SUNCORP

ASX announcement

11 May 2020

Suncorp Group update on COVID-19 impacts, APS330 and preliminary results of pay and leave entitlements review

Key points

- Suncorp Group entered the uncertain period of COVID-19 in a sound financial position:
  - Group Excess Common Equity Tier 1 at 31 Mar 2020 of $682m (31 Dec 2019: $691m ex-dividend)
  - Conservative investment portfolio with over 94% of investments in cash and fixed income securities
  - Strengthened reinsurance program and natural hazard allowance for FY20
  - Suncorp Bank remains low risk with sound capital, funding and liquidity, benefitting from the Group's A+ credit rating
- COVID-19 will have a range of impacts on Suncorp's businesses:
  - Suncorp Bank COVID-19 collective provision of $133m (23 basis points of gross loans and advances)
  - General Insurance expects reduced consumer motor claims volumes, increased landlord loss of rent claims and negative mark-to-market movements on the investment portfolio. GWP to be impacted by lower economic activity.
- Suncorp update on pay and leave entitlements review:
  - A review of the Group's pay and leave entitlements has identified potential incorrect payments to some employees
  - Preliminary estimate of the costs to remediate those eligible for additional payments and the costs to implement new processes is between $40 - $70 million
- FY20 Group costs to be slightly above $2.7 billion including pay and leave entitlements remediation
- Non-cash impairment charge of circa $90 million (post-tax) for the deposit and transaction modules of the core banking platform
- Suncorp remains focused on building the long-term sustainability of the organisation:
  - Acceleration of digital strategy to meet changing customer demands
  - Reshape and create new ways of working

Suncorp Group (ASX: SUN | ADR: SNMCY) today updated the market on the impacts of COVID-19, provided its quarterly update as at 31 March 2020, as required under the Australian Prudential Standard 330 and released the preliminary results of the pay and leave entitlements review.

Suncorp Group CEO Steve Johnston said: "This is a difficult and uncertain time for the community, and our thoughts are with those feeling the emotional and financial impacts of COVID-19.

"Suncorp was quick to respond to this crisis, realigning our business around five clear priorities to guide our response: ensuring the health and safety of our people, supporting our customers, protecting our business, engaging our stakeholders and preparing for the post-COVID-19 environment.

"A key priority for us is to ensure our customers are protected and prioritising those most in need. We have launched several support packages and financial hardship options, and we have been working closely with industry bodies, government and regulators to ensure a coordinated response.

“We have already received thousands of requests for financial hardship from both our bank and insurance customers and have provided discounts and premium waivers to 12,300 insurance customers in Australia and New Zealand and approved $4.05 billion in loan deferrals.

“From an operational perspective, in early March we moved over 90 per cent of our workforce to work from home, and the digital capabilities and systems we already had place positioned us well to manage this transition.”

Mr Johnston said it was important to remember the customers impacted by the unprecedented damage caused by storms and bushfires across Australia in recent months. Suncorp’s customer support teams set up bases in bushfire affected areas to support customers with claims lodgements, access to emergency funds and temporary accommodation, and to help them get their lives back on track as quickly as possible.

Suncorp has delivered an industry-leading claims response to the 12 declared events and over 72,000 claims lodged across our brands, with progress in finalising claims as follows:

- For bushfire customers, 70 per cent of property claims and 80 per cent of motor claims have been finalised; and
- For storm, hail & flood customers, over 30 per cent of the 35,000 consumer home claims and almost 60 per cent of the 28,000 consumer motor claims have been finalised.

COVID-19 impacts on Insurance (Australia) portfolio

COVID-19 has had a number of impacts across the Insurance (Australia) business portfolio.

As a result of recent volatility in investment markets, there has been a significant negative impact from mark-to-market adjustments. The net impact of MTM adjustments was a $205 million loss (pre-tax) from 31 December 2019 to 31 March 2020. Some of the losses have unwound in the month to 30 April 2020.

COVID-19 will also have a significant impact on consumer motor claims frequency and landlord loss of rent claims.

Suncorp expects an increase in loss of rental income claims frequency and severity. The Group has ~500,000 in-force landlord policies that provide loss of rental income cover, with the majority being Terri Scheer Landlord Preferred policies, which typically offer cover for up to 20 weeks loss of rent for a defaulting tenant. The remainder of the loss of rental income policies provide a lower level of cover.

In the consumer motor insurance portfolio, claims lodgements have declined since the introduction of mobility restrictions in March. Despite this, Suncorp expects a proportion of claims have been delayed as a result of customers experiencing financial stress and a preference to observe social distancing. Average claims size is also expected to be higher during this period due to a change in mix of claims.

A reduction in claims frequency is also evident in other portfolios, however to a much smaller extent than in consumer motor.

COVID-19 impacts in New Zealand

Suncorp New Zealand has also observed a reduction in motor claims frequency. The NZ government implemented Level 4 restrictions in late March, which resulted in a more dramatic reduction in motor claims frequency than in Australia. Claims frequency has increased following the recent easing of restrictions.

COVID-19 is not expected to have an impact on Life Insurance claims. Less than 1% of sums insured for term life polices relates to high-risk age groups. Further, there is no evidence of an increase in income protection claims.

Banking & Wealth (COVID-19 and APS330)

Suncorp Bank continues to be well capitalised with strong funding and liquidity, supported by the Group's A+ credit rating and balance sheet strength.

The Bank's lending portfolio is well diversified and low risk. Home lending represents 81 per cent of the portfolio. Around 80 per cent of home loans have a loan to value ratio (LVR) of below 80 per cent at origination, with the average dynamic LVR of the portfolio at 57 per cent.

In response to COVID-19 and the Group's expectations of economic impacts, Suncorp Bank has included a $133 million management overlay within the collective provision, equivalent to 23 basis points of gross loans and advances. The economic scenario underpinning the COVID-19 collective provision calculation includes a sharp deterioration in GDP and a slow recovery, including an increase in unemployment to 11.5 per cent, a 11 per cent decline in residential property prices and a 14 per cent decline in commercial property prices.

Suncorp Bank saw continued growth in at-call deposits with net balances increasing $1.2 billion over the quarter. Growth continues to be driven by customer-focused initiatives including zero account-keeping fees and competitive deposit rates, as well as ongoing development of online banking functionality, with over half of new deposit accounts now being opened online.

As at 31 March 2020, the Net Stable Funding Ratio was 119% and the Liquidity Coverage Ratio was 136%, demonstrating Suncorp's strong funding and liquidity positions. Suncorp priced a five-year $750 million domestic covered bond transaction on 21 April 2020, capitalising on improved market conditions.

Core Banking Platform impairment

The Group has elected to impair the carrying value of the deposit and transactions modules of the Core Banking Platform. The Retail Lending, Personal Loans and Customer Collections modules have been successfully implemented.

The risks associated with deploying the incomplete modules in the current uncertain environment have resulted in a low likelihood of completing the implementation in the near term.

The carrying value of this component will therefore be written down, and the Group will recognise a circa $90m (after tax) non-cash impairment charge for FY20, with no impact to the Suncorp Group capital position. This will be disclosed below the cash earnings line in the FY20 Investor Pack.

Group Capital

As at 31 March 2020, Suncorp Group had $682 million of excess common equity tier 1 (CET1) capital, including the impact of investment mark-to-market and the Bank's additional COVID-19 collective provision of $133 million. General Insurance and Bank CET1 ratios remain within targeted ranges with excess held at the Group level available if required. The General Insurance prescribed capital amount stood at 1.19x, at the top end of the target range. Suncorp Bank has CET1 of 9.02 per cent, within the target range.

Currently the Group is well capitalised, with capital levels in excess of what is required to cover the expected deterioration due to COVID-19.

Notwithstanding the existing solid capital buffer, given the current uncertainty, Suncorp has exercised its option to exchange the residual convertible preference shares (CPS3) which were partially refinanced in December 2019 via a resale and conversion process, providing the ability to convert up to $194m in equity and increase the Group's excess capital position.[1] Under the resale and conversion, CPS3 holders will receive face value for their securities, together with the final distribution payment.

[1] Once all CPS3 has been resold, CPS3 will be repaid or converted into ordinary shares. Any CPS3 not converted into ordinary shares will be redeemed. The final amount of ordinary shares to be issued will be announced to the ASX once the conversion is completed (expected to be on or about 25 June 2020). Refer to the Exchange Notice for further details.

Update on pay and leave entitlements review

The Group initiated an internal review of pay and leave practices in November 2019, as referenced in the accounts for the six months to 31 December 2019.

Preliminary analysis of historical data identified inconsistencies in relation to the Group's rostering and pay systems, which may have led to errors in payments of overtime, shift penalties and public holiday loadings.

While it is too early to determine individual impacts, the analysis to date has identified potential instances of underpayments and overpayments. The Group's remediation efforts will focus on individuals who are eligible for additional payments.

"As a Suncorp employee of long standing I am incredibly disappointed that we have let our people down - there is no excuse and we need to get this right. I want to offer my sincere apologies to those who may have been affected," Mr Johnston said.

Based on preliminary analysis and assumptions, Suncorp estimates that the costs to remediate those eligible for additional payments, as well as the cost of implementing new processes to prevent this happening again, are expected to be between $40 - $70 million which will be recognised in FY20.

Suncorp has self-reported to the Fair Work Ombudsman and has engaged Deloitte to assist with this matter. The Board Risk Committee will convene out-of-cycle regular meetings specifically to monitor progress of the review; ensure remediation processes are timely and accurate and are regularly communicated to employees and shareholders; and test that new processes are sufficiently robust so that this does not reoccur.

FY20 Outlook

The Group expects the following financial outcomes for the remainder of the FY20 financial year:

General Insurance (Australia and New Zealand):

- Gross written premium negatively impacted by hardship and lower economic activity
- Claims costs to be impacted by a number of offsetting factors
- Natural hazard costs are expected to remain within allowance

Bank & Wealth:

- Lending portfolio expected to contract in Q4
- Net interest margin towards the top end of the 1.85 – 1.95 per cent range

Group:

- FY20 cost base slightly above $2.7 billion
- Robust capital position maintained
- Final dividend to be considered through year end process

The Group will consider any final ordinary dividend during the normal process of preparing the year-end accounts, and will take into account the capital position, the uncertain economic outlook and APRA's guidance on capital and dividends.

Mr Johnston said: "Over the past 18 months we have made good progress simplifying our business, strengthening our capital position and we have increased our natural hazard allowance.

"While it remains difficult to predict the economic outlook with any certainty, this disruption presents opportunities to reshape our business and change the way we operate and we intend to emerge as a more efficient and sustainable organisation."

Key Reporting Dates

Suncorp advised the following changes to key reporting dates:

– FY20 Full Year Results will be released on Friday 21 August (previously Thursday 6 August); and
– 2020 Annual General Meeting will be held on Thursday 22 October (previously Thursday 24 September).

Webcast Details

A live audio webcast hosted by Suncorp's Group CEO Steve Johnston and Group CFO Jeremy Robson will commence at 9.30am and will be available on the Suncorp Group website.

Authorised for lodgement with the ASX by the Suncorp Disclosure Committee.

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