

# DIRECTORS' REPORT

The Directors present their report together with the financial report of Insurance Australia Group Limited (formerly NRMA Insurance Group Limited) and the consolidated financial report of Insurance Australia Group for the year ended 30 June 2002 and the auditors' report thereon.

The following terminology is used throughout the financial reports:

- Parent entity or the Company – Insurance Australia Group Limited (“IAG”); and
- IAG Group, Group or consolidated entity – the consolidated entity constituted by Insurance Australia Group Limited and its controlled entities.

## Directors of Insurance Australia Group Limited

The following persons held office as Directors at any time during or since the financial year:

### Chairman:

Mr JA (James) Strong appointed 2 August 2001

### Other Directors:

Mr JF (John) Astbury appointed 25 July 2000

Mrs MC (Maree) Callaghan appointed 19 June 2000

Mr GA (Geoffrey) Cousins appointed 25 July 2000

Mrs M (Mary) Easson appointed 19 June 2000

Ms DG (Dominique) Fisher appointed 19 June 2000

Mr ND (Neil) Hamilton appointed 19 June 2000

Ms AJ (Anne) Keating appointed 19 June 2000

Mr RA (Rowan) Ross appointed 25 July 2000

Mr MJ (Michael) Hawker appointed 1 December 2001

### Former Directors:

Mr IF (Ian) Stanwell appointed 25 July 2000 and resigned 31 March 2002

Particulars of the Directors' qualifications and experience are set out on pages 14 and 15. Mr Ian Stanwell resigned his position as a Director of the Company due to health considerations.

## Principal activities

The principal continuing activities of the IAG Group are the underwriting of general insurance, investing and retirement services.

## Result and review of operations

The Group recorded a net loss attributable to shareholders of \$25 million (2001 – \$122 million profit).

The underlying business has performed strongly, producing a general insurance underwriting profit of \$142 million compared with a breakeven result in the previous period. However, the positive underwriting result was offset by the impact of poor investment market returns on the Group's Australian and international equities portfolios.

The Company acquired NRMA Insurance Limited (“NRMAI”) upon the demutualisation of NRMAI on 22 July 2000. The comparative figures in the financial statements include the results of the major operating subsidiary NRMAI for the period from 22 July 2000 to 30 June 2001.

Highlights of the Group's performance over the year are as follows:

- Premium growth: gross written premium was \$3,558 million, representing an increase of 18% on the previous year. Premiums from the acquisitions of State Insurance (February 2001) and a national workers' compensation portfolio (March 2001), and the growth in core products, have been major drivers of this growth;
- Expenses: the expense ratio (underwriting expenses to net earned premium) of 19.7% compares favourably to 20.2% for the previous year;
- Fee-based businesses have generated \$32 million in profit before tax which is an increase of \$18 million from last year. This result includes the full year contribution from workers' compensation premium and claims management contracts assumed in March 2001;
- Short-tail underwriting continued to perform soundly with a combined ratio (claims and underwriting expenses to net earned premium) of 95.5%;
- The long-tail portfolio performed strongly with a combined ratio of 95.4%, which is below the Group's long-term operating target range of 105% – 110%. This result includes the Group's inwards reinsurance portfolio, together with a reinsurance recovery from the Group's whole of account aggregate stop loss reinsurance contract; and
- The Company sold NRMA Building Society Limited in November 2001 for \$138 million. This resulted in a profit before tax on sale of the Building Society of \$45 million.

There are several other significant items affecting the result:

- The continued strong underwriting performance of the Group resulted in reinsurance recoveries of \$185 million through the Group's whole of account aggregate stop loss reinsurance contract;
- A \$21 million expense for the year for the Insurance Protection Tax imposed by the New South Wales Government to fund the shortfall on compulsory third party and builders' warranty claims following the HIH collapse;
- A \$12 million expense incurred in the settlement of defendant legal costs for failed litigation concerning the 1994 "Share the Future" restructuring proposal; and
- The inwards reinsurance portfolio incurred a net claim expense of \$60 million in respect of the September 11 World Trade Center tragedy.

Net realised and unrealised investment losses included in the consolidated result for the year were \$110 million, compared to \$364 million of income in the previous year. The Australian and overseas sharemarkets exhibited extreme volatility during the year, culminating in the worst performing year since 1987/88. In terms of performance relative to benchmarks, fixed interest and Australian equity returns exceeded benchmarks while international equities underperformed.

The policy of matching insurance claims liabilities with fixed interest investments has enabled the positive investment returns from this class to offset or immunise some of the increase in insurance liabilities associated with movements in interest rates.

The Group undertook a process to eliminate equities exposure from its technical insurance reserves portfolio in the second half of the year. In addition, a hedge was placed on a portion of the shareholder portfolio in June 2002. These actions will partly reduce the Group's future exposure to equity market volatility.

Further information on the Group's result and review of operations can be found in the 30 June 2002 Investor Report on the Company's website, [www.iag.com.au](http://www.iag.com.au)

#### **Likely developments and expected results of operations**

Insurance and investment operations are, by their nature, volatile due to the exposure to natural disasters and industry cycles and thus profit predictions are difficult. Otherwise, the Directors agree with the market perception that the coming few years will be a favourable environment for general insurance in our region and believe that the IAG Group is well placed to leverage opportunities in this environment.

#### **Dividends**

The Company has declared a final dividend of 6.0 cents (2001 – 6.0 cents) per share which will be paid on 21 October 2002. An interim dividend of 4.5 cents (2001 – 4.0 cents) was paid on 29 April 2002. Both dividends are fully franked. The Directors declared these dividends in accordance with the policy to pay 40% – 70% of profits, normalised for fluctuation in investment returns, as dividends.

#### **Significant changes**

- a) The Company appointed Mr James Strong, Chairman and Mr Michael Hawker, Chief Executive Officer on 2 August 2001 and 1 December 2001, respectively;
- b) In November 2001, the Company sold NRMA Building Society Limited for \$138 million. This sale resulted in a profit before tax of \$45 million and reduced both assets and liabilities by approximately \$1 billion each;
- c) On 15 January 2002, the Company changed its name from NRMA Insurance Group Limited to Insurance Australia Group Limited;
- d) On 4 June 2002, the Company issued a total of \$350 million in reset preference shares which were listed on the Australian Stock Exchange;
- e) On 24 June 2002, the Company completed an off-market buy-back of shares whereby 98 million shares, which represented 6.99% of the shares on issue, were bought back at a price of \$3.05 per share (comprised of a \$1.78 capital component and a \$1.27 fully franked dividend); and
- f) On 28 June 2002, the Company announced it had reorganised its corporate structure so that NRMA Insurance Limited and its controlled entities undertake all the general insurance underwriting of the IAG Group in Australia. As a consequence, previously recognised "excess of net market value of an interest in a controlled entity" by the life company has now been capitalised as goodwill in the IAG Group. This is expected to result in a goodwill amortisation expense of \$15 million per annum for 20 years.

Other than the matters identified above, there was no significant change to the state of affairs of the IAG Group during the year ended 30 June 2002.

#### **Matters subsequent to the end of the financial year**

Since the end of the financial year:

- a) In July 2002, the IAG Group's whole of account aggregate stop loss reinsurance contract was terminated;
- b) On 20 August 2002, a final dividend of 6.0 cents per share, 100% franked, was declared by the Company. The dividend will be paid on 21 October 2002; and
- c) The IAG Group's investment portfolio has experienced continued volatility in returns in line with Australian and international equity markets. The sensitivities of the Group's results to these market fluctuations have been disclosed separately to the market.

Other than the matters as noted above, there has not arisen in the interval between the end of the financial year and the date of this report any item, transaction or event of a material and unusual nature likely, in the opinion of the Directors of the Company, to affect significantly the operations of the IAG Group, the results of those operations, or the state of affairs of the IAG Group in future financial years.

# DIRECTORS' REPORT

(continued)

## Meetings of Directors

The number of meetings each Director was eligible to attend and actually attended during the financial year is summarised as follows:

Directors	Board of Directors		Audit Committee (formerly Audit and Risk Management Committee)		Chairman's Committee (formerly Remuneration Committee)		Risk Management and Compliance Committee (formerly Compliance Committee)		Share Plan Sub-Committee	
	A	B	A	B	A	B	A	B	A	B
Mr JA Strong	13	12	–	–	5	5	–	–	–	–
Mr JF Astbury	14	13	5	5	1	1	–	–	–	–
Mrs MC Callaghan	14	13	–	–	–	–	5	5	–	–
Mr GA Cousins	14	13	5	5	–	–	–	–	–	–
Mrs M Easson	14	14	5	5	4	4	–	–	–	–
Ms DG Fisher	14	14	–	–	–	–	5	4	–	–
Mr ND Hamilton	14	12	–	–	4	3	–	–	–	–
Ms AJ Keating	14	14	–	–	–	–	–	–	–	–
Mr RA Ross	14	12	5	4	1	1	5	4	2	2
Mr IF Stanwell	11	7	–	–	3	3	3	2	2	2
Mr MJ Hawker	7	7	–	–	–	–	–	–	–	–

A Meetings eligible to attend

B Meetings attended

For the year ended 30 June 2002, the following meetings of Directors were held:

Nature of meetings	Number of meetings held during the year
Board of Directors	14
Audit Committee (formerly Audit and Risk Management Committee)	5
Chairman's Committee (formerly Remuneration Committee)	5
Risk Management and Compliance Committee (formerly Compliance Committee)	5
Share Plan Sub-Committee	2

## Indemnification and insurance of Directors and officers

The Company's constitution contains an indemnity in favour of every person who is or has been:

- A Director of the Company;
- A secretary of the Company;
- A person making or participating in making decisions that affect the whole or a substantial part of the business or Company; or
- A person having the capacity to affect significantly the financial standing of the Company or any of its wholly-owned subsidiaries.

The indemnity applies to liabilities incurred by the person in the relevant capacity to the maximum extent permitted by law.

In addition, the Company is party to deeds of indemnity with certain current and former Directors and members of senior management of the Company or its subsidiaries. Under these deeds, the Company indemnifies to the maximum extent permitted by the law the former or current Director or member of senior management against liabilities incurred by the person in the relevant capacity (and, in some cases, liabilities arising as a result of the person proposing to act in the relevant capacity). The indemnity does not apply where the liability is owed to the Company or any of its subsidiaries, or (in general terms) where the liability arises out of a lack of good faith, wilful misconduct, gross negligence, reckless misbehaviour or fraud.

Under each deed, the Company is also required to maintain and pay the premiums on a contract of insurance covering the current or former Director or member of senior management against liabilities incurred in respect of the relevant office. The insurance must be maintained until the seventh anniversary after the date when the relevant person ceases to hold office. Disclosure of the insurance premiums and the nature of liabilities covered by such insurance is prohibited by the relevant contract of insurance.

Under a deed of indemnity referred to above, the Company has, during the financial year ended 30 June 2002, advanced amounts totalling \$0.2 million in respect of reasonable legal costs incurred by a former Director of the Company in relation to an alleged liability. These amounts are repayable under the deed of indemnity if the costs become costs for which the Company, as a matter of law, must not give the former Director an indemnity. As the former Director was wholly relieved by the Supreme Court of New South Wales from the alleged liability, the advances totalling \$0.2 million may not be repayable by the former Director.

## Directors' and executive officers' emoluments

### Directors

Non-executive Directors of IAG receive a base fee of \$70,000 per annum (unchanged from 2001). The Chairman receives three times the base fee.

By resolution passed at the Company's 2001 Annual General Meeting, non-executive Directors are required to receive at least 20%, and are allowed to receive up to 90%, of their base fee in the form of ordinary shares under the Non-executive Directors' Share Plan, rather than in cash.

In addition to the base fee, fees are payable for participation in certain committees and some subsidiary boards of IAG. The setting of all fees is based on advice from external remuneration advisers, which takes into account the level of fees paid to Directors of other substantial companies operating in the financial services sector and the responsibilities and time commitment of Directors.

The table set out below shows the fees paid by IAG Group to non-executive Directors for the year ended 30 June 2002:

Non-executive Directors	BASE FEE					
	Cash	Non-executive Directors' Share Plan	Total	Other fees <sup>1</sup>	Superannuation contributions	Total
	\$000	\$000	\$000	\$000	\$000	\$000
Mr JA Strong	103	89	192	86	22	300
Mr JF Astbury	56	14	70	15	8	93
Mrs MC Callaghan	52	18	70	10	9	89
Mr GA Cousins	56	14	70	10	8	88
Mrs M Easson	56	14	70	17	2	89
Ms DG Fisher	40	30	70	10	6	86
Mr ND Hamilton	40	30	70	8	6	84
Ms AJ Keating	56	14	70	1	5	76
Mr RA Ross	56	26	82	32	12	126
Mr IF Stanwell	42	10	52	17	6	75

<sup>1</sup> Separate fees are payable for some of the IAG committees and some subsidiary boards.

### Executive Director and officers

The Chairman's Committee (formerly Remuneration Committee) is responsible for recommending remuneration policies and packages applicable to the Chief Executive Officer ("CEO") and executives who report directly to the CEO of the Company. The broad remuneration policy is to ensure the remuneration package reflects the person's duties and responsibilities; and that remuneration is competitive in attracting, retaining and motivating people of the highest quality.

Executives may receive performance bonuses based on the achievement of specific goals related to the individual's business unit and the performance of the consolidated entity in the context of the business plan. A long-term incentive plan is also in place, the purpose of which is to promote improvements in areas of financial and strategic performance.

The CEO of IAG does not receive fees for his service on the Board. The responsibilities of Board membership are considered in determining remuneration provided as part of his normal employment conditions.

# DIRECTORS' REPORT

(continued)

## Directors' and executive officers' emoluments (continued)

### Executive Director and officers (continued)

Set out below is the remuneration of the CEO and each of the five most highly remunerated current officers of the IAG Group for the year ended 30 June 2002:

	Base pay <sup>1</sup>	Bonuses <sup>2</sup>	Other compensation <sup>3</sup>	Total	PSRs granted during the year <sup>4</sup>	Date first exercisable
	\$000	\$000	\$000	\$000	Number	
<b>Chief Executive Officer:</b>						
Mr MJ Hawker	546	–	1,042 <sup>5</sup>	1,588	1,000,000	13/12/2004
	Base pay <sup>1</sup>	Bonuses <sup>2</sup>	Other compensation <sup>3</sup>	Total	PSRs granted during the year <sup>4</sup>	Date first exercisable
	\$000	\$000	\$000	\$000	Number	
<b>Officers:</b>						
Mr IF Brown	738	620	175	1,533	–	–
Mr G Venardos	516	262	76	854	–	–
Mr DRA Pearce	522	202	95	819	–	–
Mr DJP Smith	469	220	61	750	–	–
Mr RJ Jackson	407	214	59	680	–	–

<sup>1</sup> Base pay includes cash salary, annual leave and long service leave.

<sup>2</sup> Bonuses reflect payments made during the period in respect of the previous performance period and accrual of long-term incentive bonuses.

<sup>3</sup> Other compensation includes superannuation contributions and the provision of cars, parking and related fringe benefits tax.

<sup>4</sup> The Company issued Performance Share Rights ("PSRs") to certain executives during the financial year. PSRs can be converted into ordinary share capital of IAG depending on certain performance hurdles being met. The fair value of PSRs granted during the year has been determined as approximately \$0.97 each. This valuation takes into account the price at grant date (which is nil), the exercise price (\$1 per parcel), the expected life of the option, the volatility in price of the underlying shares of IAG and expected dividends. These PSRs were issued on 13 December 2001 and expire on 13 December 2011. The fair value of PSRs granted to Mr MJ Hawker during the year is estimated to be \$970,000.

<sup>5</sup> This amount includes a one-off compensation payment of \$975,000 for direct losses suffered in separation from a prior employment contract in order to take the position as CEO of IAG.

During the financial year, a number of executive officers ceased employment with the IAG Group. They are Ms S Doyle, Ms GS Morstyn and Mr T Higgins and their remuneration, excluding termination payments, for the period up to their termination was \$863,000, \$540,000 and \$285,000, respectively. Termination payments made, having regard to their employment contracts, were \$1,556,000, \$1,148,000 and \$762,000, respectively.

### Directors' interests

The relevant interest of each Director in the shares issued by the Company, as notified by the Directors to the Australian Stock Exchange in accordance with section 205G of the Corporations Act 2001, at the date of this report is as follows:

Directors	Ordinary shares directly held
Mr JA Strong	61,157
Mr JF Astbury	15,857
Mrs MC Callaghan	11,250
Mr GA Cousins	157,857
Mrs M Easson	8,842
Ms DG Fisher	21,214
Mr ND Hamilton	18,498
Ms AJ Keating	8,566
Mr RA Ross	64,538
Mr MJ Hawker	100,736

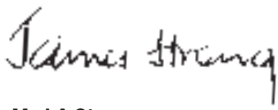
**Environmental regulation**

The consolidated entity's operations are subject to environmental regulations under either Commonwealth or State legislation. These regulations do not have a significant impact on the consolidated entity's operations. The Board of Directors believes that the consolidated entity has adequate systems in place for the management of its environmental requirements and is not aware of any breach of those environmental requirements as they apply to the consolidated entity.

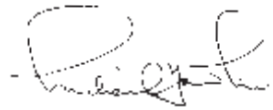
**Rounding of amounts**

Unless otherwise stated, amounts in the financial reports and Directors' report have been rounded to the nearest million dollars. The Company is of a kind referred to in the class order 98/100 issued by the Australian Securities & Investments Commission. All rounding has been conducted in accordance with that class order.

Signed at Sydney this 20th of August 2002 in accordance with a resolution of the Directors.



**Mr J A Strong**  
Chairman



**Mr M J Hawker**  
Director