

STICKING TO OUR PRINCIPLES



Michael Hawker, Chief Executive Officer

We consider long term thinking as key to running a business that deals in risk. That's why we are calling this report 'part two' of our ongoing risk management story. By sticking to our principles – paying claims, understanding and pricing risk, managing costs and reducing risk – we'll be here for the long term. That means we can generate consistent returns for our shareholders, create a stable working environment for our people, make a positive contribution to society and provide security for our customers.



PERFORMING IN A COMPLEX OPERATING ENVIRONMENT

IAG posted another year of record results in a complex operating environment, demonstrating our commitment to managing the business in such a way as to deliver sustainable long term benefits.

Despite the prolonged drought which continued to affect most of Australia during the year, the Group experienced the impact of a number of severe storms. The worst of these hit Melbourne and Sydney in early February 2005 resulting in nearly 25,000 claims. New Zealand also suffered serious floods, hailstorms and landslips. The Group incurred more than \$340 million in claims for weather-related events.

The regulatory and legislative landscape continued to evolve. During the year, we made 18 submissions to various government inquiries and reviews into activities affecting the general insurance industry. In addition, our industry body, the Insurance Council of Australia, made on average more than one submission every week. Submissions IAG made related to:

- Proposed changes to the Financial Services Reform provisions of the Corporations Act;
- APRA's Stage 2 reform proposals;
- APRA's National Claims and Policies database;
- The review of the Insurance Contracts Act;
- ACCC's public liability and professional indemnity premium monitoring; and
- The Productivity Commission inquiries into the relationship between smash repairers and insurers, national competition policy and workers' compensation.

The tort law reforms introduced by the States and Territories started to deliver what communities, insurers and governments set out to do – access to public liability insurance has broadened and rates have fallen, injured people continue to be compensated and legal expenses are reducing.

Australia's economy continued to grow, with record low unemployment and low inflation, leading to ongoing investment in new cars, houses, household goods and business – all of which creates a demand for insurance. Similar trends were displayed in New Zealand.

The Australian share market recorded healthy double-digit growth, with the S&P/ASX 200 up around 26% compared to 30 June 2004.

At the same time, competition in the insurance industry intensified, both in commercial and retail classes. The competitive pressures were most apparent in the larger commercial customer segments, arising from increased activity by off-shore insurers.

CONSISTENTLY STRONG RESULTS

Consistently achieving quality results in this complex, and increasingly competitive operating environment, demonstrates our commitment to managing the business for the long term.

The Group achieved a net profit attributable to shareholders of \$760 million, up from \$665 million in the previous corresponding period.

We've done this by adhering to tight underwriting disciplines and focusing on building stronger customer relationships through initiatives to better align our products, service and distribution networks with our customers' needs, while reducing costs.

In our Australian personal insurance operations, customer retention in our key direct motor and home insurance portfolios has been higher than 90% for the past three years, satisfaction continues to improve and we've strengthened the depth of our customer relationships.

More than 68% of our direct home insurance customers now hold more than one policy with us, there's been an increase in the take-up of optional covers and new products have been well received by the market. Sales of our new landlords insurance product already exceed 3,000 policies monthly.

Tight disciplines were also applied in our Australian commercial insurance business, where we improved our insurance margin by 7.6% to 17.2%. We were able to achieve this by focusing on the SME and rural markets where we have the largest distribution network and significantly enhancing our service through initiatives such as online sales and claims processing.

Our New Zealand business also delivered stronger insurance margins by building on its market leading position through enhancements to its distribution capabilities and further improvements to customer service and delivery standards.

CGU and NZI, which were acquired in January 2003, are now fully integrated into the Group. This is the first year we've had a full contribution from these synergies without incurring any integration costs.

As a result, we achieved a Group insurance margin of 16.3%, up from 13.5% in the previous financial year.

STRONG INVESTMENT RETURNS

Our result was boosted by the Group's highest ever investment income, driven by highly favourable investment markets over the year and significant value added by the Group's in-house asset management team.

The Group's investment portfolio, totalling approximately \$10 billion at year end, returned 11.0% during the year.

Outperformance of portfolio benchmarks by our asset management team contributed an additional \$100 million to pre-tax profit.

Investment return on shareholders' funds contributed \$479 million to the Group's pre-tax result. That's a record return since listing and a 10.4% increase from the \$434 million recorded on this portfolio in the previous corresponding period.

Investment returns from claims reserves also performed well. Over the year, the income from this portfolio contributed \$516 million to the Group's pre-tax insurance result.

Going forward, IAG's asset managers will continue to focus on delivering superior risk adjusted returns on IAG's assets and on additional external client accounts. Through further diversification of our investments, we aim to retain our strong levels of performance while at the same time reduce both our absolute level of risk and the volatility of our earnings.

PROGRESS AGAINST STRATEGIC GOALS

IAG's strategic direction has remained clear, as we've focused our business on general insurance to achieve sustainable, quality growth.

Our priority has been our home markets in Australia and New Zealand. Now that we've generated scale, we continue to look for ways to increase value and service for our customers and to operate our business more efficiently. To maintain growth at the level necessary to remain competitive, we recognise that international expansion is required to generate incremental revenue streams and to further diversify our risks.

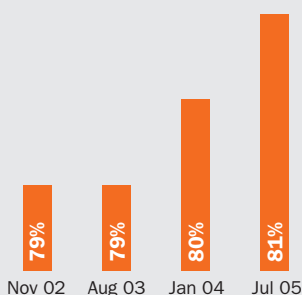
To guide the Group's progress against this strategy, we set five medium term financial goals.

The Group's first goal is to achieve top quartile total shareholder return. Since listing in 2000, IAG's total shareholder return ranks us in the top 20% of the entities in the S&P/ASX 100.

Our second goal, which we also met, is to achieve a return on equity of at least 1.5 times the weighted average cost of capital. We set this goal to ensure that shareholders receive an adequate return. We don't expect to sustain returns much above this level, as excess returns will be invested back into the business.

CEO'S REVIEW

CUSTOMER SATISFACTION INCREASING



Overall customer satisfaction in IAG's key direct motor and home books has steadily increased over the past four years.

AWARD-WINNING PERFORMANCE

Winner

General Insurance Company of the Year
Australia and New Zealand Insurance Industry Awards

Winner

National Sustainable Business Awards
– Large Business category
NZ Sustainable Business Network

Winner

'Triple Bottom Line' Award for CGU's
Risk Radar
United Nations Association of Australia

Winner

Best first time reporter in sustainability reporting
Association of Chartered Certified Accountants (ACCA) Award

Winner

Employer of Choice for Women Status
Equal Opportunity for Women in the Workplace Agency

Winner

Best Strategic Sustainability Outcomes
(over 200 staff)
NSW Department of Environment and Conservation Industry Partnership Program Awards

Progress was made on our third goal to establish an Asian foothold. In July 2005, the Group acquired a small general insurer in Thailand, formerly owned by Royal & SunAlliance Insurance Group, to add to our growing portfolio of assets in Asia.

This is our second investment in Thailand, having held a 22% shareholding in Safety Insurance since 1998. It allows us to diversify our interest in the growing Thai general insurance market and ensures we will be a player in that market's anticipated consolidation.

We will continue to research other potential acquisition opportunities in Asia, using stringent due diligence processes, to provide additional earnings growth for the long term.

We also met our fourth goal to maintain an 80:20 mix of short-tail:long-tail premiums. We consider this to be the best mix to enable us to keep risk at a tolerable level. This is because claims made for short-tail insurance, such as a home or motor insurance policy, are less difficult to predict than claims made for long-tail insurance, such as a workers' compensation policy.

Importantly, we met our final goal to maintain our very strong 'AA' Standard & Poor's insurer financial strength ratings for our key wholly-owned entities. That's a signal to our customers that we have the financial strength to be able to honour our promises to customers to pay their claims.

OUR PEOPLE

Achieving this progress would not have been possible without the dedication and talent of the more than 12,000 people who work for IAG. To all of our people, I say a big thank you.

During the year, we continued to focus on strengthening our internal culture by aligning our people around a consistent purpose and a common set of values – honesty, meritocracy, transparency, teamwork, and social responsibility. A strong culture is vital for providing a framework for decision-making which will ensure a consistent, quality customer experience.

Flexibility, valuing differences and creating the right work environment are equally important aspects of workplace sustainability at IAG, to ensure we can attract, hire and retain the right talent.

To meet these challenges, we've focused on embedding programmes designed to develop our people's skills and knowledge, provide a flexible and safe work environment, reward strong performance and develop fulfilling career paths. The success of our internal programmes is reflected in the improved engagement results scored in our annual survey of all employees.

To ensure our people can benefit directly from the value they are helping to create, the Group announced it will introduce a new employee share scheme this year.

My management team has played an important role in leading our people, strengthening our collective capabilities and consistently applying our values, policies and processes, to help improve our people's engagement and performance. I'd like to thank them for their efforts.

LOOKING FORWARD

Our strategy remains unchanged. We will continue to optimise our businesses in Australia and New Zealand and maintain high levels of customer service. We will also continue our search for additional opportunities to expand our portfolio of assets across Asia, when the right opportunities arise.

Our aim remains to deliver top quartile total shareholder return. We expect our insurance margin to reduce a little but remain above the more sustainable levels experienced in the 2004 financial year. This reflects our belief that an insurance company's performance needs to be viewed over the long term, given the influence of cyclical factors, such as underwriting conditions, weather patterns and investment returns.

Importantly, we will continue to stick to our principles – paying claims, understanding and pricing risk, managing costs and reducing risk – to ensure we are here for the long term.

Michael Hawker
Chief Executive Officer

The next pages highlight some important issues facing IAG, and our industry as a whole. We believe that, from a customer's perspective, it is important that we address these issues.

WHY A PROFITABLE INSURANCE INDUSTRY IS GOOD FOR CUSTOMERS

The past year has been the third consecutive year in which insurers, including IAG, have performed strongly. For the previous 10 years, insurers recorded significant underwriting losses.

Our return to profitability has enabled us to reclaim stability and security for our customers, shareholders, the community and the people who work in our industry.

Importantly, we've been able to achieve this while keeping premiums affordable for customers. NRMA Insurance NSW CTP prices are now as low as they were 10 years ago, comprehensive motor insurance premiums have been reducing relative to average weekly earnings and CGU has cut commercial public and product liability rates by more than 10%.

There has been some debate in the community about what has driven this turnaround. There are many reasons insurers are more profitable today than they were four or five years ago.

First, there has been significant cost reduction driven by consolidation of the industry in the last decade, through demutualisation, privatisation, acquisitions and integration of organisations. Today, the top five insurers provide approximately 95% of personal lines insurance, whereas five years ago, the top five represented less than 35%.

Second, insurers' commitment to a more disciplined approach to underwriting has ensured pricing has returned to sustainable levels. Rogue underwriters have failed and reforms to prudential regulation have meant the industry as a whole has adopted a more judicious approach to managing capital, risk and reinsurance.

Third, we've had an unusually long period of dry weather. That has meant fewer than average claims from customers because, for example, there are proportionally less car accidents.

Fourth, strong investment markets, particularly the equity markets, have significantly contributed to the bottom line

of insurance companies. For example, in the past year, IAG generated a pre-tax return on shareholders' funds of \$479 million. In contrast, when the equity markets were underperforming in 2002, the Group reported a \$234 million loss on this portfolio.

Some commentators say that the profitability of the insurance industry has come through the tort law reforms which were put in place by the Government to make public liability insurance more available and affordable. The reality is that public liability makes up less than 8% of insurers' total revenue, hardly a figure on which to build company profits. The industry's underwriting losses in liability classes for the four years up to 2001 were \$2.1 billion.

Tort law reforms are delivering what governments, communities and insurers set out to do. Premiums have fallen, injured people continue to be compensated and legal costs are reducing. The real winner from these reforms has been the community at large, as was always intended. Insurers are keen to work with governments to ensure that these improvements continue over the next few years.

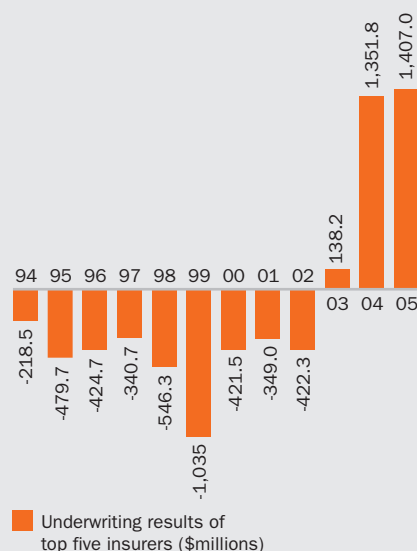
Being profitable has lifted the bar. It means that now, more than ever, insurers need to demonstrate to customers the value of insurance, how it works and how premiums are priced.

Insurance is a community product which is necessary for economies to function. With more than 41 million insurance policies in force in Australia, the industry as a whole pays more than 98% of claims, and this equates to an average of \$55 million paid every working day.

But the stark reality is that there is a huge number of Australians who do not have insurance or are underinsured. More than one in five homes in Australia are underinsured and a staggering one third of small businesses have no insurance or are underinsured.

Australia needs to maintain a strong and profitable insurance sector. Customers must have certainty that insurers have the financial strength to pay claims. At the same time, shareholders require returns commensurate with the risks associated with their investment.

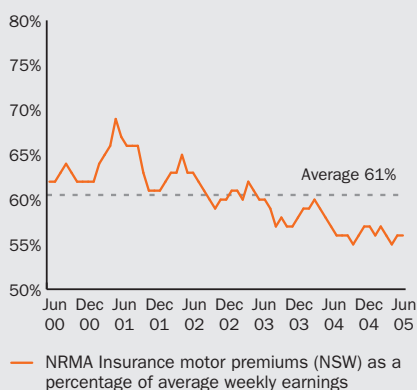
INSURERS RETURN TO PROFITABILITY AFTER YEARS OF LOSSES



Source: KPMG General Insurance Survey

Profitability has returned to the insurance industry in the last three years, but underwriting losses were common for the previous decade. Insurers need to maintain profitability, so customers can have certainty we have the financial strength to pay claims.

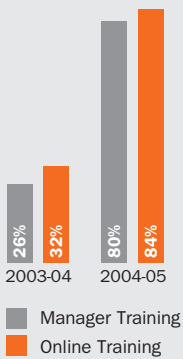
MOTOR INSURANCE HAS BECOME MORE AFFORDABLE



Source: ABS - Average Weekly Earnings

As insurers have returned to profitability, insurance premiums in many classes of insurance have become more affordable for many customers. As shown above, at April 2005, the average annual premium for NRMA motor insurance in NSW equated to 56% of average weekly earnings, compared with an average of 61% over the past six years.

SEE, THINK, BE SAFE



As Australia's largest workers' compensation insurer, IAG has a unique insight into Occupational Health & Safety. This insight has been applied to our own operations with results that had a marked impact on employee behaviour during the year.

80% of managers have completed OH&S training, up from 26% last year. One of the drivers behind this change, IAG's OH&S employee education campaign, Be Safe, was a finalist in the category of 'Best Communication of a Safety Message to Employees' in the NSCA/Telstra National Safety Awards of Excellence.

A REWARDING EXPERIENCE



- Helping Others
- Achievement
- Leadership
- Sustainability & Innovation

In 2004, IAG launched its employee reward and recognition programme – rewardhelp. Based on the Group's core values, rewardhelp allows employees to recognise the achievements of their colleagues in four distinct areas – Achievement, Helping Others, Leadership and Sustainability & Innovation. In the past year, almost 20,000 rewardhelp certificates with redeemable points to spend on IAG's rewardhelp online shopping system have been awarded to our people.

OPERATING TO CREATE VALUE FOR THE LONG TERM

Many people think that sustainability is just about being environmentally friendly, and giving back to the community.

At IAG, we think differently. We see sustainability as managing our business well to ensure we are here for the long term, to create sustainable financial returns. That means adapting to our customers' changing needs, reducing our environmental impact, creating value for society, developing a strong internal culture for our people, and delivering quality returns to shareholders.

To achieve these positive long term outcomes, an organisation must invest in initiatives closely aligned with its purpose. They must also have an economic benefit for the business, since profitability is essential to the longevity of social investments.

For IAG, our purpose is clear – we pay claims, understand and price risk, manage costs and, importantly, reduce risk in the community.

Most people see an insurance company's role as paying claims and pricing risk. We agree. But, we take this one step further by using our comprehensive understanding of what is driving insurance claims to try and prevent those claims from occurring in the first place. After all, fewer risks mean our customers can avoid unnecessary hardships and benefit from more affordable insurance, creating a better outcome for both society and insurers.

Last year, this saw us invest around \$12 million in programmes that promoted safety at home, at work and on the road; reduce crime; and help slow the effects of human induced climate change.

For example, we use our claims data to identify the worst car crash sites each year and work closely with governments to find ways to reduce accident rates at these sites, such as installing traffic lights, roundabouts or improved road signage. We also share research findings with car manufacturers, which leads to automotive innovations to improve driver visibility and safety, and reduce car repair costs.

We invest in programmes to help major employers drive behavioural change of employees to reduce the number of accidents in the workplace. It's something we also do at IAG. We share our sophisticated analysis of crime patterns based on our claims data with local communities and the police to help reduce crime.

We also invest in programmes to reduce our environmental footprint and educate customers and the broader community about how to reduce theirs. This is because our research shows a link between rising global temperatures and increased frequency and ferocity of weather events, such as hailstorms and cyclones, which devastate our customers' property.

Our sponsorship partners are organisations who share our goal of making communities safer, including St John Ambulance Australia, CareFlight, Salvation Army Emergency Services and Royal Flying Doctor Service, and we continue to provide more than \$530,000 annually in grants to small community-based groups. The focus for these sponsorships and grants is on actions or organisations which reduce insured risk or the cost of crime.

These are just some examples to highlight how we align our investments with our purpose to create sustainable communities, at the same time as ensuring the long term, profitable existence of our own organisation.

This approach also creates a more productive internal workforce and helps drive a strong culture. Our people are happier to work for a company focused on long term outcomes. In a recent survey, 73% of our people told us they value IAG's focus on balancing its social, environmental and financial responsibilities.

The link is clear. Managing a company well for the long term requires investment in customers, employees and the community. If an organisation is unable to maintain profitability, it puts at risk its community investment, the employment of its people, customer service levels and its ability to generate returns for shareholders.

MEASURING THE SUSTAINABILITY OF OUR PERFORMANCE

Measuring and reporting on our financial, social and environmental performance is an integral part of delivering on our strategy to manage our business successfully for the long term.

To supplement the financial reporting contained in this annual report, IAG will release its second Sustainability Report later this year. Our inaugural report, published in November 2004, is available at www.iag.com.au.

Our Sustainability Report provides additional information on our performance against social and environmental indicators, such as our efforts to improve the diversity within our workforce, make our communities and roads safer, and reduce our greenhouse gas emissions.

Key achievements during the year in these areas are listed below.

Sustainability strategy

- IAG has been included in the FTSE4 Good Global 100 index (designed to measure the performance of companies that meet globally recognised corporate standards).
- IAG scored 81.4%, up from 65.5% in 2003, in the St James Ethics Centre Corporate Responsibility Index, ranking exceptionally well in the areas of corporate strategy and values, leadership, stakeholder engagement, community management and OH&S.
- IAG was awarded the United Nations Association of Australia 'Triple Bottom Line' Award for the CGU Risk Radar, a tool that helps smash repairers self-assess their business against environmental, health and safety standards and develop an action plan to improve the safety and environmental performance of their workshop.

For our customers

- The Risk Radar product is being rolled out to industries such as hospitality, motor fleet and motor trades.
- IAG's reversing visibility index for cars has been updated.

In the workplace

- IAG was awarded Employer of Choice for Women status by the Equal Opportunity for Women in the Workplace Agency.
- IAG's career development process 'PATH' was rolled out across the Group, helping employees to map out a fulfilling career with the aim of driving engagement and motivation.
- The implementation of an online OH&S reporting process for both accidents and incidents has recorded an increase of IAG's incident to claims ratio from 3.7 to 7.1 indicating a proactive safety reporting culture by employees. The technology allows managers to respond quickly and take preventative action where appropriate.

In the community

- The 2005 **community** help grants programme has awarded grants to 150 community groups with a total of more than \$530,000 going toward community projects.
- IAG launched 'Insurance Basics', an education programme which helps the community learn more about insurance – how it works, how premiums are priced, and how to reduce risk on the road, in the home and in the workplace.
- IAG and its employees donated about \$751,000 to victims of the Asian Tsunami. This included employee fundraising, IAG matching and corporate donations.

In the environment

- IAG was appointed to the Steering Committee of the United Nations Environment Program Finance Initiative, aimed at promoting environmental and social issues in the finance sector.
- IAG now has 126 hybrid vehicles, which are more fuel-efficient and less polluting, in its tool of trade fleet.
- IAG has powered 6.2% of its operations through the use of Green Power, which is energy derived from renewable sources.

While these achievements highlight our progress, we recognise we have a long way to go to ensure we hit our targets. For example, a major challenge is how to reduce our ecological footprint while expanding our business. We are yet to achieve our environmental targets, but remain committed to an overall goal of reducing the Group's CO₂ emissions.

DESIGNS ON THE FUTURE OF CARS



For almost 20 years, IAG's Industry Research Centre has been working with car manufacturers to help improve the repair costs, safety and security of cars on our roads. When Holden Australia began work on its 2006 model Commodore five years ago, it called on IAG to provide input into how Holden engineers could improve design aspects to reduce repair costs and improve anti theft security. Similarly, IAG has provided design input into the Subaru Liberty, Ford Territory and the new 2005 Mitsubishi 380.

TACKLING ROAD INJURIES HEAD ON



Around 75% of head injuries are sustained in car crashes, and severe head injuries are a leading cause of death and disability for people in car crashes. In March 2005, NRMA Insurance and NRMA CareFlight launched a world-first medical trial, the Head Injury Retrieval Trial (HIRT), which aims to improve recovery outcomes for people who sustain head injuries on the road. Under the trial, specialist doctors and paramedics are sent by helicopter to assist people identified with severe head injury by providing intensive trauma care at the scene, rather than waiting until the patient arrives at hospital. NRMA Insurance is contributing \$11.2 million to fund the trial over three years.