News Release

20 November 2020

NOT FOR RELEASE OR DISTRIBUTION IN THE UNITED STATES

IAG responds to business interruption test case judgment and announces capital raising of up to $750 million to strengthen balance sheet

IAG has announced it will raise up to $750 million in new equity capital in response to the Supreme Court of New South Wales Court of Appeal (NSWCA) 18 November judgment on the business interruption insurance test case.

In a unanimous decision, the NSWCA determined pandemic exclusions that refer to the Quarantine Act and subsequent amendments, rather than the Biosecurity Act, are not effective to exclude cover for losses associated with COVID-19.

IAG's view is that the intent of its business interruption policies is to not provide cover for any losses related to pandemics such as COVID-19. As a result, IAG is in discussions with the Insurance Council of Australia to consider whether the insurers that were party to the action will seek special leave to appeal the NSWCA's judgment to the High Court of Australia. If an appeal proceeds, an outcome is expected in calendar year 2021.

Given the NSWCA's decision, IAG intends to recognise a post-tax provision of $865 million and is taking decisive action to strengthen its balance sheet via a fully underwritten institutional placement of $650 million and a non-underwritten share purchase plan to raise up to $100 million.[1]

Provision for potential business interruption claims

IAG has received a small number of business interruption-related claims to date. However, in light of the NSWCA's judgment, IAG has estimated the potential claims impact in its reserving position for the half year ending 31 December 2020.

Based on a detailed assessment of its underwriting exposure at 31 October 2020, IAG estimates a post-tax provision of approximately $865 million is required to reflect the potential impact of the NSWCA judgment. Significant judgment has been exercised to derive the provision estimate, which has been subject to independent peer review and includes a risk margin to derive a 90% level of confidence for the Group's total outstanding claim liabilities. The provision covers:

- All policies with wordings that include the Quarantine Act and without specific reference to the Biosecurity Act, which replaced the Quarantine Act; and
- All policies with prevention of access extensions used on certain broker platforms which reference the Biosecurity Act. Prevention of access clauses vary in terms but generally operate when actions of governments or other legal authorities cause business interruption by preventing or restricting access to premises.

The prevention of access issue was not subject to the test case heard by the NSWCA and it remains IAG's view that overarching pandemic exclusions also apply in this instance. Following the NSWCA judgment, IAG has prudently increased the provision to cover all policies with prevention of access extensions and this represents around $150 million of the total post-tax provision indicated above.

[1]Subject to scale-back and IAG's ability to raise less or more in its absolute discretion

IAG's estimated combined business interruption and prevention of access exposure includes allowance for a period of recovery from the lockdowns. While it does not explicitly allow for any future state or national lockdowns after 31 October 2020, IAG's exposure to the Quarantine Act wording issue will progressively reduce as all new and renewing policies now reference the Biosecurity Act.

The provision is estimated to have a net post-tax impact on IAG's FY21 earnings of approximately $805 million. This is after allowance for the business interruption portion of the $106 million pre-tax COVID-19 provision included in IAG's FY20 results, which is approximately $60 million post-tax.

Year-to-date trading update and potential 1H21 earnings impacts

As outlined at the Annual General Meeting on 23 October 2020, the opening quarter of IAG's current financial year, for the three months ended 30 September 2020, saw:

- Low single digit GWP growth, despite an adverse foreign exchange translation effect from New Zealand;
- An underlying margin performance similar to the 14.1% reported in 2H20 (excluding underlying reserve release assumption of 1%), after inclusion of broadly neutral COVID-19-related effects; and
- A reported margin which benefited from the seasonally quiet period for natural peril events.

Excluding the earnings impact of today's announcement, these GWP growth and underlying margin trends have continued into October. The October month included the impact of three separate east coast storm events. After allowing for protection provided by the calendar 2020 aggregate cover, IAG's perils costs are tracking broadly in line with the related perils allowance. Following further erosion of aggregate cover, IAG's estimated Maximum Event Retention at 1 November 2020 had increased to $92 million post-quota share (1 July 2020: $41 million).

As at 20 November, IAG has identified other items which may be recognised in its reported earnings for the six months ended 31 December 2020 (1H21). Collectively, these have the potential to result in a pre-tax charge in the range of $70 million to $90 million (~$50 million to $65 million post-tax), and include:

- An anticipated increase to the customer refunds provision established in FY20 to cover further multi-year pricing issues where discounts were not always applied in full to premiums. Consistent with FY20, any charge will be excluded from cash earnings; and
- Net prior period reserve strengthening, with increased reserving across Australian long tail classes reflecting higher large claim incidence and adverse development trends, inclusive of revised economic considerations. There has been some offset from releases from short tail claims settlement in the opening months of FY21.

These figures are based on a preliminary view of IAG's 1H21 results and remain subject to finalisation.

Capital position and proposed capital raising

At 31 October 2020, IAG held total regulatory capital of approximately $4.8 billion. This included Common Equity Tier 1 (CET1) capital of $2.85 billion, which represented a CET1 ratio of 1.34 times the Prescribed Capital Amount (PCA) compared to IAG's targeted benchmark range of 0.9-1.1 times the PCA.

Recognition of the business interruption claims provision outlined above would reduce IAG's regulatory capital by over $950 million, after allowance for the combined deferred tax, excess technical provision and premium liability effects.

As a result, IAG's CET1 ratio would reduce to approximately 0.84 times the PCA, placing it approximately $140 million below the lower end of IAG's targeted benchmark range. IAG's total regulatory capital position would reduce to a PCA multiple of 1.72, which is above the mid-point of its targeted benchmark range of 1.6 to 1.8.

Irrespective of whether there is an appeal against the NSWCA judgment, IAG believes it is prudent to maintain its capital position above the upper end of its CET1 target range. To achieve this, IAG is proposing to raise up to $750 million of new equity capital from the combination of:

- A fully underwritten institutional placement raising $650 million at a fixed price of $5.05 per new share; and
- A non-underwritten retail share purchase plan targeting up to $100 million.

Following completion of the combined capital raising, and after recognition of the additional business interruption provision, IAG's CET1 ratio is expected to increase to approximately 1.15 times the PCA, on a pro forma basis at 31 October 2020.

Further information about both aspects of the capital raising can be found in the investor presentation lodged with the ASX today.

This release has been authorised by the Group CEO

About IAG

IAG is the parent company of a general insurance group (the Group) with controlled operations in Australia and New Zealand. The Group's businesses underwrite over $12 billion of premium per annum, selling insurance under many leading brands, including: NRMA Insurance, CGU, SGIO, SGIC, Swann Insurance and WFI (Australia); and NZI, State, AMI and Lumley (New Zealand). IAG also has an interest in a general insurance joint venture in Malaysia. For further information, please visit www.iag.com.au.

Media

Amanda Wallace
Mobile. +61 (0)422 379 964
Email. amanda.wallace@iag.com.au

Investor Relations

James Coghill
Mobile. +61 (0)412 426 272
Email. james.coghill@iag.com.au

Insurance Australia Group Limited

ABN 60 090 739 923
Level 13, Tower Two, 201 Sussex Street Sydney
NSW 2000 Australia
Telephone. +61 (0)2 9292 9222
www.iag.com.au