

MANAGING RISK FOR LONG TERM SUCCESS

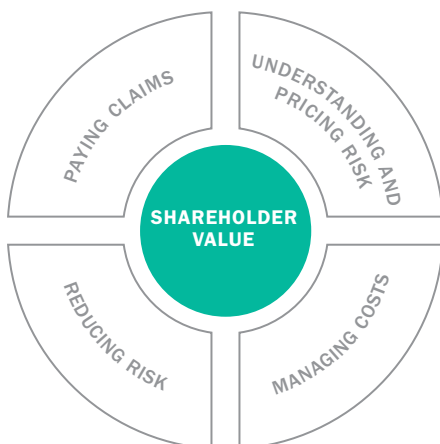
Insurance is a complex business.

The past year provides proof of that. We helped customers bear the impact of one of the worst cyclones ever to hit a populated area of Australia; we experienced major competitive pressures; and we faced slower economic growth in our key operating markets.

Each of these factors affected our performance. And yet we managed to deliver a quality financial result, maintain high customer satisfaction and improve employee engagement during the year.

We did this by focusing on long-term objectives and by learning from and adapting to our changing environment and evolving customer needs.

We also did it by employing people who are expert in managing our business and committed to improving our customers' experience. Some of these people are featured in this report.



Michael Hawker
Chief Executive Officer

Like many people in the industry, I never imagined I would become an insurance executive. But once I was part of the industry, I knew it would keep me engaged for many years. That is because I find it is a business that is both vital to society and intellectually challenging.

For instance, IAG paid more than \$12 million in claims every day over the past 12 months, helping millions of people get on with their lives. These people included children injured in horrific car crashes, families whose homes had been devastated by cyclones or fires, small business owners who had been the victims of burglary, and employees who had been injured while at work.

Providing that kind of assistance makes you realise the value of insurance.

At the same time, insurance is incredibly complex. It is a business in which you sell your product before you know its cost, and many of the factors which influence the cost are outside your control.

For example, a major weather event may occur, like Cyclone Larry for which we will pay customers about \$165 million to cover thousands of claims. Or the competitive environment may change – in the last year we have seen some insurers, particularly commercial insurers, pricing products at what we believe are unsustainably low levels and, as a result, we have ceded some market share rather than sacrifice our underwriting disciplines. Government policy may change, such as the introduction of the new Lifetime Care & Support Scheme in NSW, that will provide treatment and support for people severely injured in a motor vehicle collision, regardless of who was at fault. Crime rates, motor car accident frequency and other external factors also influence our costs.

For these reasons, we assess the risks we manage over long-term trends.

Similarly, we encourage investors to view the financial performance of IAG over the long term, factoring in the various influences on the business which may have a short-term effect on our results. The key for us is to build and deliver sustainable earnings over time.

I am pleased to report the Group delivered a strong net profit after tax of \$759 million, return on equity of 22.1%, and an insurance margin of 14.1%^A for the year to 30 June 2006.

Our ability to sustainably deliver return on equity that exceeds 1.5 times our weighted average cost of capital is testament to our strategy to build a business based on scale, with diversity across products, geography and distribution channels.

AUSTRALIA AND NEW ZEALAND

In our home markets of Australia and New Zealand, where we are the largest general insurance group, we achieved solid results despite increased industry-wide competition, lower average premiums in commercial, motor and compulsory third party (CTP) insurance, and the impact of a severe cyclone and storms.

This demonstrates our ability to strike the right balance between risk-based pricing, maintaining our leading market position and keeping premiums in commercial, motor and CTP insurance affordable for customers.

Our Australian Personal Insurance operations delivered a 12.6% insurance margin. This was a strong result, although lower than the previous year due to reduced business volumes compounded by lower average premiums in CTP and direct motor insurance. In addition, a significant amount of management time was spent resolving a debate with the NSW smash repair industry during the first half. We learnt valuable lessons during this debate and believe the steps we have taken placed us back on track to improving the way we work with our industry partners.

In the second half, following an improvement to our competitive price position, renewal rates reached their highest level in almost two years in our largest portfolio, NSW comprehensive motor, and new business levels improved significantly. Customer satisfaction also remained high.

We expect this positive momentum will continue in the current year as we leverage our competitive price position and continue to implement customer service and claims improvement programs.

In our Australian Commercial Insurance operations, we focused on improving our relationships with existing customers and selectively pursuing new business. We were also unwilling to drop our prices below sustainable levels despite increased competition from local and international players. Together with the ongoing benefits of tort reform, these factors contributed to an insurance margin of 18.0%.

Meanwhile, we achieved a strong insurance result in New Zealand, on the back of improvements in our claims processes, and dealing with only one major weather event during the year.

We continued to change the systems that support our business and contain our operating costs. By increasing automation, rolling out a new franchise model, enhancing distribution channels, and reinvigorating our approach to customer interactions, we aim to become more efficient, thereby increasing revenue per full-time employee, while improving service to our customers.

^A Insurance margins are reported differently in the statutory financial statements, due to the reclassification of the Group's captive insurer's results from the consolidated operations back to the businesses from which the captive earned profits.

CEO'S REVIEW

BUILDING AN INTERNATIONAL PORTFOLIO

To continue to generate sustainable earnings, we are growing our business offshore, initially in Asia. This will further diversify our risks and improve our resilience against the impact of regional insurance cycles.

During the year, we made investments in insurance businesses in Thailand and Malaysia, and have reached a preliminary agreement to invest in 24.9% of China's second-largest insurer. We established a regional office in Singapore, and agreed to acquire a Lloyd's managing agency and specialist Asian syndicate, Alba, primarily to provide reinsurance support to our new Asian partners.

Our share of gross written premium from our Asian businesses during the year was \$65 million. However, this reflects

only the part of the year during which we had a controlling interest in those businesses. On a full-year basis, our share would have been \$150 million. We aim to increase gross written premium as we build our global portfolio and work with our new partners to further improve their businesses. Asian markets are anticipated to deliver higher growth due to both the natural underlying economic growth and an increase in the penetration of insurance.

In keeping with our philosophy to manage for the long term, we have also started to pursue potential growth opportunities in other insurance markets, including those in Europe.

STRONG INVESTMENT RETURNS

The Group generated strong investment income, driven by favourable equities markets and significant value added by the Group's in-house asset management team.

This, together with our quality insurance result, contributed to our strong result for our shareholders.

The Group's investment portfolio, totalling approximately \$10 billion at year end, returned 8.3% during the year. Our asset management team outperformed portfolio benchmarks, contributing an additional \$124 million to pre-tax profit.

Investment return on shareholders' funds contributed \$539 million to the Group's pre-tax result. Despite rising interest rates, investment returns from claims reserves income contributed \$310 million to the Group's pre-tax insurance result.

CAPITAL STRENGTH

The Group retained its very strong capital position, with a multiple of 1.83 times APRA's minimum capital requirement at 30 June 2006. This remains above our internal benchmarks.

Our capital strength enabled us to pay shareholders a special dividend in June 2006, bringing dividends in aggregate for the year to 42 cents per share.

We are pleased to have been in the financial position to return \$200 million to shareholders at the same time as having made further international acquisitions.

REINVIGORATED EXECUTIVE MANAGEMENT TEAM

At the executive level, rotation of responsibilities, promotion of internal managers and new appointments were made during the year. These changes were designed to share talent and depth of capability across the Group, and ensure executive roles were better matched to business areas:

- David Issa became CEO, Personal Insurance, while retaining his previous responsibility for Technology Services;



From left to right:

Sam Mostyn
Group Executive, Culture & Reputation

Christine McLoughlin
Group Executive, Strategy

Jan van der Schalk
CEO, Asset Management & Reinsurance

- Nick Hawkins became CEO, IAG New Zealand, having previously been Head of Asset Management & Group Strategy;
- Jacki Johnson, formerly Head of Risk Management Services, became CEO, Business Partnerships;
- Justin Breheny joined IAG as CEO, Asia, a newly created role to manage our growing portfolio of Asian businesses;
- Christine McLoughlin became Group Executive, Strategy, having previously been Group Executive, Office of the CEO; and
- Jan van der Schalk became CEO, Asset Management & Reinsurance, having previously held the position of Head of Reinsurance.

I am delighted to have appointed three internal candidates, Jacki, Nick and Jan, to our executive, as it highlights the depth of talent in our broader management team and our focus on succession planning and career development.

As we transition from a purely Australian organisation to an international business, we will continue to evolve our executive structure to ensure we make best use of our expertise.

Rick Jackson, formerly CEO, Personal Insurance, and David Smith, formerly CEO, IAG New Zealand, decided to leave IAG. I would like to thank Rick and David for their significant contributions, each having played a fundamental role in the Group's growth and profitability in recent years. I would also like to thank Ian Brown, former Deputy CEO, who retired during the year.

LOOKING FORWARD

I am confident we will continue to grow and diversify our business in the 2007 financial year.

We expect our Australian Personal Insurance business will grow in line with the market during the 2007 financial year, and moderately above market thereafter, and we expect the 'soft cycle' in the commercial market to remain challenging for pricing while the claims environment is expected to be favourable.

Our New Zealand operations should generate similar results to those in Australia, and our Asian insurance business is expected to grow at least in line with the higher growth rates in those markets.

We should complete the acquisition of a 24.9% stake in China's second largest insurer, and we are continuing to investigate other potential acquisitions in general insurance markets in Asia and Europe.

The Group aims to continue to generate quality, sustainable returns for shareholders. We expect to grow gross written premium by 5-10% in the coming year by maintaining our pricing discipline, continuing our focus on cost management, pursuing shareholder accretive acquisitions and actively managing our capital.

PERFORMING SUSTAINABLY

To deliver sustainable financial returns for our shareholders, we believe it is vital that we adapt to our customers' changing needs, reduce our environmental impact, create value for society, and develop a strong internal culture for our employees.

Measuring and reporting on our financial, social and environmental goals are an important part of keeping check on our progress in these areas. Highlights of our progress are listed overleaf.

Our activities in this area also benefited from the advice of an Expert Community Advisory Committee, an independent panel of individuals who represent a range of community interests and professional expertise, which we convened during the year. The Committee's mandate is to provide the Board and executive with independent advice on issues that may impact our standing within the communities in which we operate.



George Venardos (left)
Chief Financial Officer

Tony Coleman (right)
Chief Risk Officer &
Group Actuary

CEO'S REVIEW

OUR PEOPLE

Being able to navigate the complexities of the insurance industry requires resilient and agile employees who understand the purpose, and share the values of our organisation. That is why we have recently invested a great deal of time and effort to improve the leadership capabilities and qualities throughout our company, based on strong values.

I believe if we can help our employees develop their leadership skills, we will drive improved results across all other performance indicators.

We use a measure of employee engagement to determine the health of our culture. In Australia, we saw a 2% lift in this score to 56% and an overall lift of 11% since measurement began in 2003. We believe our initiatives to address career development, diversity, flexibility and balance between work and personal commitments will help drive engagement higher over time. In addition, more than three quarters of our employees have signalled they value our focus on balancing social, environmental and financial responsibilities.

We also developed our workplace diversity program, which seeks not only to tolerate individual differences, but value them. As part of this, we increased the number of indigenous employees significantly over the previous year and also retained our status as an Employer of Choice for Women, according to the Australian Government's Equal Opportunity for Women in the Workplace Agency.

Our staff turnover is still higher than we would like, particularly in our call centres. This is something we must improve and, as a result, are considering alternatives. For example, we are piloting a scheme that brings call centre staff into branches, where they can alternate between face-to-face and phone-based customer service.

We must get better at integrating our values, our purpose, and all the ways in which we support and develop our people so this becomes part of our employees' everyday experience at IAG.

In my role as Chief Safety Officer, I am proud of the strides we have made to foster a safety culture, with a goal of zero harm for our people. Initiatives, such as our internal **besafe** program, helped contribute to a fall in the number of work hours lost due to injury during the year.

OUR CUSTOMERS

Measures of customer satisfaction, renewal and complaints are important indicators of the strength of our customer relationships. In our Australian direct personal lines, I am pleased that overall customer renewal and claims satisfaction remained high, and complaints as a percentage of policies decreased during the year.

Our focus on customers was recognised through a number of commendations during the year. CGU received accolades in the JPMorgan Deloitte General Insurance Industry Survey, while our New Zealand business was named Underwriter of the Year by the Insurance Brokers Association of New Zealand.

Our challenge is to continue to find ways to improve our customers' experience, every time they are in contact with us – an increasingly complex task given customers' constantly changing requirements and expectations.

COMMUNITY

During the year, we invested more than \$14 million in programs aimed at promoting safety at home, at work and on the road; reducing crime; and helping slow the effects of human-induced climate change. After all, working to reduce risk in the community and consequently the number of claims makes good commercial, social and common sense. Fewer risks mean customers and the broader community can avoid unnecessary hardships, and they may benefit from lower premiums too.

We also encourage our people to become actively involved in the community, with most employees able to volunteer work time for a not-for-profit organisation. We believe this enables staff to 'live the values' we share at IAG.

ENVIRONMENT

Climate change is a key risk for insurers. Increasing frequency and severity of weather-related events such as storms, cyclones, hail and drought, combined with growth in values insured, have a major impact on our business. We believe it is possible to reduce the impact of climate change through building awareness and taking immediate action. We proactively engage with government representatives, other businesses and non-government organisations to focus the public policy agenda on the importance of addressing climate change.

We are a member of the Australian Business Roundtable on Climate Change, which released a research report in April in order to advance the understanding of business risks and opportunities associated with climate change.

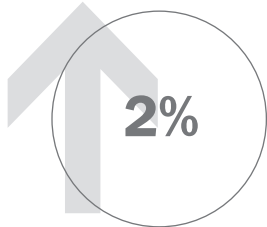
We are also committed to improving our own environmental performance, by reducing our CO₂e emissions through reduced electricity, fuel and paper consumption. We have made significant strides during the year. Now 20% of our Australian car fleet is made up of hybrid vehicles, which combine a petrol engine with an emission-free electric motor. We have introduced new energy-efficient lighting through our head office in Sydney and, in Adelaide, our employees have relocated to a specially designed energy-efficient workplace, for which the base building has been rated 5-Star by the Green Building Council of Australia.

Further information on the Group's approach to operating sustainably, as well as our performance against measures will be released in the 2006 Sustainability Report, which will be made available later this year at www.iag.com.au.



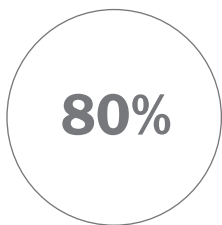
Michael Hawker
Chief Executive Officer

EMPLOYEE ENGAGEMENT



Employee Indicators	2005	2006
Head count	9,856	10,086
Staff turnover	19.5%	20.6%
Employee engagement score	54%	56%
Lost time injury frequency rate	5.3	4.9
Funding of the OH&S department	\$1.985m	\$2.125m

CUSTOMER SATISFACTION



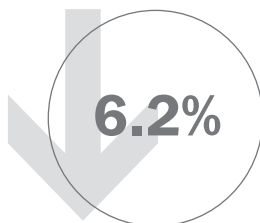
Customer Indicators	2005	2006
Business volume measure (Number of risks and policies in force)	11.9m	11.6m
Overall customer satisfaction index ^{^*}	81%	80%
Complaints as a percentage of policies [^]	0.018%	0.016%

FUNDS FOR COMMUNITY INVESTMENT



Community Indicators	2005	2006
Number of employee volunteer hours	5,629	7,771
Funds for community investment	\$12.3m	\$14.4m
Funds for community investment as a percentage of Group net profit attributable to shareholders [□]	1.6%	1.9%

CO₂e EMISSIONS



Environmental Indicators	2005	2006
CO ₂ e emissions	76,820 tonnes	72,035 tonnes
Recycled commingled waste	232 tonnes	302 tonnes

This page is covered by KPMG's independent review report on sustainability reporting in its Annual Report 2006.

Definitions for each indicator are found in the glossary. All sustainability indicators relate to IAG's Australian operations, unless otherwise stated.

[^] Relates to Australian direct personal lines only.

^{*} Due to a change in provider, the customer satisfaction index is based on six months' data from January to June 2006.

[□] The Group was required to adopt Australian equivalents of International Financial Reporting Standards (AIFRS) when preparing its financial reports for the year ended 30 June 2006. For comparative purposes, results for the 2005 financial year have also been restated under AIFRS.