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Start of Q&A session

Andrew Buncombe, Macquarie: Hi guys, thanks for taking my questions. Just the first one, maybe if you can comment on your reserve relief expectations for FY21 as they pertain to calculating the underlying margin and why that view may be different to peers? Thanks.

Steve Johnston, Group CEO: Thanks, Andrew. I'll start and I'll ask Jeremy if he'd like to add to any of the comments I make. I think if you look at the underlying ITR performance in FY20, obviously it fell below our 1.5% of net earned premium but the key item there that you should take into account is the performance from the statutory classes, which continued to deliver underlying performance ahead of that 1.5% of NEP. I think it was around 2.3% for the year.

Now, there's always going to be some volatility in longtail claims. I think we all have been around long enough to know that that's the case. Sometimes it works favourably for you, sometimes it works against you and we've seen a bit of it working against us in the past 12 months through the commercial lines.

So that - I think that caveat around uncertainty needs to always be there. I'm not certain it's any more elevated going forward than it's been in the last little while but again, it has to be a caveat. The other caveats are obviously superimposed inflation. We - the good news is that we don't see any evidence of superimposed inflation in any of the schemes that we're operating in. It's a very good outcome, I think, for the future.

Secondly - and on top of that superimposed inflation, there's underlying average weekly earnings inflation which again is very benign in the environment and I think will continue to be so. So, all of that, when you wrap it up and you sort of put those caveats in the mix, we remain very comfortable that our reserving positions are appropriate and that we can deliver that 1.5% of NEP going forward.

Again, why is it different to others? Well we don't have quota shares sitting across our business so our pool of reserves is, I think, significantly greater than many of our competitors and we have got good operating performance in each of those schemes and it will get better.

One of the things - one of the great things about having an end-to-end focus on longtail claims and having Paul back in Australia to do that, is Paul successfully ran that longtail portfolio at a period of time when we were running favourably to the average of the scheme performance in Queensland and New South Wales.

We are back on that path to do that, even before Paul came back but we were all really focussed in on that now and getting our scheme performance moving in the right direction. Which I think will be another underpinning of why that 1.5% of NEP reserve release calculation makes good sense. Jeremy, did you want to add anything to that question? I've probably covered it reasonably well.

Jeremy Robson, Group CFO: I think you've covered it, Steve. Just to reinforce that you know, we do feel comfortable that the expected release for next year would be above that 1.5% expectation, assuming that inflation remains relatively benign, which we have no reason to doubt that it wouldn't.

Steve Johnston, Group CEO: Do you have another question, Andrew?

Andrew Buncombe, Macquarie: Thank you and then - yes, please. Just one more. Just if you can talk about your reinsurance contracts. Do they have follow-the-fortune clauses in them? And maybe on the property caps and aggregates, do they cover all perils or named perils? Just some clarity on those wordings, please. Thank you.

Steve Johnston, Group CEO: Look, I don't think there's anything unusual in our reinsurance program this year relative to last year. I haven't been right through each of the - each and every one of the clauses that are embedded in each of those contracts.

The structure of the program is slightly changed. We didn't do a stop-loss on cover this year, we've rolled that into an enhanced aggregate cover and we obviously have taken more through our own natural hazard allowance.

Jeremy, I don't know whether you want to comment on any of the specifics about any of those clauses? But there's nothing unusual relative to this renewal compared to previous years.

Jeremy Robson, Group CFO: Yes. No, I think I'd support that, Steve. Just what we have seen this time through is that obviously reinsurers have been a little bit more specific around the way they've approached the pandemic wording in the various covers.

So the exclusion of pandemic is more specific now, which effectively just backs up with the current intent of our policies anyway. So that's probably been the key change that we've seen.

Andrew Buncombe, Macquarie: Okay, thank you.

Operator: Thank you. The next question comes from Nigel Pittaway from Citi. Please, go ahead.

Nigel Pittaway, Citi: Good morning, gents. Just first of all, trying to get a little bit more colour about costs. You keep saying you've got more to do on costs. There's obviously been some cost variance in the half through project changes, most notably in the bank. Previously, you've guided to reg costs falling in '21.

So is there anything you can help there? Are you still expecting reg costs to fall in '21? How much of the project cost was deferral and is there any way we can think more about these cost savings moving forward, even though you don't like the cost saving program targets?

Steve Johnston, Group CEO: Yes, I might make some overarching comments and then get Jeremy to dig into the details. I do see an opportunity for us to continue on the program of balancing out our costs in this business and making sure that we're as efficient as we can be.

I think we've done a good job of that over the years, although we have done it typically through the prism of these big programs of work, which provide big upfront costs for longer tail benefits and have been a bit hard, I think, for the market to track through the underlying expense ratios, which is fundamentally where I think it needs to pay out.

We are going through an alignment of our organisation now, relatively to the operating model. That will mean that we will reduce some of the layers within our business. That's not necessarily been come at from a cost out program, it's more around improving the efficiency of our business. Making sure we're streamlining it better. We're getting better decision making. We're avoiding duplication.

Then there will be other opportunities through that program of work. Realigning our brands. Product simplification. Optimising our digital footprint.

There will be some investment that we'll need to make, particularly in digitisation and automation but we need to do a better job of leveraging the investments that we've made and the things that we've already got embedded in our organisation. Things like operational excellence. We need one set of productivity measures right across our business. We need to get better value out of our partnering arrangements.

We've typically looked at partnering - we have partnering arrangements in place. That's a great thing. We don't have to start from scratch. We've typically looked at them in a bit of an incremental basis or a labour arbitrage basis. We see an opportunity to get a more strategic alliance with our partners.

I might hand to Jeremy. He can go through some of the elements of reg costs and project costs, et cetera.

Jeremy Robson, Group CFO: Thanks, Steve. So just to remind, with our cost base this year, we landed at $2.747 billion and that included $60 million of pay and lave review provisions and about $22 million of COVID costs. Now, some of those COVID costs will probably stick a little bit into 2021. The minority of them. So we have seen some progress on the cost base.

In terms of the outlook to FY21, I - we're sort of at pains to say that the investment slate, so that regulatory program of work, is part of the cost base and we manage the cost to the overall pool of costs.

We would expect the regulatory program of work to probably come down a little bit into FY21. Maybe not to the same extent that we had originally anticipated, given the deferrals of some of those programs but we would expect that to come down. We've still got maintenance programs and other programs that we need to roll through.

So in terms of the underlying cost base, we do have - we know there are opportunities, as Steve outlined, around costs. Some of those things require a little bit of upfront cost to prise out. So I think they're probably the key dynamics that we'll see into FY21.

Nigel Pittaway, Citi: Okay, thank you for that. Maybe I could ask a question also about the rates in the - particularly in the commercial but particularly in the commercial SME book? There has been a little bit of difference between your other two competitors as to what they think was happening and most notably, in terms of the propensity for people to roll over on existing terms, expiring terms.

Can you give some comments as to where you think rate rises are at in that space and also whether or not you're seeing a prevalence of that type of behaviour?

Steve Johnston, Group CEO: Yes. No, we - again, I'll ask Jeremy to add to this if he chooses but I think the rate environment - commercial lines - and I would make the point that many on the call would recognise that we led a lot of those rate movements over the past three years to reflect what was an unsustainably low level of margin across commercial insurance.

Now, it is absolutely the case that there is going to be some movement around that portfolio given the impacts of COVID and the deferrals etcetera. We've been reasonably well placed in terms of the pricing that we put through that book in FY20 and we expect it to continue around the sorts of levels that we've talked about for the last two or three years, which in aggregate is lower single digit type increases for the package book - the SME book - somewhere between 3-5% potentially.

The mid-market is obviously a step above that and it does depend on whether or not we have got loss effected renewals going through that book but that's been typically in the high single digits and again our expectation is that that will continue. Then obviously in the top end of the market, which we have material less exposure to, those increases are significantly higher and then significantly higher again if there is a loss effected element of the renewal.

So I think our view on the dynamic in commercial insurance - yes there will be some dislocation through COVID as it comes through the back end of the deferrals. I think generally it's a hardening market - remains a hardening market. I think the benefit we've got relative to our competitors is we led. So what we're about at the moment is maintaining that margin improvement that we've built over the past two years and consolidating it within that target level of margin performance that drives the sorts of levels of return that we need in that portfolio.

That's roughly in the 10-12% ITRs, generating the sorts of returns in the portfolio we're looking for. Again, we remain very confident in our under-riding in that portfolio, we ran very confident the trajectory of margin and the pricing we've been disciplined around putting through the book to get the right level of return.

Steve Johnston, Group CEO: Anything else Nigel?

Nigel Pittaway, Citi: Well just quickly - you've not seen a large prevalence then of people renewing on expiring terms? You don't think that's a big factor? Presumably we can conclude that from what you've just said.

Steve Johnston, Group CEO: Yeah, I think there is - look there is evidence of that potentially in the book from time to time but again I think it's probably at the periphery not necessarily the overarching fanatic, Nigel.

Nigel Pittaway, Citi: Fine and then maybe just finally, obviously you took the full 130 million increase on the CAT allowance. Have you calculated the probability of exceeding the 950 now - is that something you can share?

Steve Johnston, Group CEO: Look we are working through all of that. Again, we've done it in two stages. Obviously, we built the reinsurance program around the natural hazard allowance upfront when we came to the market in early July, having just conclude the reinsurance program. We obviously put a range of natural hazard outcomes in there as we did a bit more work on it through the course of the last month.

What we put in place 12 months ago was a belts and braces approach. I think what we are very keen to do is take that issue off the table and substantially get it off the table so that we could get the market to focus on other elements of our operational performance and our underlying business.

I think - I talked about and it was the case that we built it to a one in five type level of probability of exceedance. Significantly ahead of what we had done previously. The new program won't be at that level of belts and braces approach. It was never going to be given the increase in reinsurance. It's one of the reasons I talked at the half year about us having the flexibility on the balance sheet which meant we could trade of some of the elements of significantly increased reinsurance pricing and bring a bit more risk back onto our book.

It's certainly going to be better than what it was prior to last year Nigel, but it's not going to be as good as last year's program in terms of the likelihood of exceedance. We've really balanced it out. Believe it to be the right outcome and the right balance between volatility, our balance sheet and the cost of reinsurance.

Nigel Pittaway, Citi: Great, thank you very much.

Operator: Thank you. The next question comes from Siddharth Parameswaran from J.P. Morgan.

Siddharth Parameswaran, JP Morgan: Thank you just a couple of questions if I can. Firstly, just on the underlying margin trajectory - those numbers have been quite volatile for a while actually. In the second half of 2020 you had a number of 9.4% from memory - sorry 12.4% and down to 9.3% and now up to 12.9% underlying margins. Can you just comment on what are the moving parts in this?

In particular, in your slide there you show a 1.8% improvement but I'm not really sure what that relates to and you also flag there is an improvement in investment income. I'm surprised given that yields have been falling. I suppose I am just at a loss to explain why these numbers have been moving around so much.

Steve Johnston, Group CEO: Yeah - and again I will hand to Jeremy in a minute Sid but one of the fundamental factors is that we've made some material readjustments to our reinsurance program and natural hazard charges. So that obviously goes through and when you reset your reinsurance program and cost of reinsurance goes up, take new covers or the cost of incremental cost rate online goes up and you increase your natural hazard allowance you take it through margin upfront.

The improvement comes, obviously through, as you improve either your pricing or the underlying performance in a loss ratio sense across the business. I think in the last couple of years that has been a big dynamic. The underlying performance in the investment portfolio reflects something that Jeremy and I have been working on or probably five years to get the panel of managers in the right position so that we could drive our performance through our manager profile.

This year we have been able to on elements of that portfolio - deliver returns well above our 60-day percent expected differential to risk free. And that has been a deliberate effort over a long period of time to be able to get that out performance. So, there will always be volatility in this margin. Some of it reflects the one -off nature of some of the input costs that go through insurance. Jeremy did you want to add to that…

Jeremy Robson, Group CFO: Yeah, thanks Steve. So, I mean I agree in terms of the volatility components in that underlying ITR have really been around natural hazard costs, reinsurance natural hazard costs and then investment income.

On the investment income, Sid, in 2H, as Steve said, we've had some very strong manager outperformance contributing to that. We've also had a little bit of help along the way with some of the inflation securities we've got with a step up in CPI at the end of the half. So that's helped a little bit as well which we'd expect to reverse next year.

Then with the margin piece, the 180 basis points on what we call margin, what that number is effectively is the contribution from NEP growth, net of working claims. So, it's an underlying, excluding the things on the left-hand side of the chart effectively.

And we've seen good expansion there across all of the categories. So, we've seen expansion in home. We have been putting through rate increases through home to start to pay for that ongoing higher reinsurance natural hazard cost which is in the other parts of the bar chart.

We have seen growth in New Zealand. So - and I referenced that the working claims ratio in New Zealand is still as it was last year, is unusually low. We'd probably expect that to revert.

We've seen some expansion in CTP with some of the price increases there. Workers compensation has performed well for us during the year with claims performance I called out. I mean and commercial has been going well for us as well in terms of the price increases, we've been putting through that portfolio.

In terms of the outlook, I called out three things. One is - where does that number go forward? Three things. One is natural hazards. So, the $130 million of allowance will go through underlying ITR for FY21.

We will expect yields, that underlying investment yield to be lower in the underlying ITR. We'll see some of that reversion from manager outperformance, some of the inflation piece goes, we'll see lower yields will impact through.

And then, as I called out, we'll see some of that reversion to more normalised working claims loss experienced in New Zealand.

Siddharth Parameswaran, Group CFO: Thanks for that clarity. Just a second question then, if I can just ask about the rate increases that you are getting. I mean they don’t seem that high, I mean high enough to be clawing back inflation plus reinsurance costs and 3.5% in motor and home in the second half. I mean could you just comment on that and also just perhaps where you are in commercial.

You mentioned you're still getting good momentum and you're still short of that 10% to 12% ITR range, but just if you could just comment how much more there is to go to get back to the 10% to 12%?

Steve Johnston, Group CEO: Yeah, I'll just go through the portfolios one by one. So in home, I guess we've been able to get quite substantial pricing through home or haven't been focused on doing that given the impact of the higher natural hazard allowance and the prevalence and the frequency of weather events right across the market.

So, you know, the pricing in home has probably been - we typically think about the short tail portfolio and pricing in the sort of 3% to 5% range. Over the last few years, home pricing has been close to the 5% and motor pricing has been close to the 3%.

Home pricing has probably been a little bit above that in the last 12 to 18 months reflective of firstly the catch up on the increases of the allowances and the reinsurance program from 12 months previously. And again, as we've come into this renewal, we've seen what we anticipated to be a higher reinsurance cost coming through and we have tried to get ahead of that a little bit with some increased pricing in the portfolio.

So, I'd probably say while we typically look at 3%to 5% across home and motor, home has probably been at the top end of that range and maybe a little bit above that. But again, very reflective of the input costs. So we have had allowances, reinsurance, and obviously the non-hazard water claims environment going through elevating inflation in those portfolios.

In motor, it's probably been at the lower end of that range, for a whole range of obvious reasons. I mean I think in an environment where frequency has been lower, we've been very cautious about pricing into that portfolio. Again, in motor, the factors around driving inflation at the moment are the ones that we talked about before around pricing. About the cost of parts, cost of repairs, sophistication of motor vehicles et cetera.

So again, I don’t think things have necessarily changed, Sid. Pricing in home, top end of that 3% to 5% or above and at the motor end, probably closer to the bottom end of that range for the last 12 months.

Siddharth Parameswaran, JP Morgan: But just in your charts, I mean you quoted sort of 3.5%, so home and motor combined for the second half. Is that a mix issue?

Steve Johnston, Group CEO: Yeah. Look, I think it's very - the numbers I've given you are the pricing parameters that we put into our pricing models. There's always a risk issue that goes - so I'll get Jeremy to talk briefly about the mix of the book but obviously new business versus renewal premiums, mix of business between landlord insurance and renewing average written premium levels for a traditional Suncorp home and contents cover.

So, you do get mixed issues going through the book. Jeremy do you want to…

Jeremy Robson, Group CFO: Yeah, I was going to say, Sid, that when you look at the AWP growth, there is a reasonable mix impact between that AWP outcome and the headline prices that we're putting through to customers. That is new business renewal mix. So, in home, the new business premiums tend to be lower than renewals.

Motor is the other way around. New business tends to be higher. Then there's a bit of brand mix going on there as well. You know, Terri Scheer for example versus AAMI/Shannon's versus AAMI et cetera.

So, you've got to be careful I think the AWP number is reflective of the pricing we're putting through. There's a reasonable difference between the two.

Steve Johnston, Group CEO: Of course, atop of all of those explanations is the premium in a rising rate environment, we typically see customers adjusting that premium increase through the prism of their excess.

So, when they make an adjustment to their excess to offset some of the premium increase, that obviously - the benefit to that flows through net incurred claims which are obviously lower as a result of that excess lift.

Siddharth Parameswaran, JP Morgan: Sure, thank you. Great, thank you.

Operator: Thank you. The next question comes from Andrei Stadnik from Morgan Stanley. Please go ahead.

Andrei Stadnik, Morgan Stanley: Good morning, I wanted to ask first question about bank margins. Margins were very strong, four basis points up on half and it looks like you'll be pretty much reverting back to higher margins on the back of in part lower term deposits and higher at-call deposits, do you have the appetite to continue to push that dynamic further into FY21? Do you have an appetite to push your term deposits mix even lower? Also, what kind of headwinds should we be expecting as the replicating portfolio steps down in line with lower rates?

Steve Johnston, Group CEO: I'll just make a couple of brief comments on the margin performance and the deposit and transaction account activity, which I think is a really good story for Suncorp and it demonstrates the alignment that we've had in that particular portfolio around leveraging our digital investments. We matched up a very innovative product, which is the Great Saver account, which at the time was one of the first two and best in market alongside a cross-group collaborative view around how we digitise that portfolio and leverage the investments that we've made in things like the app and other elements of our APIs and the technology space, been a great cross-company collaboration issue.

We've taken significant positive impact on margin through transaction account balances lifting the opening of new transaction accounts through digital and managing through that term deposit arbitrage that sits there.

Jeremy, did you want to talk to the outlook?

Jeremy Robson, Group CFO: Yes, I mean in terms of, just before I go to the outlook, in terms of what we've seen in FY20, we think that deposit growth is probably a differentiator and when we look at the residual margin outcome for FY20, there's been a bit of an offset, as you'd expect, between what we're seeing on lending spreads, with where the relatively to cash rate went during the year and what's happened with BBSW and in offsetting that for us has been two dynamics. One has been the lower carry on the replicating portfolio, which for us a smaller drag than for others, because we have that lower level of customer, low rate customer deposit funding. Then the other piece for us as been, as others have seen, is high liquidity. We're all carrying high liquidity, which comes at some cost and then lower yields on that liquidity.

We've seen those two elements have probably offset in FY20. We'd expect to, yes, see some of that drag continuing in FY21 on the low rates on the replicating portfolio. We'll see where the lending spread goes with

BBSW, but we still expect to see some benefit from the ability to improve the deposit mix with the at-call versus term deposit outcomes.

Andrei Stadnik, Morgan Stanley: Thank you. So you've called out the strong abilities in digital in the bank is helping to growth the deposit growth and it looks like there's still about 130, 140 branches the Suncorp Bank is running and some of your competitors have grown mortgages very strongly without any branches at all. Is the 130, 140 branches the right size or could you be writing with 20 branches?

Steve Johnston, Group CEO: I think that's probably a bit of a stretch, Andrei, but we do have to really test ourselves against what we're seeing post-COVID, or through COVID and what is likely to occur post-COVID, I guess. Banking has always been a part of our portfolio, as it has been for the whole industry, which has been an earlier adopter in terms of financial service, in terms of digital, it's very transactionally based and we've now got our digital capability to where it needs to be and you can see that evidence through what we've done on deposits.

Now we need to turn that into a similar type cross-collaborative approach, the way we look at our lending portfolio and drive to a higher level of origination through our lending portfolio through digital. We obviously have had some branches that have been closed through the COVID environment and one of the key things I talked about, that Clive and the Bank team will be looking at, is that optimised distribution footprint, which in the Bank really revolves around contact centres, digital online and a physical store footprint.

As in insurance, where it's more contact centre and digitally based, there is an opportunity for us to optimise all of that distribution footprint across both banking and insurance, to make sure that we can meet customers in the manner that they want to be met and make the cost to serve for our business as low as it can possibly be, to make it as efficient as it can be.

Andrei Stadnik, Morgan Stanley: Thank you. If I can ask just a quick third question, just on the insure, would the natural perils increase, you'd think the $130 million versus prior guidance of a range of between $90 million and $130, what's driving thinking the top end of the range? Is that coming down to having more confidence in your ability to push through price increases and recoup that?

Steve Johnston, Group CEO: Well we'll always be driving to making sure that we appropriate reflect the costs, the input costs in our pricing. I would make the point that pricing can't do all the heavy lifting in this environment. We don't want to take ourselves out of market and we want to continue to grow our franchise. So all the other things I talked about around loss ratio performance, whether it's branding, marketing, effectiveness, products, product coverage, claims, that all sits in that prism of loss ratio.

We see a huge opportunity with Lisa and Paul to drive through material improvements in the way that we underwrite, the way we risk select, the way we price, the way we offer coverage, the way we simplify our products and manage our claims, to dive that performance.

In terms of why we landed at the top end, look I think hopefully you've seen a track record of this management team in terms of setting this business up as conservatively as it can be. We would prefer not to be in the environment of managing through all the elements of COVID operationally and financially, we'd rather not be having a protracted debate about the adequacy of our reinsurance program and natural hazards. So we have a bias to be conservative and look, this year that served us well. There's a trade-off between reinsurance costs, natural hazard costs, pricing, margin, I think we've landed at the right point, but it is at the conservative end of where we set it and talking about on 1 July.

Andrei Stadnik, Morgan Stanley: Thank you.

Operator: Thank you. The next question comes from Ashley Dalziell from Goldman Sachs. Please go ahead.

Ashley Dalziell, Goldman Sachs: Thanks, morning guys. Just an initial question on the Bank and the loan deferral update, the 50% of customers that you're talking to there are returning to normal payments or full repayments, that compares pretty favourably to some of your peers who are talking more to 15%, 20%-odd of customers returning to normal payments. I think there's one bank saying 50%, but that's an expectation rather than experience at this stage. Just wondering what you think within your book is driving the better-than-peer outcome at this stage.

Steve Johnson, Group CEO: Yes, I think it's three things. One is I think we've been telling everyone that we've been driving a low-risk book of banking business. Since the GFC we've done a lot of work to de-risk our Bank. I'm very confident that this is some reflection of a decade of hard work on that basis. I think the fact that we're doing three-plus-three check-ins, I've always had the view and as does Jeremy and Clive, that that three-plus-three check-in approach through this deferral piece is one of the best insights that we can get as a management team around the future outlook for provisioning.

So, we've spent a lot of time with our customers understanding how they're tracking, the industries they're working in and their prospective views on deferral requirements and repayment requirements. I think we're benefiting at the moment from having a biased Queensland in that portfolio. Queensland is not at the same level of restriction. We're seeing a really good substitution of international tourism with people that are travelling within Queensland and I think that's potentially serving us well.

Jeremy, did you want to add anything to that?

Jeremy Robson, Group CEO: I think that's right Steve. The other thing that we do is a reasonably robust, rigorous process around those check-ins. Three months is different to what some others are doing to start with. We risk weight customers, we call some if we think they're higher risk, because we want to speak to them and understand their issues, for those that are lower risk, we'll email where customers – so there's a reasonably sophisticated process around that.

Just to add to Steve's point around Queensland, when we look at the percentage of the book that is in deferral, it's relatively less weight in Queensland, which supports that thesis that Queensland is, at the moment at least, doing a bit better than the rest of the country.

Ashley Dalziell, Goldman Sachs: Okay, great. Maybe just a follow-on question then around the outlook for provisioning. I mean appreciate it's a difficult one, but where you've provided for in the overlay absent any further second wave, is it pretty difficult to envisage needing to materially top up again through 2021, based on what you're seeing in the book?

Steve Johnston, Group CEO: Look, I mean I'm not going to make any absolute statement about what may or may not happen. I mentioned in my commentary before, a bit of a folly to think this is all behind us and it can manifest itself in many different ways between many different geographies, so I'm very cautious about that and we are very cautious about that.

I think when we came in to settling the accounts, there's probably nothing in front of us that suggested that we needed to top up that collective provision. Our assumptions that are driving the modelling and again, I think we've got one of the best models around in terms of being able to calculate the future losses in that portfolio and we know the book really well, we probably saw some upside probably to our assumptions that were going through the book.

But we were just staring into the imminent lockdowns in Victoria and while we don't have a huge bias to Victoria in terms of our lending book per se, we were very conscious of the potential flow-on effects through border closures and how that might impact our book in Queensland and our book in New South Wales. Again, it's another reflection of a conservative bias and again, I think we just have to be, all of us in financial services, be open to the fact that this is a very fast-moving environment and we have to set a core of conservatism and prudence in our underlying business and then be prepared to accept some movement around provisioning and actual outcomes as things become clearer.

Jeremy Robson, Group CFO: I'll just add to that Steve, that there is this vagary of the accountant standard, with what they call stage one loans, for those that are not in default, not overdue, you only book one year's worth of losses on those loans, so every new year you're booking another 12 months of losses on those loans. That's probably the element that we'll keep a watch on.

We've taken, as Steve said, a very conservative view around those customers who are in deferral at the moment. What we've made by way of assumptions around those going through into potential overdue hardship forwards, we've made a conservative view around it already, but there may be some increase stage one loans, depending on where the economy unfolds over the next 12, 18 months.

Ashley Dalziell, Goldman Sachs: Thank you. Just a second question on the capital position, I think back at the reinsurance announcement you were suggesting the new program might chew up maybe $60 million-odd of capital. Just wanted to get an update on that data point and then beyond, are there any major capital drags, I guess, that you can envisage for the business into 2021?

Steve Johnston, Group CEO: Thanks Ash, I mean that number, I think, data point is right in terms of the reinsurance impact of it. Again, it came back to why we were keen to hold the proceeds of S.M.A.R.T. on the balance sheet. I think, in hindsight, it was the right decision. But to also give us flexibility around the renewal and that $16 million number is correct.

I would also make the point that over many years people have asked us why we've held an excess buffer in our insurance business. Those of us that have been around insurance long enough know that when things move in insurance, they typically do move both on an actual basis and a prospective basis, through your target capital. Through your excess tech provision. Through your premium liability. Through your outstanding claims. There's so many moving parts in capital and insurance business that when things move you want to have enough capital to be able to manage that process. You can see that in that waterfall there.

It's not gone. One of the other dynamics in insurance capital is that as you start to make the adjustments that you need to in pricing and improve the performance of your business and you improve the profitability of it, as we expect to do, then that many of the factors that have driven that increase in capital, in the insurance business, will start to unwind. They'll unwind to the betterment of the balance sheet in totality.

Jeremy, did you want to add to that?

Jeremy Robson, Group CFO: I mean, that's a complex number in that capital chart, that one. It's the combination of a few things. So, one of them is that impact of the FY21 re-insurance program on slightly less P&L volatility cover, which then goes through to the target capital numbers. There's the natural hazard allowance. So, as we increase the natural hazard allowance, that then impacts through to PCA and then premium liabilities in terms of a forward look around that.

Lower yields impact in the form of profitability, which also impacts on PCA and excess tech premium liabilities. Then we've also, as I've said, put some money into premium liabilities for COVID uncertainty. So, the way that works is, in terms of the premium liability outlook number, we've made some conservative assumption for a really modest amount of COVID uncertainty in there, as well.

So, it's a pretty dynamic set of factors in there. There's DTAs and DTLs and all those sorts of good things. But as Steve said, I think the critical piece to think about is it's not necessarily gone. As we improve the performance of the business, we'd expect to get some of that back.

Steve Johnston, Group CEO: We could've spent the full 30 minutes of the presentation on that matter alone, if we chose to Ash, but we avoided that for the purposes of brevity.

Ashley Dalziell, Goldman Sachs: Yeah, I appreciate that. Thanks guys.

Operator: Thank you. The next question comes from Michelle Wigglesworth from Milton Corporation. Please go ahead.

Michelle Wigglesworth, Milton Corporation: Hello, on a very high level, and I could be wrong, I calculated that the SME book on your banking side, that potentially 10% of loans could be on deferral. I'm not sure if that's correct. I was just wondering, is there any crossover with those customers that are on loan deferrals on your insurance side? So, are you – could you see some potential weakness for those customers, on the insurance side, if you do sell both insurance and also lend to them?

Steve Johnston, Group CEO: Jeremy, I don't know whether you want to sum it up [unclear].

Jeremy Robson, Group CEO: Michelle, we've – we have given the numbers in the pack. So, it's 11% of our business customers are in deferral at the end of July. So, that's the latest number. Now obviously the difference between them and the mortgage customers, is they're on a six-month deferral. So, there is no three-month check-in with the business customers. In terms of the crossover, I don't think there's a significant crossover. Because, at the end of the day, it's a relatively small book of business.

But what we do do, is some reasonably sophisticated mapping across our insurance exposures by industry types. What's happening with their premium flows and through to the bank and what's happening with deferrals. So, we do have all that mapping. But I don't think it's a particularly significant impact.

Michelle Wigglesworth, Milton Corporation: Just one more question on the insurance business. The commercial long term strengthening for molestation claims. Am I correct in saying that's – assuming that's sexual harassment type claims? How do you get comfortable on your provisions for that if that's what that relates to?

Steve Johnston, Group CEO: Yes, it is. It's outcomes of the Royal Commission, more than anything else and the commendation of some legal positions from more recent times stretching back over a number of years of cover. Probably back 30 or 40 years. Again, that numbers been reasonably stable over time. The increase is certainly not material in the context of the reserves. It does pop out a little bit when you talk to movements year-on-year.

We're very comfortable in reserving position. It is well set. It doesn't mean it's not going to change over time. But I think the changes will be more incremental than substantive going forward. But, again, it's one of those uncertainties in long-tail provisioning. You see that through books over time on asbestos books, on silicosis. The molestation pieces there are, these books of business that sit there that do have adjustments. Sometimes up, sometimes down. So, we put – if I called it out as a caveat around the 1.5%. Because these things do occur, from time-to-time. Sometimes strengthening, sometimes releases.

Michelle Wigglesworth, Milton Corporation: Thank you.

Operator: Thank you. The next question comes from Matt Dunger from Bank of America. Please go ahead.

Matt Dunger, Bank of America: Thanks very much gentleman. I wondered if I could ask a question on the dividend pay-out ratio. You've paid out 61% for the full year, but the second half obviously down at 33%. You've made a point of saying, over the medium term, you're looking to 60 to 80% pay-out ratios. Could you just confirm that that is looking at the second half pay-out in the short-term? Also, should we consider the bottom end of the target pay-out ranges as a new benchmark?

Steve Johnston, Group CEO: No, I think the dividend policy hasn't changed. It's really good and pleasing to see, even in an environment like we've been through in the last 12 months, that a dividend policy that we probably said five or six years ago has been sufficiently robust enough to see us through the last 12 months. So it's a 60% to 80% payout of our cash earnings. We've had typically, prior to this year, been at the top end of that and appropriately this year at the bottom end of that.

The other element of our guidance has always been that we will return capital that's excess to the needs of the business and we remain committed to that. As we get more comfortable with the external environment, when that will be, then that part of our policy will be obviously back on the table again. Nothing's changed in terms of dividend policy, 60% to 80% is the benchmark for this year and going forward.

But obviously we would never take a call around distribution that would compromise the longer-term health of the franchise, that's a fundamental precondition around our consideration of dividend. This year we've stressed that dividend payout to a level that's never been seen before around some of our stress testing, which has been very thorough and obviously in conjunct with the demands of the regulator and with the regulator well informed of the stress testing that we've done and the proposals that we've put in front of the market today.

Matt Dunger, Bank of America: Thanks very much Steve and if I could just follow up with a question on the $85 million provision and how you've allowed for business interruption claims, how much are relating to costs for the actual claims themselves and risk margins within that $85 million.

Steve Johnston, Group CEO: Well let me just precursor, Jeremy's already said we're comfortable with the intent, comfortable with the wording. It is appropriate though, the majority of that $85 million is in risk margin. Those of us know, that are familiar with the accounting standards and the actuarial standards, would know that that risk margin is designed to true-up the probability of sufficiency to the 90th percentile. I think it'd be more of a concern if we hadn't made some assumptions around the broader COVID levels of uncertainty reflective in a risk margin of that magnitude.

It is a COVID risk margin, so business interruption is one part of that, but it's also landlord and various other elements of uncertainty relating to COVID. So I think it's an appropriate thing to do, doesn't in any way contradict the commentary we've made around our comfort around the intent of our policies, the wording that's associated with those policies and again, our support for the test case that's going to be underway in the next couple of months.

Matt Dunger, Bank of America: Thank you.

Operator: Thank you. The next question comes from TS Lim from Bell Potter. Please go ahead.

TS Lim, Bell Potter: Good morning guys, well done on the result. You just happened to mention a test case coming through, can we get some clarity around your thinking around this again?

Steve Johnston, Group CEO: TS, look I'm going to – we're responding on that well-worn political response, which is that given the matter is likely to be before the courts very soon, I'd rather not prejudice anything that goes on ahead of that time, other than to say we fully support it. We think it's an appropriate process to go through and we're fully supporting in every sense the ICA's representations in conjunct with AFCA, to get some clarity around these matters through the process. But I don't want to get into a running commentary ahead of the court appropriately determining the matter.

TS Lim, Bell Potter: Okay. In that case, can I ask a question about the Bank?

Steve Johnston, Group CEO: I'd be disappointed if you didn't.

TS Lim, Bell Potter: But I won't ask a question about selling the Bank. Anyway, if you rate the Bank out of 10, what would you give the Bank?

Steve Johnston, Group CEO: Oh dear. I'd probably not give it a rating out of 10, I'd go back to the report cards which I used to get when I was at school which is great potential but could do better.

TS Lim, Bell Potter: Okay, good to know, thank you.

Operator: Thank you. The next question comes from Brett Le Mesurier from Shaw and Partners. Please go ahead.

Brett Le Mesurier, Shaw and Partners: So the report card, Steve, what report card would you give yourself now, is it the same as school?

Steve Johnston, Group CEO: Oh well, I'd like to think I've improved over time. There are a few years that have passed between when I was at school and now, Brett, so I hope I've improved a little bit over that time, but I'd leave that for people like you to form views on.

Brett Le Mesurier, Shaw and Partners: Thank you. Now commercial premium rates, we can see how the average home and motor premium rates increased, but you're silent on the average commercial premium rate increase. Can you tell me what that was from 2019 to 2020?

Steve Johnston, Group CEO: Jeremy, I might let you do that one and again, it's a bit like the average written premium commentary on the home and motor side, it does get a little bit distorted in that absolute sense given the portfolio remediation that has gone through that book over the last little while. Jeremy, do you have an average?

Jeremy Robson, Group CFO: The average would be the mid to high single digits, high single digits, in terms of price increases over the last 12 months. As Steve said, before when talking about those price increases, we're seeing mid-single digits going through SME, which is a reasonable sized portfolio. We're seeing up into double digits going through into the higher property portfolios and then a mix in between. It's probably around the higher single digit number as an average increase.

On top of that, Brett, we’re seeing some pretty good retention rates, particularly up in the top end of those increases, we’re seeing retention rates with 90s in front of them, so we’re pretty pleased about that as well.

Brett Le Mesurier, Shaw and Partners: What portfolios did you exit?

Jeremy Robson, Group CFO: We exited, as we called out last year, the key one, I think we’ve named it was the Longitude strata book, as it wasn’t profitable for us, that’s the key one that we’ve exited. Then there’s been a number of others as we’ve – particularly in that strata space, but the key one was Longitude.

Brett Le Mesurier, Shaw and Partners: Okay, moving on to the Bank, what’s the level of security you’ve got for you $1.2 billion in business loan deferrals?

Jeremy Robson, Group CFO: So 100%, those business loans are all fully secured and most of the against or a lot of them against residential mortgage.

Brett Le Mesurier, Shaw and Partners: Okay and lastly, your perils allowance, what’s the distribution look like? Do you have a symmetric distribution when you think about how the perils look over a range of outcomes, or is it skewed in the one direction?

Steve Johnston, Group CEO: Well I don’t know that I can describe it as symmetric. I can tell you how we go about calculating it. We look at it in three categories, one is events that we call attritional, which are in that sub-$10 million category and we’ll look at that back over a limited number of years and provide a distribution around our expectation of what that might look like going forward. That’s based primarily on our own data.

When we move to events that are between the $10 million and $150 million category, we stretch that back over a slightly longer period of time. Then when we look at events that are from that point through to our attachment point, we typically take them back over 30 and 40-year periods and we use data that we have generated across our book, looking back over that period of time, but also supplement it with the data that’s provided to us by our reinsurance partners and more sophisticated modelling around perils like earthquakes and cyclones, et cetera which typically fall into that category that’s closer to our deductible.

Brett Le Mesurier, Shaw and Partners: You just look at averages, you don’t look at a range of outcomes?

Steve Johnston, Group CEO: Well I think we do. If you look at that as a means via which – and look, there are many ways you could calculate a natural hazard allowance, I’m very open to the different ways of doing it, but I think that provides the most sophisticated approach to the way that you model a book like this and again, I think the variable that has been subject to some debate is just how far back you go. By definition, if you are of a mindset that says the weather is changing and more recent frequency and intensity of weather has been greater than it might have been 10 or 15 years ago, then you get a different outcome relative to how far back you take the book.

I know one of the biggest drivers in the increase in natural hazard allowance over the past two years is that we’ve taken a view that we should bring in our backward looking view of events, particularly in that attritional bucket lower down in the claims cost pool. Again, you may have a better way of doing it, Brett, but I think that’s the established pathway that we’ve looked at over a number of years.

Brett Le Mesurier, Shaw and Partners: Okay, great. Thanks, they’re all the question I have.

Steve Johnston, Group CEO: Thank you.

Operator: Thank you. the next question is a follow-up from Siddharth Parameswaran from JP Morgan. Please go ahead.

Siddharth Parameswaran, JP Morgan: Sorry, gentlemen, just one question, just on the potential for business interruption losses, I just want to be clear about whether – I think the original views that were coming from Suncorp were that you had very few policies which potentially had exposure to the incorrect Act, the Quarantine Act. I’m just wondering if you could just update us whether that is still the thinking, whether most policies actually reference the correct Act. I think one of your peers gave a number that about, I think, 30% of their polices use the wrong Act and if you could just give us a comment around that.

Steve Johnston, Group CEO: Look, I'm not going to go into the specifics of how many reference particular Acts, I think that's for a bit later down the path and I think the comments that I've made still stand. I have comfort around the intent and the wording and the comment you made about that smaller number; I don't think anything's happened that changes that view. But again, I think we should all wait for the test case to work its way through the jurisdictional court and we remain very confident in our position, obviously.

Siddharth Parameswaran, JP Morgan: Okay, so just to be 100% clear, have you taken any central estimate provisions or is everything in the risk margin for potential offers?

Steve Johnston, Group CEO: Well I think, Sid, you'd be again surprised I think if we didn't take some central estimate provision. By definitely, it's a smaller number, but there will be some legal costs that will be incurred as we work our way through the next little while in terms of some of the proceedings that we will want to participate in. That's probably the best way to describe how we look at that, but the majority of it is in risk margin.

Jeremy Robson, Group CFO: So Steve, just to corroborate that, there is no central estimate for claims, per se, there is a little bit of central estimate for potential litigation costs.

Siddharth Parameswaran, JP Morgan: Okay, great. Thank you very much.

Operator: Thank you. At this time we're showing no further questions via the phones.

Steve Johnston, Group CEO: Well that's fine, we've gone over time by a little bit of time, but again, I just wanted to thank everyone for coming on the call today. Obviously just to reiterate, it's been a slightly different process and format. We're all working differently, not only us, but those on the call, so we do thank you for your time and hopefully we will have borders released soon, restrictions coming down and we can all get together in our normal course of road-showing.

Thank you for everyone coming on and have a great day, have a great weekend and stay safe. Thank you.

End of Transcript