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Credible result during difficult year but needs to do better

Company/ASX Code	Insurance Australia Group Limited /IAG
AGM date	Friday 21 October 2022
Time and location	9.30am AEDT Wesley Conference Centre,220 Pitt St, Sydney
Registry	Computershare
Type of meeting	Hybrid
Poll or show of hands	Poll on all items
Monitor	Ian Graves assisted by Sue Howes
Pre AGM Meeting?	Yes with Chairman Tom Pockett, George Savvides , Chairman People & Remuneration Committee , Peter Horton Company Secretary, Phil Rutgers Remuneration, Mark Ley Investor Relations

Monitor Shareholding: The individuals involved in the preparation of this voting intention have shareholdings in this company.

Summary of issues for meeting

Remuneration

ASA has been critical of the remuneration report with its emphasis on Short Term Incentives, resulting in our voting against the report for the previous 2 years. Last year IAG received a first strike.

Financial performance.

Over the last five years, performance has been inconsistent with TSR for the period (3.05%). Admittedly results have been impacted by several major natural hazard events, however results have also be affected by poor underwriting decisions.

Governance & Culture

Compliance issues relating to Customer refunds and payroll compliance. Much of this resulted from legacy systems. These have mainly been rectified, although were a major distraction to the business.

Associated with these compliance issues has been the associated instability of the KMP's through the necessary remedial actions.

No.	Resolution description	
1	Re-election of Tom Pockett as a Director	For
2	Re-election of Helen Nugent as a Director	For
3	Re-election of George Savvides as a Director	For
4	Election of Scott Pickering as a Director	For
5	Adoption of Remuneration Report	Against
6	Allocation of share rights to Mr Nick Hawkins CEO/Managing Director	Against
7	Spill motion (contingent resolution)	Undecided

See ASA Voting guidelines and Investment Glossary for definitions.

Summary of ASA Position

Consideration of accounts and reports - No vote required

IAG, despite 14 significant natural hazard events over $15m, and another $387m for events under $15m (a total of $1,119m), was able to post a credible 89.6% (COR)combined operating ratio. FY 22 was also the first full year under the new CEO, who further clarified the company strategy and the completion of the exit from Asia to concentrate on the Australian and New Zealand markets.

This has increased the emphasis on the Insurance Broker market in general and specifically the South & Western Australia markets, using the CGU brand. This strategy has enabled customer growth for the first time for several years.

Governance and Culture

In FY22, voluntary turnover was 17%, which is 30% higher than the previous year of 13% and the 11% in 2020, with Retention rates very strong during Covid. The average staff tenure is 14 years.

Risk management

Cyber security, with increased digitalisation, has become a major issue. The cyber team at IAG report to the Board at each meeting on a range of metrics, including number of attacks and level of success. This issue is receiving continual focus and updating of safeguards. The framework follows ASIC rules and the company has undertaken several tests. They are also a member of an industry peer group sharing information as well as receiving assistance from government. To date there have been no serious issues.

As a result of past failures, IAG have rebuilt their entire risk team, as well as developing a new risk program with one accountability end to end. i.e., pricing, product, marketing, overarching approval for policy wording changes.

Financial performance Although there were heartening developments, shareholders have yet to benefit from these initiatives. Receiving a reduced dividend of 11c, down 50% on the previous year, providing a (TSR) Total shareholder return for the year of (13.3%) and (3.05%) for the last 5 years.

Key Board changes.

M/s Sheila McGregor, who has been a Board member since 2018, has announced her retirement from the Board. This reduces the number of Directors to 9, 27% Female, down from 40% in August last year.

The Chairman has advised that the Board is actively searching for a female Director and it is their intention to return to the target of 40% as soon as is practical.

Summary

(As at FYE)	**2022**	**2021**	**2020**	**2019**	**2018**
NPAT ($m)	424	(264)	498	969	1,026
UPAT ($m)	1,140	1,103	1,126	1,227	1,093
Share price ($)	4.36	5.16	5.77	8.26	8.53
Dividend (cents)	11.0	20.0	10.0	37.5	34.0
Simple TSR (%)	(13.3)	(7.10)	(35.04)	2.35	25.80
EPS (cents)	14.1	(17.8)	18.9	46.3	39.1
CEO total remuneration, actual ($m)	2.272	2.949	5.743	5.407	4.502

Re-Election and Election of Directors

Tom Pockett
Was appointed a Director of IAG on 1 January 2015, becoming Chairman at the conclusion of the 2021 AGM. Chairman of Nomination Committee since 22 October 2021. Tom is also Chairman of Insurance Manufacturers of Australia Pty.
Directorships of other listed companies:
Chairman of Stockland Group, Non-Executive Director of O'Connell Street Associates
Previous experience was CFO of Woolworths and then Finance Director with Woolworths Limited,

Helen Nugent AC
Insurance Industry experience.
Helen Nugent was appointed a Director of IAG on 23 December 2016. She is a member of the Audit Committee and Nomination Committee.
Previously, was Chairman of Swiss Re (Australia) and Swiss Re (Life and Health) Australia, and a Non-Executive Director of Mercantile Mutual.

George Savvides
Insurance Industry experience previously CEO Medibank for 14 years (2002-2016), and CEO of Sigma Company (now Sigma Healthcare) (1996-2000)
George Savvides was appointed a Director of IAG on 12 June 2019 and has been Chairman of the People and Remuneration Committee since 10 February 2021 and a member of the Risk Committee and Nomination Committee.

Election
Scott Pickering
Over 30 years Insurance Industry experience. Scott Pickering was appointed to the IAG Board on 1

November 2021 and is a member of the Audit Committee.
Prior to that was Chief Executive of New Zealand's Accident Compensation Corporation until June 2021.
Scott has been a CEO and Global leader in the insurance industry for over 30 years.
Scott is a Non-Executive Director in state-owned Kiwibank and was formerly NED for Chubb Insurance for ANZ.

Adoption of Remuneration Report

Details of the remuneration for the CEO are shown in Appendix 1.

For the last 2 years ASA has voted against the remuneration report because of its emphasis on short term incentives. Last year IAG received a 1st strike with 57.25% votes against the report.

This year there have been changes, to ensure:

- Greater alignment between shareholder & executive remuneration outcomes.
- A simplified approach to performance measures
  - Reduced STI measures to 6 and aligned more closely with IAG's strategy pillars
  - Increased Financial weighting of STI financial measures to 60%.
  - LTI reported ROE measure replace Cash ROE.
  - Increased TSR threshold to 50.1% percentile weighting.
- Enhanced Transparency
  - Retrospective disclosures of STI financial measures.
  - Greater disclosure on determining the STI pool.
- Longer-term – Framework review to comply with CPS 511 regulatory changes from 2024.
- Review ESG metrics into Executive arrangements from 2024.

Although the changes that have now been made are welcome, they don't yet address our major concern of the excessive STI component.

ASA are hopeful that the LTI review will act on our concerns, but until then we are unable to support the Remuneration report and will be voting all undirected proxies against this resolution.

Allocation of equity grants to Nick Hawkins CEO/Managing Director.

This resolution proposes that that for Mr Hawkins long term incentive he be awarded Deferred Award Rights (DAR's) and Equity Performance Rights (EPR's), in accordance with the terms of the schemes and to be purchased on market.

Rights are only awarded if Mr Hawkins meets the necessary hurdles. Details can be found in Appendix 1. If resolution 6 is approved, Mr Hawkins will be granted 61,600 DARS. The amount of the award is determined as being $528,046 and EPRs of 629,500.

Fixed pay at the time of the grant being $1.8m and the VWAP, based on 30 days up to 30 June 2022, being $4.29.

Although ASA agrees with the EPR's and DAR's as explained in the resolution, we don't support the resolution as we are opposed to the Remuneration plan and will be voting all undirected proxies against this resolution.

Spill motion (in the event of a second strike on remuneration report)

Generally, we will oppose spills as it is a dramatic step to take, as opposed to just sending a message on remuneration policies. However, as we are opposing the remuneration report and have continued to do so consistently for a number of years, if IAG receives a second strike, we will decide at the meeting based on the discussion and events that occur at the AGM.

Appendix 1
Remuneration framework detail

The CEO remuneration structure is set out below.

CEO remuneration framework	Target* $m	% of Total	Max. Opportunity $m	% of Total
Fixed Remuneration	1,763	29%	1,763	25%
STI - Cash	850	14%	1,320	19%
STI - Equity	850	14%	1,320	19%
LTI	2,570	43%	2,570	37%
Total	6,033	100%	6,973	100%

NPAT used to set the STI pool. This year this was set at 20% of maximum and 33% of target.

Balanced Scorecard measures are then used to determine actual award.

STI is 50% cash and 50% DAR that vests over two years at 30-day VWAP.

LTI is 50% ROE (no longer cash ROE) and 50% TSR and has a four year performance period. Vesting to commence at the 50.1 percentile and 50% by Reported ROE, with no vesting if under the 10% threshold.

ASA has voted against the remuneration plan at IAG largely on the basis of the structure of the STI part of the plan. The maximum STI is set at 150% of fixed remuneration and is paid 50% in cash, 25% in DAR that have no vesting criteria and are vested at the end of the year in question and another untested DAR that vests one year hence.

The actual remuneration for the CEO is set out in the following table:

	FY22	FY21	FY20	FY19	FY18
Fixed (incl ancillary benefits)	$ 1,846,000	$ 1,574,000	$ 1,926,000	$ 1,994,000	$ 1,788,000
STI cash current year	$ 264,023	$ 634,000	$ -	$ 709,000	$ 1,258,000
STI DAR current year	$ 132,012	$ 136,000	$ 256,000	$ 199,000	
STI DAR from previous year	$ 136,000	$ 818,000*	$ 199,000		
LTI ROE	$ -	$ -	$ 782,500	$ 781,000	$ 801,515
LTI TSR	$ -	$ -	$ 782,500	$ 781,000	$ 256,485

- Is STI that relates to the previous CEO and includes an amount due to be paid in FY22 that would otherwise have made things more confusing.

The green shaded area relates to payments to the previous CEO.

The LTI has failed to vest in the last two years due to not meeting hurdles that align performance with shareholder experience.

While the actual STI for the current and previous years does not seem unreasonable, our issue is with the structure of these benefits and the potential this has for incentivising short-term thinking over longer-term alignment in management.

Looking at the FY22 STI the following can be seen:

The maximum for the CEO for the year was $2.64m. There is an effective financial gateway with the pool being set based on NPAT before amortisation compared to the amount budgeted. The budget for this year was $640m. The Board used its discretion to reduce the actual figure calculated to take out a significant one off writeback plus a few other one-off items. Actual ended up coming in at $214m – giving a pool size of 20% of maximum.

If the Board had not used their discretion that actual NPAT figure was $424m (NB: not adjusted for amortisation), giving a pool size of about 66% of target, for the CEO this would be $1.1m, for a not wonderful net profit result, albeit better than the previous year.

The group balanced scorecard items then apply as follows, our workings based on the metrics in the annual report:

Item	Weight	Actual result	
Underlying Profit	25%	107%	27%
Cash ROE	25%	33%	8%
Customer No's	15%	74%	11%
NPS	5%	-60%	-3%
Employee engagement	7.50%	86%	6%
Leadership agility	7.50%	129%	10%
Risk Maturity	10%	100%	10%
Key Control Effectiveness	5%	95%	5%
			74%

The CEO total STI for this year was $0.528m, indicating that a rating of 100% was actually applied to the maximum pool amount available for the CEO. The difference is due to the actual results being calculated differently to our rough pro-rating approach as well as the calculations above being based on group information available in the annual report, not the individual CEO information.

Our issues are:

- Underlying profit – the table below compares underlying profit with NPAT for the last 5 years:

(As at FYE)	2022	2021	2020	2019	2018
NPAT ($m)	424	(264)	498	969	1,026
UPAT ($m)	1,140	1,103	1,126	1,227	1,093

  It can be seen that the underlying is both smoother than and significantly different from the actual NPAT. Much of the reason for this relates to issues around policy wording, need to strengthen reserves, write offs, and investment performance.

  Underlying profit accounts for 25% of the result and, it can be seen, is not well aligned with the shareholder experience or the overall results of the organisation.

- Many of the other indicators are quite subjective and could easily be focused on to achieve an end rather than move toward long-term goals.

Our overall view is that having an STI of 150% of Fixed with no vesting criteria, with little coming from LTI, could drive management to push toward results that don't align well with the long-term goals of the company or shareholder experience. For these reasons we will be voting all undirected proxies against the remuneration resolution at the AGM and request that the Board review the balance between STI and LTI and shift the balance more toward LTI.