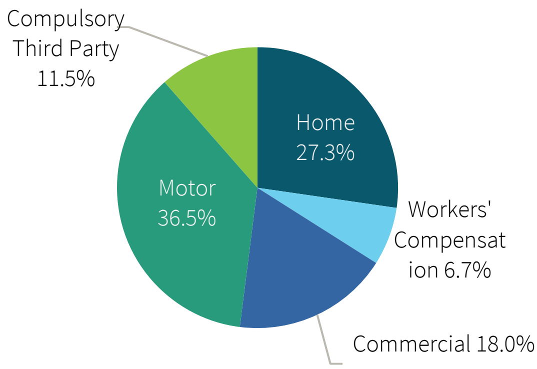
- Diversified operations : Suncorp Group has a well-diversified business portfolio, dominated by its well-regarded general insurance division and large retail and business bank. Suncorp reported a NPAT of AUD681m for the full year ended 30 June 2022 (FY22). General Insurance within Australia contributed 26% of the most recent profit and Suncorp's Banking business contributed 54% of overall profit (New Zealand general insurance makes up the residual) (see Figure 1 for the five-year average). Suncorp's General Insurance portfolio is spread across five different products, with Motor Insurance being the largest contributor (see Figure 2). While the proposed sale of Suncorp-Metway to ANZ will result in some loss of diversification, this is mitigated by the insurance earnings being currently of higher quality than the bank's.

Figure 1: Profit contributions by function (5-yr Avg)




*Source: Company*

Figure 2: General insurance portfolio by product (Australia)




*Source: Company*

- Strong and resilient earnings : The Group's earnings and balance sheet displayed resilience, particularly in the property/casualty (P/C) businesses, given the backdrop of lingering pandemic effects, rising inflation and interest rates and volatile markets. Its insurance business benefited from a 9.2% increase in gross written premiums in Australia and 14.1% in New Zealand, on the back of both premium rate increases and strong retentions, thus highlighting the strength of its franchise and its ability to reprice its policies without foregoing customer numbers.
- Prudent balance sheet and capital management : Suncorp exercise a conservative approach to balance sheet and capital management, and as such it maintains a strong capital position with the General Insurance and Bank subsidiaries, reporting a total capital ratio of 1.77x and 12.99%, respectively, at FY22. Suncorp also exhibits a well-diversified funding profile by source and maturity. Property and casualty insurers, such as Suncorp, accumulate substantial funds due to the time gap between the receipt of premiums and the payment of potential claims. To ensure Suncorp has sufficient liquid funds available to meet payment obligations to policyholders and creditors, the Company maintains a high proportion of high-

quality liquid assets, with the majority being fixed income investments with only a small exposure to equities. As at 30 June 2022, Suncorp's total investment securities (backing policyholder and shareholder funds) equalled AUD21.0bn, of which 94.5% are investment grade fixed income (inc. cash).

- Reinsurance arrangements provide capital and earnings protection : Insurers including Suncorp overlay the risk from catastrophes and other claims expenses with reinsurance, whereby they transfer portions of their risk portfolios to other insurers (reinsurers) to reduce the likelihood of paying a large obligation resulting from an insurance claim. Suncorp's reinsurance program is wide-ranging and comprises arrangements with over 85% of business protected by reinsurers rated 'A+' or better. The program's group maximum event retention remains at AUD250m with an upper limit of AUD6.5bn which covers the Home, Motor and Commercial property portfolios across Australia and New Zealand. The FY22 limit remains in excess of Australia and New Zealand regulatory requirements. Catastrophe cover for major events is AUD6.5 billion for FY22 (modelled outcome on a 1-in-200 year event loss for Australia), while its aggregate excess loss of cover (reinsurance for total losses that occur over a period of time) provides AUD400m in protection for natural hazards in excess of AUD5.0m, once a total retained cost of these events reaches AUD650m. Suncorp also maintains a 30% multi-year quota share arrangement covering the Queensland home insurance portfolio (which in effect attempts to share the claims expense by ceding some of the premiums earned over the life of the contract).
- Sound macro environment and regulatory oversight : Australian financials benefit from operating in an economy characterised as having a very high degree of economic resilience with low susceptibility to event risk. While the Australian economy has recovered relatively strongly from the direct impacts of the pandemic, the current high inflation environment and associated interest rate increases by the Reserve Bank of Australia have the potential to put strain on the post-pandemic recovery, with increased pressure on consumers. The current low level of unemployment and significant savings accumulated over the past two years should provide a buffer. Nevertheless, Suncorp maintains adequate level of credit provisioning to account for this uncertain outlook. Australian banks including Suncorp are overseen by a highly regarded prudential regulator, APRA, who oversees banking, insurance and superannuation, with the aim of maintaining the integrity, safety and soundness of financial institutions.
- Sale of Suncorp Metway: In mid-2022, Suncorp announced that it will sell its banking business (Suncorp Metway Ltd) to ANZ for AUD4.9bn, meaning it will solely operate as an insurance business. The rationale behind this, from Suncorp's point of view, is to simplify its business and focus on becoming an even larger player in the insurance industry. Although the transaction has some negative aspects (the Company will lose some of its current earnings diversity), its earnings quality will improve over time, which we view as a positive given they will reside in its largest business arm. The transaction, subject to a number of regulatory approvals, is expected to take twelve months and due for completion in 2H23.

### Strengths relevant to Senior Unsecured Covered instrument

- Limited Recourse Security: Covered bonds, such as the August 2026 notes, are senior unsecured obligations of the issuer but also have the benefit of a security over a pool of residential mortgages. In the event of a default of an issuer, the trustee will have the ability to liquidate the pool of mortgages in order to repay the notes. This feature enables covered notes to be rated above the rating of the issuer.

### Risks

- Material exposure to natural peril events: As a property and casualty insurer, the Group is vulnerable to natural hazard costs; the significant increase in the number and volume of natural hazard events has resulted in hazard costs being higher than the Group hazard allowance for the last two years (it is not uncommon for natural hazard costs to come in above allowances). This quantum of catastrophe losses will drive increased allowance (reduced earnings retention), and therefore rising reinsurance costs. The high exposure to natural perils particularly in Queensland, a state with a heavy prevalence of natural disasters such as floods, drought and cyclones, is also likely to have an impact on Suncorp's banking services (both regional and rural), which in-turn may impact the Suncorp's overall earnings performance.
- Overweight in Queensland: Across its businesses, Suncorp's portfolio is heavily weighted towards Queensland with this state making up approximately 25% of Suncorp's Insurance in addition to 47% of Suncorp Bank's lending portfolio,

respectively (although the latter has reduced in recent years). This leaves the Group and its consolidated operations significantly exposed to unfavourable events specific to Queensland, exogenous (such as material weather events) and otherwise (rising unemployment, falling house prices etc.)

- Interest rate risk within investment portfolio: Like all insurance companies, Suncorp's interest rate risk arises primarily from fluctuations in the valuation of investments in fixed interest-bearing securities (~95% of Suncorp'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 crystallised (realised) to support the company's ability to meet its claims, losses should in theory unwind). Suncorp reported total investment income on insurance funds (funds held to support premium liabilities and outstanding claims reserves) and shareholder funds of AUD(590m) in its FY22 results, due largely to widening credit spreads and market volatility.
- Bond is issued out of holding company: Given that Suncorp Group Limited receives revenue from its subsidiaries, the bond is reliant on the dividends from the subsidiaries. Despite this, these subsidiaries are highly profitable businesses, particularly the banking and general insurance divisions. As such, it is unlikely that we will see a situation where these subsidiaries won't pay a coupon.

### Risks relevant to Senior Unsecured Covered instrument

- August 2026 notes are obligations of Suncorp Metway Limited: The August 2026 notes have been issued by Suncorp Metway Limited and do not benefit from a guarantee from Suncorp Group. Despite the structure, the credit quality of Suncorp Metway largely mirrors the credit quality of the Group, given the assumption that the broader group would provide support to Suncorp Metway in almost all circumstances. While Suncorp Metway's stand-alone credit quality is weaker than that of the Group, the assumption of group support means that Suncorp Metway's ratings are solely influenced by the rating of Suncorp Group.

### Risks relevant to Subordinated Unsecured Tier 2 Instrument

- Deeply subordinated ranking: Tier 2 are unsecured and deeply subordinated instruments, ranking ahead only of ordinary shares and additional Tier 1 (AT1) hybrids. Tier 2 rank behind senior creditors, which includes depositors, senior unsecured and senior non-preferred creditors (mostly relevant for European banks, only), noting that Tier 2 instruments will rank ahead of AT1 hybrids.
- Optional call dependent on regulatory approval: Tier 2 and AT1 notes include an early call feature where the face value of the notes may be repaid early in cash from a given date stated in the terms and conditions of the instrument. The optional redemption requires regulatory approval, which may not be provided.

  In general, regulators are unlikely to provide approval for a Tier 2 or AT1 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.
- Conversion or write-down following a Non-Viability Trigger Event: A Non-Viability Trigger Event occurs when APRA determines conversion to ordinary shares (or write-off) of some or all of an issuer's contingent capital securities (AT1 and Tier 2) is necessary to prevent that financial institution becoming non-viable. Whether a non-viability trigger event will occur is solely at the discretion of APRA. APRA does not define what constitutes a non-viability event and there are currently no precedents under Basel III to determine non-viability. If such event occurs, the issuer may be required to convert some or all of its AT1 or Tier 2 notes into ordinary shares. In a more severe scenario, the issuer may be required to write-off the value of these notes. We note that it is expected that the conversion / write-off would be expected to be applied first to AT1 hybrids and only then to the Tier 2 if the AT1 conversion / write-off was not sufficient to restore the issuer to a viable position.

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- Capped equity conversion: Conversion of Tier 2 and AT1 notes following a capital trigger event (for AT1 only) or a non-viability trigger event is subject to a maximum number of shares being issued. As such, if the notes are converted into ordinary shares, the value of ordinary shares an investor receives may be significantly less than the face value of their notes.

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