CEO'S REVIEW

In just one year, our first under the IAG umbrella, we have witnessed some extraordinary events. The tragic September 11 attacks on the World Trade Center resulted in the largest insurance loss in history. In Australia and New Zealand, we experienced a record number of severe catastrophes, including devastating storms, bushfires and floods. The collapse of Australia's second largest general insurer, HIH, led to a Royal Commission and a tightened regulatory framework. It also resulted in the insurance industry facing more public scrutiny than ever before.

Michael Hawker at the King Street Branch, Sydney.

We saw premium increases in public liability, builders' warranty and medical indemnity insurance that were unmanageable for many community organisations. This crisis resulted largely from social changes relating to the personal assumption of risk and the continuing escalation of claims, and has put pressure on State Governments to introduce reforms.

Finally, international equity markets have fallen in value for the second consecutive year, producing their worst performance since the stock market crashed in 1987.

It is during times like these that an insurance company is truly tested. It's testimony to the strength of our strategy and the expertise of our people that despite our overall loss of $25 million, we delivered a record result in our underlying business without compromising our high levels of customer service and our absolute commitment to paying claims.

I would like to use the rest of this review to outline our result for the past financial year, present our strategy for future growth, and demonstrate how we intend to support our customers and the wider community by reducing risk in people's lives.

FINANCIAL RESULT

Our business is impacted by two long-term cycles: a catastrophe cycle and an investment cycle. During the past 12 months, we witnessed low points in both these cycles, which created difficult conditions for general insurers.

Not only was there an unusually high number of severe and sustained catastrophes, the equity markets recorded the worst performance in 14 years. The measure of our success in the face of these challenges is in our underwriting and insurance results.

We recorded an underwriting profit of $142 million for the full year, compared to a loss of $22 million last year. Our insurance profit increased 32% to $278 million. This was primarily a result of our initiatives to better manage claims and underwrite risk, as well as our commitment to diversify our business across different products and geographies.

Despite the solid performance of our underlying business, we delivered a net loss attributable to shareholders of $25 million due to the poor performance of the equity markets. Like all insurance companies, our result is tied to the earnings we make on the funds we invest. During 2001/02, the S&P/ASX200 Accumulation Index fell by around 5% and international equity markets fell by 23% (MSCI World Index ex-Australia).

In the past, we have invested a portion of our technical reserves and our shareholders' funds in equities. This year, our technical reserves produced a return of 3.5% and our shareholders' funds of $2.5 billion lost 8.2%. These returns are well below historical rates of return. If we had earned the same level of return on investments this year as we did in 2000/01, our net profit attributable to shareholders would have been around $290 million.

Due to the difficult investment markets and less than satisfactory returns, we have taken steps to reduce the volatility of reported earnings. We removed the exposure to equities from our technical reserves, decreased the tracking error on our equities portfolio, and implemented a number of hedges to reduce the downside exposure to any further significant reductions in equity investment values.

This offers our profitability a level of protection should the downturn in equity markets continue. Perhaps the best "health check" for an insurance company is the combined ratio. This measures the claims and underwriting expenses as a percentage of net earned premium. Our combined ratio for the full year was 95.6%, and our aim is to keep this below 100% over the long-term.

We ended the year with an expense ratio of 19.7%, down from 20.3% in the previous year. We will continue to focus on realising greater efficiencies and reducing our expense ratio over the next 12 months. In 2001/02 we implemented another plank of our capital management strategy. In June we issued $350 million in reset preference shares and bought back around $300 million of IAG ordinary shares. More than 78,000 shareholders participated in the buy-back, reducing our shareholder base by 7%. We now have around 1.1 million ordinary shareholders. These initiatives helped move us closer to our target mix of capital, further reduced the cost of our capital, and maintained the underlying strength of our capital base.

We remain reserved at a level of 90% probability of sufficiency, well above the minimum Australian Prudential Regulation Authority (APRA) requirement of 75%. Our capital adequacy as at 30 June 2002 was 1.56 times the minimum APRA requirement and we hold one of the highest Standard & Poor's insurer financial strength ratings.

Reflecting the strength of this performance, we will pay a final dividend of 6.0 cents per ordinary share to our shareholders in October. That takes the full year dividend to 10.5 cents per share fully franked, up 5% on last year. This is in keeping with the Board's policy to return between 40% and 70% of normalised earnings to shareholders as dividends. However, curtailing the increase in the annual dividend to 5% reflects our prudence during this time of poor investment returns.

REFINING OUR STRATEGY

In May this year, we confirmed a strategy that builds on our financial strength and past successes. The strategy is centred around five key priorities:

- Reinvigorating our customer focus
- Extending scale and diversity in core general insurance
- Leveraging our core capabilities
- Managing risk
- Delivering high quality growth and earnings.

REINVIGORATING OUR CUSTOMER FOCUS

When I joined this Company, I had been a satisfied customer of NRMA Insurance for 17 years. I wasn't surprised to discover the customer service ethic in this Company is outstanding. We have an 80 year history that is built on meeting our customers' needs. It almost runs in the blood of our

During the New South Wales bushfires in December 2001, IAG donated $500,000 to help fund two helitankers brought over from the United States. Known as Incredible Hulk and Georgia Peach, these helitankers helped put out fires and saved people's homes. This is an example of how we can support our customers and the community in times of intense hardship.

people and is the heartbeat of our organisation. We plan to capitalise on this strength and make it an even more important competitive advantage. Reinvigorating our customer focus simply means ensuring our customers are at the centre of everything we do. It means listening to our customers and responding to what they say they need.

It's about promoting a culture in which customers are the focal point. Everything we do must come back to helping our customers – not just when they pay a premium or make a claim, but at all points in between.

We recognise that convenience and expertise are the key to delivering on this strategy. To help us achieve this, we have undertaken a quality review process that encompasses all points of the customer experience, from sale to claim. Its single objective is to make sure all our internal and external processes lead to the highest quality customer experience. We've called the program "Getting it Right", and that's just what we intend to do for our customers.

To improve the customer experience in our branches and telephone business centres, we've trialed a program called Productivity and Efficiency Promotes Service (PEPS). It's an initiative designed to reduce waiting times and improve the delivery of information to our customers. Since PEPS was introduced, results have shown substantial growth in satisfaction among our customers and our people. The program is being rolled out to all our branches and call centres during 2002/03.

We're also looking at our policy documents. Customers tell us their policies are too long and unnecessarily complicated. So we've embarked on a process of reviewing all our policy documentation to make it simpler, shorter and easier to understand. In conjunction with Getting it Right, we will focus on aligning our businesses around one set of brand values. To help us achieve this, we have appointed two new Group Executives, Karyn Baylis, Group Executive, Sales & Marketing, and Sam Mostyn, Group Executive, Culture & Reputation. We have also appointed M&C Saatchi as our new advertising agency and launched the first phase of our new advertising campaign in September 2002.

EXTENDING OUR SCALE IN GENERAL INSURANCE

We are the largest general insurance group in Australia and New Zealand, with national market shares of 18% and 21%, respectively. But being the largest general insurance group does not diminish our ambition to grow the business and our financial strength even further. The challenge is to leverage our capabilities and depth of expertise to grow in a way that benefits our customers and shareholders.

Natural premium growth Total Australian gross written premium in the private sector has grown at a compound rate in excess of 11% per annum for the past 20 years. As the value of people's assets increase, so does the cost of premiums to cover these assets. This, together with increases in the number of people taking out insurance, will continue to drive natural premium growth.

Deepening the relationship with existing customers As well as welcoming new customers, it's important we meet the needs of our existing customers. Our motor market share exceeds our home market share in every State, presenting significant opportunities to cross-sell home and contents insurance to our motor insurance customers. We will maximise cross-sell opportunities with existing customers by offering multi-policy discounts.

Growth in other States Critical to our ambition is the need to grow our market share outside New South Wales and the Australian Capital Territory – the traditional stronghold of the NRMA Insurance brand. We have taken a number of steps to diversify our business geographically and 42% of our business is now generated outside these regions.

In September 2002, we opened four branches in Queensland, the fastest growing State in Australia and home to many former NRMA Insurance customers. We have also recently entered into an agreement with Elders in Queensland to distribute our compulsory third party (CTP) product in regional areas. This is part of our commitment to ensure we have a strong national presence and a broader geographic distribution of our products.

New products We also plan to grow our core business by offering customers new products. Our EasyBiz product, launched last year, is growing at a compound rate of 25% per annum. The success of Easybiz is an example of how we can deliver tailored insurance products for niche markets. We also have EasyTrade and EasyFarm policies.

CTP and workers' compensation We are the leading underwriter of CTP in New South Wales and the Australian Capital Territory and, following our 2001 portfolio acquisition, we are now one of the leading underwriters of workers' compensation in Australia. In both these classes of insurance, our focus is on helping people recover from injuries as soon as possible. We are also focused on injury prevention. We help employers create safer work environments and drivers adopt safer road behaviour.

Our strength in CTP and workers' compensation means we're well placed to participate in the potential privatisation of those schemes that remain underwritten by State Governments. We estimate premiums underwritten by Governments in these markets is close to $5 billion.

Of the 8,820 natural catastrophes analysed worldwide between 1960 and 1999, 85% were weather related. This is why we have a research and development team, including climatologists dedicated to researching weather patterns. This team examines weather events dating back more than 100 years to understand future climate scenarios. We know how and where hailstorms and cyclones affect different parts of Australia. We use this information to price risk and determine our reinsurance needs.

LEVERAGING OUR CORE CAPABILITIES

We intend to use our expertise in underwriting, claims management, direct distribution and asset management to grow our business.

Underwriting and claims management Our underwriting and claims management processes set benchmarks on a global basis.

In May this year, we put our processes to the test by commissioning Accenture to rate our expertise internationally. The results showed our underwriting, product development and claims management practices are world class.

We will continue to improve and simplify the claims process to make the customer experience as simple and stress free as possible. For example, this year we introduced online eClaims in our home insurance business. The eClaims system allocates work to preferred suppliers electronically, enabling work orders to be processed immediately. Minor repairs can be attended to within 24 hours of the claim being lodged.

Direct distribution Our customers in Australia and New Zealand can communicate with us via our 87 branches, 199 country service centres, call centres, the internet, and affiliated Australia Post outlets. This direct contact means we really get to know our customers, their needs, and their risks. Direct distribution also enables us to keep the price of our premiums down due to its lower cost structure relative to third party distribution networks.

Our people We have around 8,000 employees and it's their commitment to helping our customers that sets us apart from our competitors. In 2002/03, we will focus on developing a culture of continuous learning, increasing the level of training for our people so they remain the best in the industry.

Asset management For six successive years, our Australian equities team has outperformed market indices. Earlier this year, we commissioned a study by Mercer Manager Advisory Services to independently evaluate the capabilities of our Asset Management division in the Australian equities and fixed interest sectors. The report highlighted our strengths, and recommended ways we could enhance our processes.

The launch of ClearView Retirement Solutions in New South Wales this year built on this expertise. ClearView Retirement Solutions develops and distributes superannuation and retirement income products and offers financial advice to customers nearing, or in, retirement.

UNDERSTANDING AND MANAGING RISK

Our understanding of risk is among the best in the world. We operate sophisticated statistical models and maintain vast databases that enable us to model risk fairly and accurately for each of our customers.

Our focus on maintaining best-practice risk management processes is reflected in our internal structure. We recently restructured our Board sub-committees and three bodies now oversee risk: the Risk Management and Compliance Committee, the Chairman's Committee and the Audit Committee. We also have an Asset Liability Committee comprised of members of our Executive Team, who oversee the management of risk across the Group and make recommendations to the Board in relation to our risk profile.

Managing risk well ensures we are in a position to achieve sustainable and profitable growth. We will continue to reserve conservatively, maintaining our claims reserves at a level that gives us an average 90% probability of sufficiency to cover claims.

We also aim to maintain a ratio of short to long-tail business of 80:20. Ensuring most of our business is in short-tail – or personal lines insurance such as motor and home – provides us with greater certainty of costs and, therefore, performance.

Reducing risk for customers and the community The vast pool of knowledge we hold about risk presents us with a wide range of opportunities to reduce risk in our community.

At our Artarmon Research Centre in New South Wales, we test cars to evaluate risks associated with various models and the cost of repairs. We then share this information with manufacturers who use the information to design cars that are safer and less costly to repair.

We also work with the community in more direct ways to reduce risk. Since 1996, we have provided almost $1 million to support crime prevention projects in Australia through our NRMA Insurance CrimeSafe program. These programs not only deal with symptoms of crime, but work to tackle the cause of crime within local communities.

Through our sponsorship of NRMA CareFlight, an emergency helicopter rescue service in New South Wales, we helped nearly 1,000 people who were involved in road accidents, floods, bushfires and other emergency situations in the past 12 months. We also helped fund two specially equipped helitankers, known as Incredible Hulk and Georgia Peach, that were brought in from the United States to help fight the New South Wales bushfires.

The NRMA Insurance Crimesafe program provides one-off grants to assist crime prevention activities. Following the tragic death of Constable Glenn McEnallay, we set up a $10,000 commemorative grant. The first recipient of the Glenn McEnallay Grant was the Street Retreat program. This program takes young offenders and children from underprivileged backgrounds camping with a group of police officers. The results speak for themselves – 90% of children who have attended the camp have not come under notice of police again.

DRIVING GROWTH AND QUALITY EARNINGS

During the past five years, around 50% of our growth was organic and 50% was delivered through acquisitions. In addition to extending the scale of our existing business, we have a number of avenues for delivering growth in the long-term.

New insurance classes We will consider moving into new insurance classes such as public liability and builders' warranty if sufficient legislative reforms are made to stabilise these schemes. These insurance classes require a legislative framework that matches the expectations of legitimate claimants with the financial capacity of those who pay the premiums.

We are confident we can work with Governments to achieve this balance, having been instrumental in the development of the stable and successful workers' compensation scheme in Western Australia.

IAG recently entered into an agreement with two other insurers to provide public liability insurance for not-for-profit organisations in New South Wales and the Australian Capital Territory, at cost. This co-insurance pool has been formed in response to the shortage in public liability cover. It will enable charities and associations to continue their important work.

Consolidation of the market We expect the new capital requirements introduced by APRA will drive further consolidation within the industry, primarily because some participants are unable, or unwilling, to provide the capital required to support their business going forward.

We also recognise potential for future consolidation among the six major players in the Australian insurance industry. We are well positioned to participate in this consolidation should it occur.

International growth Our priority is to be strong at home, and there are sufficient opportunities to grow our business here in the short to medium term. However, we will continue to investigate international opportunities in which we can apply our core competencies – primarily in personal lines insurance. Long-term, international expansion will be necessary if we are to continue to grow and diversify our risk.

Our purchase of State Insurance in New Zealand in February 2001 represents our first major step in this direction. State Insurance delivered 20% of the New Zealand insurance market and is already earnings per share positive. We also successfully launched the Circle broker brand in New Zealand, which has grown ahead of expectations in its first year.

To reduce the risk involved in offshore expansion, we intend to focus on opportunities in personal lines insurance. This means looking for market participants with either an underperforming insurance business, or a customer database that lends itself to insurance. We've recently entered into a research agreement with the Japanese company AIOI to investigate potential international opportunities. AIOI is one of the leading non-life insurers in Japan and Toyota Group is its largest shareholder.

OUTLOOK

The simultaneous disruptions in the investment and catastrophe cycles are unusual, and we expect conditions to improve in the medium term. The strength of our underlying business means we are well positioned to post strong results when these cycles rebound. We are well reserved, our underlying insurance business achieved a record result in a difficult year, and we hold one of the highest insurer financial strength ratings assigned by Standard & Poor's.

IN SUMMARY

Delivering on our five key priorities will put us on track to reach our five year aspirational financial goals:

- Achieve top quartile total shareholder returns
- Record a normalised 13% to 15% return on capital per annum
- Double gross written premium by 2007
- Maintain a combined ratio at less than 100%.

We believe IAG will grow faster and perform better if the way we do business is in line with what our communities and customers expect of us. As Australasia's largest and strongest general insurance group, it is our responsibility to protect and improve the communities in which we operate.

We will work with our people to create cohesiveness and teamwork across the Group, continually looking for ways to improve our customer service. We will also look for ways to work closely with the community – helping people at all times, not just when they have to make a claim.

This vision won't become a reality without the support of our people. I'd like to take this opportunity to thank our team for their ongoing dedication and commitment, as well as our customers for their loyalty. I'd also like to thank you, our shareholders, for your continued support.

Michael Hawker
CEO