As an insurance group, our business is to pay claims. But, as you can see from this annual report, to fulfil this role we must stand for more:

- We need to help our customers and the community beyond just paying claims.
- We need to share our experience and knowledge with the community to help manage and reduce risks.
- We need to build a culture of which our people can be proud – one that allows them to develop and work to the best of their abilities.
- And, we need to ensure our business is sustainable and can deliver ongoing value to our shareholders.
We've seen continuing issues with professional Community Care Underwriting Agency. to not-for-profit organisations through the other insurers to provide public liability cover. In addition, we've joined forces with two changes to benefit the entire community. played an instrumental role in effecting laws, and Insurance Australia Group has warranty insurance classes. In response, public liability, medical indemnity and builders' last year, we experienced the crisis in the terrorism legislation which took effect from 1 July 2003. This will lead to increases in commercial insurance premiums from 1 October 2003, principally so that the Australian Government can build a fund to pay for possible future losses from terrorism.

Last year, we experienced the crisis in the public liability, medical indemnity and builders' warranty insurance classes. In response, we've seen ongoing reform of personal injury laws, and Insurance Australia Group has played an instrumental role in effecting changes to benefit the entire community. In addition, we've joined forces with two other insurers to provide public liability cover to not-for-profit organisations through the Community Care Underwriting Agency. We've seen continuing issues with professional indemnity and directors' indemnity insurance this year. While these classes account for around 1% of our business, the issues highlight the difficulties created when insurance classes are unprofitable.

Also last year, the investigation into the collapse of HIH Insurance continued at the HIH Royal Commission. This year, we have received the recommendations of the HIH Royal Commission which are already having a substantial impact on the regulation of the insurance industry in Australia. In line with Insurance Australia Group's submissions to the Commission, the recommendations include proposed changes to fire services levies and stamp duty charges on insurance policies. The adoption of these recommendations would distribute the costs of services more equally across the community and help make insurance more affordable.

We've also seen further consolidation in the local insurance market. This incorporated the withdrawal of three UK-based insurers through a series of transactions, including our own acquisition of CGU and NZI completed on 2 January 2003. Having said that, the sector still includes more than 100 competitors in Australia and 17 in New Zealand.

OUR PROGRESS AGAINST OUR STRATEGY
In the face of this complexity, Insurance Australia Group's direction remains clear.

In May 2002 we confirmed our business strategy to grow quality earnings, extend our scale and diversity in general insurance, reinvigorate our customer focus, leverage our core capabilities, and manage risk.

We believe the strategy will support the financial goals we set to:

- Achieve top-quartile total shareholder returns;
- Deliver a normalised 13% to 15% return on capital per annum;
- Double gross written premium (GWP) to $6.6 billion by 2007;
- Maintain a combined ratio at less than 100%; and
- Maintain ‘AA’ category insurer financial strength rating.

I am pleased to report we have made significant progress against this strategy over the past 12 months.

Growth in quality earnings
We have continued to improve the quality of our operational earnings, as shown through our financial results for the 2002/2003 financial year.

As a Group, we exceeded all operating targets for the year. We recorded a net profit attributable to shareholders of $153 million, improving from a loss of $25 million for the previous year. Our insurance margin rose to 12.3%, up from 8.7% in the previous year and exceeding our current target range of 9% – 11%. And we ended the year with a Group combined ratio of 95.7%, consistent with 95.6% in the previous year.

There were two primary drivers of these results. First, the performance of CGU and NZI, included in our results since 2 January 2003, was better than expected. Second, our existing business also performed strongly, underpinned by improved customer retention, continued stability in major personal injury classes, the realisation of targeted business improvements in our New Zealand operations and largely benign weather conditions which sustained a reduced claims frequency.

That we were able to simultaneously maintain the improvement in the underlying business while managing a major acquisition is a particularly satisfying aspect of these results. Our GWP increased by 45% for the year, from $3.6 billion to $5.2 billion, with approximately 9% being from organic growth – over half of
THE ROLE OF INSURANCE IN THE COMMUNITY

Insurance is the ultimate community product. People pool money with us so that, if an individual suffers a hardship, he or she is protected. People expect and hope they won't have to make a claim. But, with appropriate insurance, they can live their lives knowing their home, car or business is protected in case they do.

As an insurer, our role is to pay that money when it is needed. It’s our role to pay claims.

To pay claims, we need to be able to do two things well. First, we need to price risk fairly and appropriately. If risk is under-priced, the available funds won’t match claims and business will fail to the detriment of policyholders. If risk is over-priced, people will take their insurance business elsewhere. Or they will choose not to insure at all, which puts them, and the community, at risk.

Second, we need to keep our operating costs down. The price of premiums includes not only the measure of risk, but also the costs that go into providing the policy in the first place. Keeping our own overhead and infrastructure costs per policy down ensures we can offer affordable insurance.

However, there are other things that impact on the price of insurance. Such as government taxes and charges. And the increased risk in the community due to elements like weather, crime (which, for example, costs the Australian motor insurance industry around $1 billion a year) and cases of fraud, where people try and claim more than they are entitled. As you will see from this annual report, we are taking numerous steps to help the community understand and reduce these risks.

Understanding the role of insurance gets to the heart of clear direction.

which was new policy growth – and the remaining 36% coming from the acquisition of CGU and NZI. We also locked in annualised runrate synergies of $54 million against our first six month target of $21 million, and we are on track to deliver the anticipated $160 million pre-tax per annum in sustainable integration synergies by June 2004.

At the same time, our overall returns from investments increased, reflecting both the change in our asset mix and improved market performance. Investment returns from technical reserves, which are now wholly invested in cash and fixed interest assets, increased to $372 million from $136 million in the previous year. However, shareholders’ funds, which are substantially invested in equities, returned a loss of $120 million due to another year of declining equity markets both locally and internationally, as well as from the cost of the tactical derivatives programme designed to protect the Group’s capital while completing the fundraising for the CGU and NZI acquisition.

The $1.86 billion acquisition of CGU and NZI was funded by a capital raising programme which included the issue of:

- $500 million Institutional placement – ordinary shares
- $300 million Dated subordinated debt
- $380 million Share Purchase Plan – ordinary shares
- $200 million Reset preference shares
- US$240 million Dated subordinated debt
- $75 million Underwritten Dividend Reinvestment Plan – ordinary shares.

Based on the momentum in the business, and our expectation of a continued low interest rate environment, we have upgraded our Group combined ratio target to 93% – 96% for the coming 12 months. Operating within that range should enable us to maintain an insurance margin of 9% – 12%. Ultimately, our goal remains to provide our shareholders with a top-quartile shareholder return throughout the cycle.

Scale and diversity in core general insurance

It’s our view that, unless you have a competitive edge in a niche area, scale is crucial to succeeding in general insurance. There are considerable infrastructure costs in running an insurance company well. Spreading these across a greater premium base is beneficial, allowing us to keep our costs per policy down.

Clearly, our acquisition of CGU and NZI from Aviva plc, along with the NSW workers compensation management business we acquired from Zurich Insurance in January 2003, has added significantly to the Group’s scale and diversity by product, geography and distribution channel in both Australia and New Zealand.

We now enjoy a strong presence in a range of general insurance classes, with the composition of our business by GWP consisting of 57% personal, 20% commercial, 16% personal injury, 3% health and 4% other short-tail business, as at 30 June 2003. We are also well represented in both the direct and indirect distribution channels, with nearly 60% of our business distributed directly through our branches, country service centres, call centres and the Internet. The remainder of our business is distributed through our broker network and third party partners, including financial institutions and alliances.

Reflecting this increased presence as a provider of indirect insurance, we have appointed two new Group Executives who joined the Group through the CGU acquisition. They are Group Executive, Business Partners, Lou Power, and Group Executive, Intermediary Business, Bob Wagstaffe.

Importantly, we have achieved our goal of having at least 80% of our business in short-tail insurance (such as motor, home and rural), with the remainder in long-tail insurance (such as professional indemnity, compulsory third party motor liability and workers compensation). This balance, combined with our reinsurance protections, provides a greater likelihood that we will be able to deliver combined ratios of less than 100% throughout any insurance cycle.

The fact we didn’t enjoy the same advantages of scale in health insurance led us to sell our health manufacturing and claims operations to MBF. At the same time, we have entered a marketing alliance to enable us to continue to promote and sell health insurance products, now underwritten by MBF, to our customers.
A PHASED APPROACH TO GROWTH

This decision, announced on 1 July 2003, followed a thorough review of our health insurance operations and allows us to continue to service our more than 95,000 health insurance customers with no changes expected to cover or policies.

Reinvigorating our customer focus
The Getting it Right programme, one of the Group's primary initiatives to reinvigorate how we help our customers, completed its review of our end-to-end customer systems and processes. Out of that review more than 400 initiatives designed to improve the customer experience are now being implemented progressively across the Group. The programme is explained further on page 7.

We also completed the rollout of our Productivity & Efficiency Promotes Service (PEPS) programme in our Australian call centres and branches. The PEPS programme, which was successfully trialled in the 2001/2002 financial year, allows us to identify our customers' needs early in the interaction, so we can quickly direct them to relevant specialists.

We are already seeing results from our efforts to date. Strong customer renewal rates have been sustained at around 90% in all major products for the past two years.

At the same time, customer satisfaction, a key predictor in building long-term customer relationships, has consistently risen over the past 18 months. In the Victorian motor insurance portfolio, for example, customer satisfaction with claims service was 86% at June 2003, reflecting an average increase of 3.5% each six months since November 2001.

In Australia, we launched major advertising campaigns supporting our direct general insurance brands – NRMA Insurance, SGIO and SGIC – and our indirect general insurance brand, CGU. To date, the campaigns have been successful in reinforcing our shared customer propositions of help and confidence.

These are examples of how we are improving the customer experience, when purchasing products or making claims. But we're also focusing on reducing the risk of accidents or other insurable events from occurring in the first place.

Our launch of the Reversing Visibility Index is one such example. Based on detailed research, this index compares 50 of the most popular vehicle models in terms of their safety performance when reversing. One of the key research findings was the link with fatal reversing visibility accidents involving children. By highlighting the link between reversing and vehicle accidents, we aim to improve road and vehicle safety. This work was very well received and an information brochure is available through childcare centres as well as our branches and websites.

Pilot Theft Forums were another risk reduction initiative organised during the year, aimed at reducing the impact of crime in local communities. Working with local councils, police, members of parliament and local groups in the Dubbo, Shellharbour and South Sydney areas, the forums facilitated discussion around combating home burglaries and car theft. The success of those discussions means we are now working with the local organisations to develop practical and locally relevant crime prevention initiatives.

Overall, our commitment to our customers and what we stand for was no more evident than during the ACT bushfires, the seventh largest insured catastrophe in Australian history. We were able to play an integral role in helping our customers and the community in Canberra to 'get back on their feet', through both direct claims support and events such as the NRMA Insurance Help Expo, which is discussed on page 9. We continue to play a role in the recovery process through ongoing cooperative dialogue with the ACT Government initiated ACT Bushfire Recovery Taskforce.

Leveraging our core capabilities
Our core capabilities in underwriting, and claims and asset management – as well as the capabilities of our people – need to be maintained and developed on an ongoing basis.

As an insurance group, one of our core responsibilities is to price risk fairly. Our ability in this field was recognised during the year by our high rankings in the Deloitte Touche Tohmatsu/JP Morgan 2002 General Insurance Survey.

We also continued to extend our claims management skills across the Group, including CGU and NZI. For example, we introduced our proven preferred supplier model into new areas of the business, tailored for the extent of our presence in each region. In June 2003, it was adopted for the tow truck industry in NSW, following a successful trial over the previous year. The preferred smash repairer scheme was introduced into Victoria, South Australia and Western Australia. We also launched a national code of practice governing our dealings with preferred suppliers.

As well as pricing risk and paying claims, we also need to generate investment returns on the funds backing our insurance liabilities and our capital. We aim to generate returns ahead of the benchmarks while limiting the risks we take and maintaining high quality liquid portfolios. This year our fund managers again outperformed internal benchmarks on the overall funds under management. However, the total return for the year was hampered by the cost of capital protection measures in place while we completed our fundraising for the acquisition of CGU and NZI. As the funding is now complete and the capital position is strong, we have no plans to take out further protections of this nature.

We are also focused on having an effective and efficient infrastructure to support everything we do. During the past year we committed to an overhaul of our technology services strategy and, under our new Chief Information Officer, David Issa, the transformation is well underway.

Our 11,000 people are just as important as any technical capability when it comes to delivering on our promise to customers. As a result, during the year we invested significant time and energy on setting the framework for a common culture after the series of acquisitions. Examples of initiatives to date are included on page 7.

Risk management
Strong risk management is the backbone of any insurance company. Understanding risk allows policies to be priced appropriately and ensures sufficient reserves so we can always deliver on our business of paying claims.
It also underpins the reinsurance arrangements we put in place and ensures we have the required capital backing.

The new Australian Prudential Regulation Authority (APRA) prudential guidelines came into effect from 1 July 2002. We have extended the practices across all our general insurance entities, including New Zealand.

Even within the context of the APRA requirements, we continue to reserve conservatively, maintaining our claims reserves at a level that gives us a minimum probability of sufficiency of 90%, well above the minimum APRA requirement of 75%. As at 30 June 2003, our Australian operations had capital equivalent to 2.03 times the risk-weighted minimum capital requirement. At the same time, our Group’s capital was 1.62 times the minimum determined on the same basis as the APRA requirement. This is very comfortably within our target range of 1.35–1.65 times, set applying APRA principles to the consolidated operations of the Group, not just our individual licensed entities which is the APRA approach.

In July 2003, a number of our major businesses began operating under their licences issued under new Australian Financial Services Reform (FSR) legislation. This legislation is designed to instil consistent standards for licensing, training and customer disclosure to the financial services industry. Despite the extensive workload and resources involved, this FSR implementation programme has been delivered on schedule and ahead of the maximum timeframe set down in legislation. That the necessary changes have been aligned with existing company processes should mean that customer protection is sustainable. The remainder of our businesses in Australia are on track to obtain their licences ahead of the March 2004 deadline.

Our reinsurance programme has been adjusted following the acquisition of CGU and NZI and shows clearly how scale and diversity benefit our risk management. Despite an environment of rising reinsurance costs globally, we secured a more extensive Groupwide catastrophe reinsurance programme at the same cost. Both the depth of coverage for a single event and the breadth of coverage for multiple events have improved.

For example, Australasia’s worst ever insured catastrophe was the 1999 NSW hailstorms, for which the insured cost was about $1.9 billion. Insurance Australia Group’s share of the impact was about $400 million. The net impact after reinsurance was $33 million (pre-tax), including the cost of reinstating our reinsurance protection, a 4.7% effect on our Group combined ratio. Were those hailstorms to occur today, our current reinsurance programme would mean our maximum net loss would be $70 million (pre-tax), which is less than a 1.5% impact on our combined ratio.

Our risk management team’s focus on the environment and global warming is breaking new ground in terms of the community’s understanding of climate change impacts and increased catastrophe risks. Further information can be found on page 5.

And we are sharing our risk management expertise in our national partnerships with St John Ambulance and the Salvation Army Emergency Services, helping to promote safety and risk reduction in the community.

LOOKING AHEAD – OPPORTUNITIES AND CHALLENGES

While there is still much work to do, our financial result and the initiatives completed or underway demonstrate we are delivering on the strategic objectives we set ourselves in May last year.

We have completed our goal to generate domestic scale in Australia and New Zealand. Our task for the next year is to consolidate our achievements and secure domestic organic growth and profitability before we consider further growth internationally.

We will do this by completing the integration of CGU and NZI during the current financial year, and continuing to extend our core capabilities in underwriting and claims management to improve the quality and efficiency of all our business operations. We will seek to leverage our competitive advantage to drive further cost synergies in our procurement strategy and around our own infrastructure. And we will continue to focus on working with relevant parties to minimise the costs associated with fraud and crime, and government taxes and charges, and to prevent the risk of insured events occurring in the first place.

In summary, by optimising what we have and remaining focused on what Insurance Australia Group stands for, we will deliver sustainable earnings growth and cement our ability to pay claims for the long-term.

THANKS TO OUR PEOPLE

Of course, our results could not have been achieved without the extraordinary efforts of our people. That we maintained and exceeded our performance targets while integrating our businesses are a testament to their commitment and ability. I would like to take this opportunity to thank everyone for their contribution to what has been an exciting and historic year.

Michael Hawker
Chief Executive Officer