

# DIRECTORS' REPORT

The Directors present their report together with the financial report of Insurance Australia Group Limited and the consolidated financial report of the Insurance Australia Group for the year ended 30 June 2004 and the auditors' report thereon.

The following terminology is used throughout the financial report:

- IAG, parent entity or Company – Insurance Australia Group Limited.
- IAG Group, Group or consolidated entity – the consolidated entity consists of Insurance Australia Group Limited and its controlled entities.

## DIRECTORS OF INSURANCE AUSTRALIA GROUP LIMITED

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

### Chairman

|                      |                          |
|----------------------|--------------------------|
| Mr JA (James) Strong | appointed in August 2001 |
|----------------------|--------------------------|

### Other directors

|                          |                            |
|--------------------------|----------------------------|
| Mr JF (John) Astbury     | appointed in July 2000     |
| Mr GA (Geoffrey) Cousins | appointed in July 2000     |
| Ms DG (Dominique) Fisher | appointed in June 2000     |
| Mr ND (Neil) Hamilton    | appointed in June 2000     |
| Ms AJ (Anne) Keating     | appointed in June 2000     |
| Mr RA (Rowan) Ross       | appointed in July 2000     |
| Mr MJ (Michael) Hawker   | appointed in December 2001 |

*Particulars of the Directors' qualifications and experience are set out on pages 30 and 31.*

### Former independent non-executive directors who retired during the financial year

|                          |                                       |
|--------------------------|---------------------------------------|
| Mrs MC (Maree) Callaghan | from 19 June 2000 to 1 September 2003 |
| Mrs M (Mary) Easson      | from 19 June 2000 to 1 September 2003 |

## PRINCIPAL ACTIVITIES

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

## RESULT AND REVIEW OF OPERATIONS

The IAG Group net profit after tax for the year was \$806 million (2003 – \$217 million). After adjusting for outside equity interests in the IAG Group result, the net profit attributable to shareholders of the Company was \$665 million (2003 – \$153 million).

The key components contributing to the full year result were:

- Significant improvement in underwriting profit of \$548 million compared to \$199 million in 2003. Part of this improvement is attributable to the full year impact of the acquisition of CGU Insurance Australia Limited ("CGU") and Belves Investments Limited ("NZI") undertaken in January 2003 (previous financial year only had 6 months impact of CGU/NZI).
- The strength of the underwriting result and synergy benefits from the CGU/NZI acquisition produced an insurance margin of 13.5% (2003 – 12.3%), exceeding the IAG Group's long-term target range of 9% – 12%.
- Gross written premium was \$6,427 million, representing an increase of 24.8% on the same period last year (\$5,150 million). The major driver of this growth is a full year's result from CGU/NZI.
- The expense ratio (underwriting expenses to net earned premium) of 25.6% compares to 23.2% for the same period last year. A full year's result from the CGU and NZI businesses has been the major driver of this increase. CGU and NZI bring a higher expense ratio, in the form of commission expense, due to the intermediary distribution of their products.
- The quality of the result was driven by strong performance of all major business segments and includes benefits derived from continuous business improvement, essential completion of the CGU and NZI integration programme and generally favourable weather conditions during the second half of the year. The IAG Group's combined ratio of 90.7% was better than the target range 94% – 96% and was a significant improvement on 95.7% in 2003. Excluding the impact of interest rate movements during the year on outstanding claims provisions, the combined ratio is 92.7% (2003 – 93.9%).
- The result includes \$52 million (2003 – \$45 million) of expenses associated with the restructuring and integration of the CGU and NZI businesses acquired. This marked the completion of the integration programme expenditure.
- After two years of negative return on equity portfolios, the recovery in the global equity markets delivered a welcome positive contribution to the IAG Group's results. Total investment income included in the consolidated net profit before tax for the financial year was \$813 million (2003 – \$296 million).

# DIRECTORS' REPORT

## RESULT AND REVIEW OF OPERATIONS (CONTINUED)

- The results include a one-off gain of \$57 million after tax from the sale of the ClearView retirement services businesses in January 2004.
- There is also a benefit of \$13 million included in income tax expense, as a result of the changes in the IAG Group's tax cost base arising from the application of new tax consolidation rules to the wholly-owned entities in Australia.

Further information on the IAG Group's result and review of operations can be found in the 30 June 2004 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. The Directors believe that premium rate growth will be lower in the coming year than in recent periods reflecting the benefits of improved claims experience, cost control and the international insurance cycle. The IAG Group's insurance margin for the coming year is still expected to be above the IAG Group's long-term target range of 9% – 12%. In addition, the growth in business volume is expected to continue. The Directors consider that the IAG Group is well placed to continue to leverage opportunities in this environment.

## DIVIDENDS

Details of dividends paid or declared by the Company are set out in note 7.

## SIGNIFICANT CHANGES

Significant changes in the state of affairs of IAG Group during the financial year were as follows:

- On 1 July 2003, IAG announced the sale of NRMA Health Pty Limited for \$99 million to MBF, effective 25 July 2003. IAG has entered into a six-year marketing alliance, including a possible four-year extension, with MBF;
- On 11 December 2003, IAG announced the agreement to sell its ClearView retirement services businesses to MBF, effective 21 January 2004. The sale price was \$218 million plus up to an additional \$50 million earn-out, subject to business performance over the following five years; and
- On 28 June 2004, IAG completed an off-market share buy-back of \$414 million, whereby the Company repurchased 94 million shares at a price of \$4.40 per share, which included a fully franked dividend of \$2.62 per share. This represented approximately 5.6% of the IAG Group's ordinary shares on issue.

## MATTERS SUBSEQUENT TO THE END OF THE FINANCIAL YEAR

Details of matters subsequent to the end of the financial year including a dividend declared of 14 cents per ordinary share and the impact of the introduction of Australian equivalents of the International Financial Reporting Standards are set out in note 47.

# DIRECTORS' REPORT

## MEETINGS OF DIRECTORS

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

|                                      | Board of Directors |    | Audit Committee |   | Nomination, Remuneration & Corporate Governance Committee |   | Risk Management & Compliance Committee |   | Reinsurance Committee |   |
|--------------------------------------|--------------------|----|-----------------|---|---|---|--|---|-----------------------|---|
|                                      | A                  | B  | A               | B | A   | B | A                                      | B | A                     | B |
| <b>Total number of meetings held</b> | 12                 |    | 4               |   | 4   |   | 7                                      |   | 4                     |   |
| <b>Directors</b>                     | A                  | B  | A               | B | A   | B | A                                      | B | A                     | B |
| Mr JA Strong                         | 12                 | 12 | -               | - | 4   | 4 | -                                      | - | 4                     | 4 |
| Mr MJ Hawker                         | 12                 | 12 | -               | - | -   | - | -                                      | - | -                     | - |
| Mr JF Astbury                        | 12                 | 12 | 4               | 4 | 4   | 4 | -                                      | - | -                     | - |
| Mrs MC Callaghan*                    | 4                  | 4  | -               | - | -   | - | 1                                      | 1 | -                     | - |
| Mr GA Cousins                        | 12                 | 11 | 4               | 3 | -   | - | -                                      | - | -                     | - |
| Mrs M Easson*                        | 4                  | 4  | 1               | 1 | -   | - | -                                      | - | -                     | - |
| Ms DG Fisher                         | 12                 | 12 | -               | - | -   | - | 7                                      | 7 | -                     | - |
| Mr ND Hamilton                       | 12                 | 11 | -               | - | -   | - | 7                                      | 7 | -                     | - |
| Ms AJ Keating                        | 12                 | 12 | 4               | 4 | -   | - | -                                      | - | -                     | - |
| Mr RA Ross                           | 12                 | 11 | -               | - | 4   | 3 | 7                                      | 7 | 4                     | 4 |

|                                      | ClearView Sale Committee |   | IAG Share Buy-Back Committee |   | IAG Board Sub-Committee |   |
|--------------------------------------|--------------------------|---|------------------------------|---|-------------------------|---|
|                                      | A                        | B | A                            | B | A                       | B |
| <b>Total number of meetings held</b> | 2                        |   | 3                            |   | 2                       |   |
| <b>Directors</b>                     | A                        | B | A                            | B | A                       | B |
| Mr JA Strong                         | 2                        | 2 | 3                            | 2 | 2                       | 2 |
| Mr MJ Hawker                         | 2                        | 2 | 3                            | 1 | 2                       | 2 |
| Mr JF Astbury                        | -                        | - | -                            | - | -                       | - |
| Mrs MC Callaghan*                    | -                        | - | -                            | - | -                       | - |
| Mr GA Cousins                        | -                        | - | 3                            | 3 | -                       | - |
| Mrs M Easson*                        | -                        | - | -                            | - | -                       | - |
| Ms DG Fisher                         | -                        | - | -                            | - | -                       | - |
| Mr ND Hamilton                       | -                        | - | -                            | - | -                       | - |
| Ms AJ Keating                        | -                        | - | -                            | - | -                       | - |
| Mr RA Ross                           | -                        | - | -                            | - | -                       | - |

A – Meetings eligible to attend as a member

B – Meetings attended as a member

\* Mrs MC Callaghan and Mrs M Easson retired as Directors on 1 September 2003.

# DIRECTORS' REPORT

## 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) a Director of the Company;
- (b) a secretary of the Company;
- (c) a person making or participating in making decisions that affect the whole or a substantial part of the business or Company; or
- (d) 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 (except a liability for legal costs). That indemnity also applies to legal costs incurred in defending or resisting certain legal proceedings.

In addition, the Company has granted deeds of indemnity to certain current and former Directors and secretaries and members of senior management of the Company and its subsidiaries and associated companies. Under these deeds, the Company indemnifies to the maximum extent permitted by the law the former or current Directors or secretaries or members of senior management against liabilities incurred by the person in the relevant capacity. The indemnity does not apply where the liability is owed to the Company or any of its subsidiaries or associated companies, 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 effectively required to maintain and pay the premiums on a contract of insurance covering the current or former Directors or members 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.

During previous years, the Company advanced amounts, in accordance with a deed of indemnity, in respect of legal costs incurred by a former Director of the Company (Mr Nicholas Whitlam) in defending legal proceedings brought against the former Director by the Australian Securities & Investments Commission. Mr Whitlam was successful in his defence of those proceedings which are now at an end. Whilst the advances previously made by the Company in respect of legal costs are not repayable by the former Director, the former Director has the benefit of costs orders in his favour in the proceedings. The Company is entitled to the benefit of any amount recovered by Mr Whitlam in respect of the costs of the proceedings, so far as it had previously advanced those costs to him. The Company has requested Mr Whitlam to take the appropriate steps to recover those costs.

## DIRECTORS' AND EXECUTIVE OFFICERS' EMOLUMENTS

### Non-executive directors

Base fees for non-executive Directors are set according to external advice. The payment of Directors' fees also seeks to align the interests of Directors with those of shareholders by requiring them to receive at least 20% and up to 90% of their annual base fee under the Non-executive Directors' Share Plan in IAG shares, rather than cash. No other equity-based remuneration is available to non-executive Directors.

Following consideration of changing views on non-executive Directors retirement benefit arrangements, a decision has been made to freeze the operation of the non-executive Directors' retirement benefits scheme with effect from 1 September 2003. This means no further accruals to existing benefits will be made and new Directors will not be admitted to the scheme.

In consideration of the cessation of retirement benefits and the increased size and complexity of the IAG Group, including additional duties on subsidiary boards, remuneration for non-executive Directors was increased with effect from 1 September 2003. This is the first change since the Company listed four years ago. The base fee increased from \$70,000 to \$100,000 per annum, with the Chairman's fee maintained at three times the base fee per annum. Under the new fee arrangement, the Chairman does not receive additional fees for serving on the Nomination, Remuneration & Corporate Governance Committee or for serving as a director of IAG Re Limited.

The table below sets out the fees paid by the IAG Group to non-executive Directors for the year ended 30 June 2004.

| Non-executive directors         | Primary benefits <sup>(1)</sup> | Post-employment benefits <sup>(2)</sup> | Equity compensation <sup>(3)</sup> | Total |
|---------------------------------|---------------------------------|---|------------------------------------|-------|
| Mr JA Strong                    | \$000                           | \$000                                   | \$000                              | \$000 |
| Mr JA Strong                    | 266                             | 39                                      | 131                                | 436   |
| Mr JF Astbury                   | 106                             | 12                                      | 18                                 | 136   |
| Mrs MC Callaghan <sup>(4)</sup> | 10                              | 271                                     | 3                                  | 284   |
| Mr GA Cousins                   | 89                              | 10                                      | 18                                 | 117   |
| Mrs M Easson <sup>(4)</sup>     | 11                              | 277                                     | 2                                  | 290   |
| Ms DG Fisher                    | 51                              | 10                                      | 55                                 | 116   |
| Mr ND Hamilton                  | 46                              | 11                                      | 79                                 | 136   |
| Ms AJ Keating                   | 101                             | 11                                      | 17                                 | 129   |
| Mr RA Ross                      | 80                              | 11                                      | 44                                 | 135   |

(1) Primary benefits include base fee paid by cash and fees paid for some of the IAG committees and two subsidiaries board.

(2) Post-employment benefits include superannuation contributions made and retirement benefits paid for the two retired Directors, refer to (4) below for further details.

(3) Equity compensation relates to portion of base fee received as IAG shares under the Non-executive Directors' Share Plan. Refer to note 42(i) for details.

(4) Post-employment benefits include retirement benefits of \$269,000 and \$276,000 paid to Mrs MC Callaghan and Mrs M Easson, respectively. The retirement benefits were calculated in accordance with the Non-executive Directors' Retirement Benefits Policy and the Corporations Act 2001.

# DIRECTORS' REPORT

## DIRECTORS' AND EXECUTIVE OFFICERS' EMOLUMENTS (CONTINUED)

### Executive director and officers

The Nomination, Remuneration & Corporate Governance Committee ("NRCGC") is a committee of the Board which provides assurance to the Board of the effectiveness, integrity and compliance of the Company's remuneration policies and practice. The NRCGC makes recommendations on the remuneration to be paid to the executive director who holds the office of Chief Executive Officer ("CEO") and approves the remuneration to be paid to the executives who report directly to the CEO.

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. The broad remuneration policy is to ensure the remuneration package reflects the person's duties and responsibilities, is market competitive and aligns reward with the achievement of the Company's strategic objectives and the creation of value for shareholders.

The tables below set out the remuneration of the CEO and each of the officers of the IAG Group for the year ended 30 June 2004. For the CEO, a comparative is also provided on his remuneration for the previous financial year.

| Executive director       | Primary benefits <sup>(1)</sup> | Post-employment benefits <sup>(2)</sup> | Equity compensation <sup>(3)</sup> | Other benefits | Total |
|--------------------------|---------------------------------|---|------------------------------------|----------------|-------|
|                          | \$000                           | \$000                                   | \$000                              | \$000          | \$000 |
| Chief Executive Officer: |                                 |   |                                    |                |       |
| Mr MJ Hawker             |                                 |   |                                    |                |       |
| - 30 June 2004           | 1,933                           | 146                                     | 1,296                              | -              | 3,375 |
| - 30 June 2003           | 1,804                           | 135                                     | 860                                | -              | 2,799 |

The increase in the remuneration of the CEO is primarily attributable to an increase in his base pay of \$150,000 and an increase in equity compensation, through an additional allocation of Performance Award Rights. The comparative primary benefits have been adjusted to reflect bonus paid in accordance with the changed requirements of Accounting Standard disclosure.

| Officers        | Primary benefits <sup>(1)</sup> | Post-employment benefits <sup>(2)</sup> | Equity compensation <sup>(3)</sup> | Other benefits     | Total |
|-----------------|---------------------------------|---|------------------------------------|--------------------|-------|
|                 | \$000                           | \$000                                   | \$000                              | \$000              | \$000 |
| Ms KL Baylis    | 727                             | 60                                      | 159                                | -                  | 946   |
| Mr IF Brown     | 965                             | 92                                      | 348                                | -                  | 1,405 |
| Mr AM Coleman   | 858                             | 69                                      | 185                                | -                  | 1,112 |
| Mr DA Issa      | 757                             | 60                                      | 88                                 | -                  | 905   |
| Mr RJ Jackson   | 1,121                           | 88                                      | 14                                 | -                  | 1,223 |
| Ms SJ Mostyn    | 717                             | 59                                      | 145                                | -                  | 921   |
| Mr DRA Pearce   | 737                             | 61                                      | 155                                | -                  | 953   |
| Mr MJ Pirone    | 699                             | 61                                      | 198                                | -                  | 958   |
| Mr LF Power     | 823                             | 32                                      | 26                                 | -                  | 881   |
| Mr DJP Smith    | 919                             | 70                                      | 156                                | 124 <sup>(4)</sup> | 1,269 |
| Mr G Venardos   | 1,062                           | 77                                      | 212                                | -                  | 1,351 |
| Mr RJ Wagstaffe | 940                             | 36                                      | 26                                 | -                  | 1,002 |

(1) Primary benefits include amounts of salary paid in cash, bonuses, provision of cars, parking and related fringe benefits tax, annual leave and long service leave. Bonuses, including short-term and long-term incentive bonuses, are measured on accruals basis.

(2) Post-employment benefits include superannuation contributions made and deemed contributions for the IAG & NRMA Superannuation Plan (formerly NRMA Superannuation Plan) where IAG is on a contribution holiday.

(3) Equity compensation includes values of the executives' participation in the Bonus Equity Share Plan ("BESP") for their short-term incentive bonus and values for Performance Share Rights ("PSRs" – related to unissued shares) and Performance Award Rights ("PARs" – related to issued shares) in accordance with AASB 1046: Director and executive disclosures by disclosing entities. Values of BESP are in accordance with market price of IAG shares at grant date. An allocated portion of unvested PSRs and PARs is included in the total remuneration disclosure above. To determine these values the Black Scholes model has been applied. The valuation takes into account the share price at grant date, the expected life of the option, the exercise price of the option, the volatility in price of the underlying shares of IAG, expected dividends and the risk-free interest rate. Refer to notes 42(g) and 42(h) for details.

(4) Represents an accommodation allowance on relocation to Auckland in New Zealand.

# DIRECTORS' REPORT

## DIRECTORS' AND EXECUTIVE OFFICERS' EMOLUMENTS (CONTINUED)

### Executive director and officers (continued)

Set out below is the Performance Award Rights ("PARs") granted during the year ended 30 June 2004.

| Executive director       | PARs granted during the year <sup>(1)</sup> | Date first exercisable |
|--------------------------|---|------------------------|
|                          | Number                                      |                        |
| Chief Executive Officer: |   |                        |
| Mr MJ Hawker             | 400,000                                     | 29/09/2006             |

| Officers        | PARs granted during the year <sup>(1)</sup> | Date first exercisable |
|-----------------|---|------------------------|
|                 | Number                                      |                        |
| Ms KL Baylis    | 61,679                                      | 29/09/2006             |
| Mr IF Brown     | 80,451                                      | 29/09/2006             |
| Mr AM Coleman   | 80,451                                      | 29/09/2006             |
| Mr DA Issa      | 67,042                                      | 29/09/2006             |
| Mr RJ Jackson   | 80,451                                      | 29/09/2006             |
| Ms SJ Mostyn    | 67,042                                      | 29/09/2006             |
| Mr DRA Pearce   | 61,679                                      | 29/09/2006             |
| Mr MJ Pirone    | 73,746                                      | 29/09/2006             |
| Mr LF Power     | 53,634                                      | 29/09/2006             |
| Mr DJP Smith    | 80,451                                      | 29/09/2006             |
| Mr G Venardos   | 93,859                                      | 29/09/2006             |
| Mr RJ Wagstaffe | 53,634                                      | 29/09/2006             |

(1) The Company has issued PARs to certain executives during the financial year. Each executive who participates in the PARs becomes eligible to receive a number of shares by paying \$1 per tranche of rights allocated, subject to a specific performance hurdle met.

### DIRECTORS' INTERESTS

The relevant interest of each Director in the shares and/or options 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 | Ordinary shares indirectly held* | Reset preference shares | Performance share rights | Performance award rights |
|----------------|-------------------------------|----------------------------------|-------------------------|--------------------------|--------------------------|
| Mr JA Strong   | 12,083                        | 139,122                          | -                       | -                        | -                        |
| Mr JF Astbury  | 10,083                        | 38,252                           | -                       | -                        | -                        |
| Mr GA Cousins  | 150,000                       | 18,252                           | -                       | -                        | -                        |
| Ms DG Fisher   | 4,799                         | 56,078                           | -                       | -                        | -                        |
| Mr ND Hamilton | 4,817                         | 60,460                           | -                       | -                        | -                        |
| Ms AJ Keating  | 709                           | 18,252                           | -                       | -                        | -                        |
| Mr RA Ross**   | 102,557                       | 40,053                           | -                       | -                        | -                        |
| Mr MJ Hawker** | 183,971                       | -                                | -                       | 1,000,000                | 700,000                  |

\* Ordinary shares indirectly held includes shares held in the Non-executive Directors' Share Plan and held by Directors' related entities.

\*\* Ordinary shares indirectly held disclosed in the above table only include shares held by related entities as defined by the Corporations Act 2001. However, in note 9(g), these numbers also include shares held by personally-related entities.

# DIRECTORS' REPORT

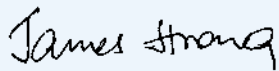
## ENVIRONMENTAL REGULATION

The IAG Group's operations are subject to environmental regulations under either Commonwealth or State legislation. These regulations do not have a significant impact on the IAG Group's operations. The Board of Directors believes that the IAG Group 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 IAG Group.

## ROUNDING OF AMOUNTS

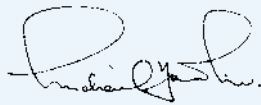
Unless otherwise stated, amounts in the financial report and Directors' report have been rounded to the nearest million dollars. The Company is of a kind referred to in the class order 98/100 dated 10 July 1998 issued by the Australian Securities & Investments Commission. All rounding has been conducted in accordance with that class order.

Signed at Sydney this 19th of August 2004 in accordance with a resolution of the Directors.



**Mr J A Strong**

Director



**Mr M J Hawker**

Director