

# DIRECTORS' REPORT

The Directors present their report together with the financial report of Insurance Australia Group Limited and the consolidated financial report of the Insurance Australia Group for the year ended 30 June 2005 and the auditors' report thereon.

The following terminology is used throughout the financial report:

- IAG, parent entity or Company – Insurance Australia Group Limited.

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

## DIRECTORS OF INSURANCE AUSTRALIA GROUP LIMITED

The Company's Directors in office at any time during or since the end of the financial year are as follows. Directors were in office for this entire period unless otherwise stated.

### Chairman

Mr JA (James) Strong appointed in August 2001

### Other directors

Ms YA (Yasmin) Allen appointed in November 2004

Mr JF (John) Astbury appointed in July 2000

Mr GA (Geoffrey) Cousins appointed in July 2000

Mr ND (Neil) Hamilton appointed in June 2000

Mr RA (Rowan) Ross appointed in July 2000

Mr B (Brian) Schwartz appointed in January 2005

Mr MJ (Michael) Hawker appointed in December 2001

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

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

Ms DG (Dominique) Fisher from 19 June 2000 to 10 November 2004

Ms AJ (Anne) Keating from 19 June 2000 to 10 November 2004

### SECRETARIES OF INSURANCE AUSTRALIA GROUP LIMITED

The name and details of the Company's secretaries at any time during or since the end of the financial year are as follows:

#### Ms AB (Anne) O'Driscoll FCA, ANZIIF (Fellow), GAICD

Ms Anne O'Driscoll was appointed to the position of company secretary in July 2002. Before this appointment, Ms O'Driscoll has held a number of senior positions in the IAG Group, including the position of General Manager, Finance. Currently, Ms O'Driscoll is also the Head of Investor Relations of IAG. Ms O'Driscoll is responsible to the Board for ensuring Board procedures are complied with. She also provides advice and counsel to the Board in relation to corporate governance and other matters.

#### Mr GD (Glenn) Revell BCom, MBus, FCPA, FCIS, GAICD

Mr Revell was appointed to the position of company secretary in October 2002. Prior to holding this position, he held the position of General Manager Corporate Affairs & Company Secretary of Howard Smith Limited for eight years.

### MEETINGS OF DIRECTORS

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

	BOARD OF DIRECTORS		AUDIT COMMITTEE		NOMINATION, REMUNERATION & SUSTAINABILITY COMMITTEE		RISK MANAGEMENT & COMPLIANCE COMMITTEE		IAG BOARD SUB-COMMITTEE	
	A	B	A	B	A	B	A	B	A	B
<b>Total number of meetings held</b>	<b>16</b>		<b>4</b>		<b>5</b>		<b>8</b>		<b>3</b>	
<b>Directors</b>	A	B	A	B	A	B	A	B	A	B
Mr JA Strong	16	16	-	-	5	5	-	-	2	2
Mr MJ Hawker	16	15	-	-	-	-	-	-	2	2
Ms YA Allen*	10	10	-	-	-	-	6	6	-	-
Mr JF Astbury	16	15	4	4	5	5	-	-	-	-
Mr GA Cousins	16	14	4	4	-	-	-	-	-	-
Ms DG Fisher**	6	5	-	-	-	-	2	2	-	-
Mr ND Hamilton	16	15	-	-	-	-	8	8	1	1
Ms AJ Keating**	6	6	2	2	-	-	-	-	-	-
Mr RA Ross	16	15	-	-	5	5	8	8	1	1
Mr B Schwartz*	8	8	2	2	-	-	-	-	-	-

A – Meetings eligible to attend as a member.

B – Meetings attended as a member.

\* Ms YA Allen and Mr B Schwartz were appointed as Directors on 10 November 2004 and 1 January 2005, respectively.

\*\* Ms DG Fisher and Ms AJ Keating retired as Directors on 10 November 2004.

# DIRECTORS' REPORT

## PRINCIPAL ACTIVITIES

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

## OPERATING AND FINANCIAL REVIEW

### Operating Result for the Year

The IAG Group's net profit after tax for the year was \$879 million (2004 – \$806 million). After adjusting for outside equity interests in the IAG Group result, net profit attributable to shareholders of the Company was \$760 million (2004 – \$665 million).

### Underwriting result

The IAG Group produced an underwriting result before investment income on technical reserves of \$484 million (2004 – \$548 million). The underwriting profit has been affected by interest rate movements which change the discount rate applicable to claims reserves. In 2005, this resulted in an increase in claims expense by \$88 million compared to a benefit of \$123 million in 2004. This resulted in an increase in loss ratio to 66.2% (2004 – 65.1%) and combined ratio to 92.1% (2004 – 90.7%). Excluding the impact of movement in interest rates on claims expense, the underlying ratios improved – the loss ratio was 64.8% (2004 – 67.2%) and combined ratio was 90.7% (2004 – 92.8%).

The expense ratio of 25.9% (2004 – 25.6%) remained fairly constant despite a reduction in premium growth.

The insurance profit of \$1,000 million (2004 – \$792 million), representing an insurance margin of 16.3% (2004 – 13.5%) reflects an improved underwriting performance and strong investment returns on technical reserves.

### (a) Australian personal lines insurance operations

The personal lines insurance operations produced an insurance margin of 16.0% for the financial year (2004 – 16.5%). The continued strong margin performance was achieved despite approximately \$100 million of additional claims expense from major storms during the year. The strength in the underlying performance was a result of the continued focus on adhering to underwriting discipline and risk selection and the continued stability in NSW compulsory third party insurance.

Gross written premiums increased by 2.0% to \$3,978 million.

### (b) Australian commercial lines insurance operations

The commercial lines insurance operations produced an insurance margin of 17.2% for the financial year (2004 – 9.6%). The significant increase in the margin over prior year, was due in part to reserve releases in the property, liability and workers' compensation, and also in part due to the benefits flowing from tort reform. However, it was underpinned by a strong performance by the core business. After adjusting for the releases from prior period reserves, the underlying insurance margin remained strong at 15.8% for 2005.

Gross written premiums increased by 5.0% to \$1,694 million.

Fee based income for the year incurred a loss of \$14 million (versus a \$21 million profit in the prior year). This result was negatively impacted by significant provisioning required in the NSW workers' compensation business arising from the overstatement of fee income relating to prior periods.

### (c) International insurance operations

#### IAG New Zealand operations:

The international insurance operations produced an insurance margin of 10.6% for the financial year (2004 – 8.5%), despite incurring approximately \$20 million more in storm related claims in 2005. The improved margin performance was driven by better claims management and processes on its motor portfolio and improved risk-based pricing in its home and commercial portfolios.

Gross written premiums increased by 9.5% to \$1,001 million, which includes a benefit of \$47 million or 4.7% from favourable exchange rate movements in 2005.

#### Captive reinsurer:

The Captive acts solely as the IAG Group's reinsurer assuming risk from other parts of the business and obtaining reinsurance protections for the Group in the open market. There was a significant improvement in the insurance result from a loss of \$8 million in 2004 to a profit of \$77 million in 2005. This was mainly driven by the absence of any major insured catastrophes in 2005 and the recognition of reinsurance recoverables on attritional storm losses incurred by the rest of the IAG Group.

### (d) Corporate and investments

Investment income on corporate and shareholders' funds (net of investment expenses) decreased by 7.7% to \$501 million. This decrease was primarily due to the reduction in outside equity interest in investment income by \$28 million and the profit on sale of ClearView retirement services and Health insurance businesses in the 2004 financial year of \$59 million. Excluding these items, investment income on shareholders' funds has increased by \$45 million to \$479 million. The increase is due to strong investment performance by all the major asset classes, particularly Australian equities, in the 2005 financial year and investment income from the portfolio of investments established from the proceeds of the issue of reset exchangeable securities ("RES") during the financial year.

The net corporate expenses have increased by 10% to \$224 million. This increase was mainly attributable to:

- the financial services profit of \$15 million included in net corporate expenses in 2004. The financial services segment was sold in January 2004;
- increase in borrowing costs by \$13 million in 2005 due to the issue of reset exchangeable securities. This expense is offset by the interest income from the portfolio in the shareholders' funds; and
- increase in corporate expenses by approximately \$7 million due to internal restructuring and mergers and acquisition costs.

These increases were offset to some extent by the decrease of \$13 million in amortisation of intangibles due to accelerated amortisation of certain contractual arrangements in 2004.

## Review of Financial Condition

### (a) Financial position

#### Assets:

The total assets of the IAG Group as at 30 June 2005 are \$17,147 million (2004 – \$16,291 million).

The increase is mainly attributable to funds generated from insurance operations during the financial year, reflecting the increase in investments and insurance balances held at 30 June 2005. This increase was offset to some extent by total dividends paid of \$442 million and an increase in income taxes paid.

#### Liabilities:

The total liabilities of the IAG Group as at 30 June 2005 are \$12,707 million (2004 – \$12,067 million) with the major component being general insurance liabilities of \$10,426 million (2004 – \$9,799 million).

#### Equity:

Equity was impacted by the following activities during the year:

#### Increase:

- net profit of \$760 million.

#### Decrease:

- payment of dividends of \$442 million; and
- a decrease in outside equity interests.

### (b) Cash from operations

#### Cash flows from operating activities:

Cash flows from operating activities have decreased by 23% to \$897 million.

The decrease is mainly attributable to:

- a decrease in reinsurance and other recoveries received;
- higher income taxes paid;
- an increase in other operating payments; and
- a decrease in other operating receipts.

The decrease was offset to some extent by the:

- increase in premiums received; and
- decrease in reinsurance expense paid.

# DIRECTORS' REPORT

## *Cash flows from investing activities:*

Cash outflows from investing activities have decreased by \$599 million to \$185 million.

The decrease is largely attributable to the lower level of investing activity in 2005 in light of increased dividends (funded by a reduction in investments) and the net redemption of units in IAG controlled trusts by outside equity interests.

## *Cash flows from financing activities:*

Cash outflows from financing activities have increased by \$89 million to \$679 million.

This increase is attributable to \$160 million in additional dividends paid in the 2005 financial year and net redemptions of units in IAG controlled trusts of \$126 million in the year compared with net proceeds of \$381 million in the prior year.

The issue of reset exchangeable securities and the investment of the proceeds from RES in the Portfolio involved a net outflow of \$13 million, mainly attributable to the transaction costs associated with the issue.

## **(c) Capital adequacy/minimum capital requirements**

The IAG Group minimum capital requirement ("MCR") multiple, calculated by applying APRA standards for individual licensed insurers to the relevant consolidated results, is 2.00 times as at 30 June 2005 (2004 – 1.75 times). The multiple remains above the IAG Group's current benchmark multiple of 1.55 times MCR.

Further information on the IAG Group's result and review of operations can be found in the 30 June 2005 Investor Report on the Company's website, [www.iag.com.au](http://www.iag.com.au).

## **LIKELY DEVELOPMENTS**

Insurance and investment operations are, by their nature, volatile due to the exposure to natural disasters and industry cycles and thus profit predictions are difficult. The Directors believe that, while the volume of risks-in-force will continue to grow, this increase will be offset to an extent by lower premium rate growth in the coming year than in recent periods reflecting the benefits of improved claims experience, cost control and the international insurance cycle. The IAG Group's insurance margin for the coming year is expected to moderate to be more in line with the 2004 financial year. The Directors consider that the IAG Group is well placed to continue to leverage opportunities in this environment. Equity markets are not expected to repeat returns as high as those experienced in the last two financial years.

The IAG Group is continuing to investigate potential investments in general insurance operations offshore.

## **DIVIDENDS**

Details of dividends paid or declared by the Company are set out in note 8.

## **SIGNIFICANT CHANGES IN THE STATE OF AFFAIRS**

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

On 11 January 2005, IAG announced the issue of 5.5 million reset exchangeable securities ("RES") by the New Zealand branch of IAG Finance (New Zealand) Limited, a wholly-owned subsidiary of IAG, raising a total of \$550 million. The RES began trading on the Australian Stock Exchange ("ASX") on 12 January 2005. The gross proceeds of the issue, through a series of intra-group arrangements, are invested by IAG Portfolio Limited, a wholly-owned subsidiary of IAG, in a portfolio of high quality, short-dated, fixed interest securities ("Portfolio"). IAG's obligations to the RES holders are secured by the Portfolio and interest payments and redemption amounts will depend on the performance and creditworthiness of this Portfolio. IAG may, at any time, exercise its right to exchange some or all RES for preference shares issued by IAG. The RES may be redeemed for cash or converted into ordinary shares of IAG on a reset date or under certain circumstances.

The issue of RES has had a net positive, though immaterial impact, on IAG's financial performance as the increase in investment income generated by the Portfolio is largely offset by the increase in interest expense from interest payments to RES holders and the amortisation of deferred borrowing costs. RES and the Portfolio are set-off in IAG's statement of financial position with a net asset being recorded to the extent that the Portfolio value is greater than the RES redemption amount.

## **EVENTS SUBSEQUENT TO REPORTING DATE**

Details of matters subsequent to the end of the financial year including a dividend declared of 14.5 cents per ordinary share, the acquisition of a general insurance business in Thailand in July 2005 and the transitional impact of the introduction of Australian equivalents of the International Financial Reporting Standards are set out in note 40.

## **NON-AUDIT SERVICES**

During the financial year KPMG, the Company's auditor, has performed certain other services in addition to their statutory duties.

The Directors have considered the non-audit services provided during the financial year by KPMG and in accordance with written advice provided by resolution of the Audit Committee, are satisfied that the provision of those non-audit services by the Company's auditor is compatible with, and did not compromise, the auditor independence requirements of the Corporations Act 2001 for the following reasons:

- all non-audit assignments were approved in accordance with the process set out in the IAG Audit Committee Charter ("Charter") on the agreed framework for engaging auditors for non-audit services; and
- the non-audit services provided do not undermine the general principles relating to auditor independence as set out in Professional Statement F1 *Professional independence*, as they did not involve reviewing or auditing the auditor's own work, acting in a management or decision making capacity for the Company, acting as an advocate for the Company or jointly sharing risks and rewards.

A copy of the auditor's independence declaration as required under section 307C of the Corporations Act is included in the Directors' report.

The level of fees for non-audit services amount to approximately 50% of total audit fees (refer to note 31 to the financial statements for further details on costs incurred on individual non-audit assignments).

## **LEAD AUDITOR'S INDEPENDENCE DECLARATION UNDER SECTION 307C OF THE CORPORATIONS ACT 2001**

The lead auditor's independence declaration is set out on page 57 and forms part of the Directors' report for the year ended 30 June 2005.

## **INDEMNIFICATION AND INSURANCE OF DIRECTORS AND OFFICERS**

The Company's constitution contains an indemnity in favour of every person who is or has been:

- (a) a Director of the Company;
- (b) a secretary of the Company;
- (c) a person making or participating in making decisions that affect the whole or a substantial part of the business or Company; or
- (d) a person having the capacity to affect significantly the financial standing of the Company or any of its wholly-owned subsidiaries.

The indemnity applies to liabilities incurred by the person in the relevant capacity (except a liability for legal costs). That indemnity also applies to legal costs incurred in defending or resisting certain legal proceedings.

In addition, the Company has granted deeds of indemnity to certain current and former Directors and secretaries and members of senior management of the Company and its subsidiaries and associated companies. Under these deeds, the Company indemnifies, to the maximum extent permitted by the law, the former or current Directors or secretaries or members of senior management against liabilities incurred by the person in the relevant capacity. The indemnity does not apply where the liability is owed to the Company or any of its subsidiaries or associated companies, or (in general terms) where the liability arises out of a lack of good faith, wilful misconduct, gross negligence, reckless misbehaviour or fraud.

Under each deed, the Company is also effectively required to maintain and pay the premiums on a contract of insurance covering the current or former Directors or members of senior management against liabilities incurred in respect of the relevant office. The insurance must be maintained until the seventh anniversary after the date when the relevant person ceases to hold office. Disclosure of the insurance premiums and the nature of liabilities covered by such insurance is prohibited by the relevant contract of insurance.

# DIRECTORS' REPORT

## INDEMNIFICATION AND INSURANCE OF DIRECTORS AND OFFICERS (CONTINUED)

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

## ENVIRONMENTAL REGULATION

The IAG Group's operations are subject to environmental regulations under either Commonwealth or State legislation. These regulations do not have a significant impact on the IAG Group's operations. The Board of Directors believes that the IAG Group has adequate systems in place for the management of its environmental requirements and is not aware of any breach of those environmental requirements as they apply to the IAG Group.

## REMUNERATION REPORT

This report outlines the remuneration arrangements for IAG's directors and senior executives and provides the disclosures which meet the remuneration reporting requirements of the Corporations Act 2001 and takes into account the requirements of the Corporate Law and Economic Reform Programme (CLERP 9) which applies to reporting periods commencing from 1 July 2004. This report also provides the disclosures required by the accounting standard AASB 1046 Director and Executive Disclosures by Disclosing Entities and AASB 1046A Amendments to Accounting Standard AASB 1046.

This report outlines the Board's policy in relation to, and details of, the remuneration of IAG directors (including the Chief Executive Officer and Managing Director) and the senior executives (referred to as "specified executives" or "executives") having the greatest authority for managing the IAG Group, including the five executives receiving the highest remuneration during the financial year.

### 1. NOMINATION, REMUNERATION & SUSTAINABILITY COMMITTEE

The role and responsibilities of the Nomination, Remuneration & Sustainability Committee ("Committee" or "NRSC") are set out in the Committee's charter and a copy of it is available at [www.iag.com.au](http://www.iag.com.au). The key responsibilities of the NRSC in relation to remuneration are to:

- (a) provide assurance to the Board relating to the effectiveness, integrity and compliance of the Company's remuneration policies and practices;
- (b) ensure the overall remuneration policy and approach fits the strategic goals of IAG;

The Chief Executive Officer ("CEO"), Group Executive Culture & Reputation and Head of Human Resources regularly attend Committee meetings and assist the Committee in its deliberations.

The Committee receives reports from Mercer Human Resources Consulting and Egan Associates on remuneration for executives and directors. Mallesons Stephen Jaques provides legal advice to the Committee as required.

## 2. EXECUTIVES

### 2.1 Executive Remuneration Policy

IAG's approach to executive remuneration is to ensure that IAG can attract and retain the best people and reward performance in line with returns delivered to shareholders. Building and retaining a high quality management team has enabled IAG to achieve superior performance.

The principles that underpin IAG's approach to executive remuneration are that:

- the quantum and mix of remuneration is sufficiently competitive to attract and retain a high calibre executive team;
- remuneration practices are consistent with IAG's values;
- the mix of fixed and variable remuneration reflects the impact of each executive position on IAG's short term and long term results;
- remuneration levels take account of both external market practice and internal relativities; and
- measures of performance are based on a balanced scorecard with a focus on the delivery of sustainable value to shareholders.

In determining the market positioning against the external comparator group of the largest 50 companies in the S&P/ASX 100 index, IAG aims to set base pay around the market median and total reward opportunity (which includes short and long term incentives) between the median and the 75th percentile depending on individual performance and contribution to the Group's results.

### 2.2 Executive Remuneration Structure

Executive remuneration consists of four components:

- base salary
- superannuation
- short term incentives
- long term incentives

#### (a) Base salary

Base salary is defined as the total value of components that make up an executive's salary. Components are cash, salary sacrifice items such as superannuation, cars or parking and any related taxes. Base salary is determined by a review of job size, internal relativities and market benchmarking. Mercer Human Resources Consulting provides advice on job responsibility and market benchmarking. The comparator group for market benchmarking is the largest 50 companies in the S&P/ASX 100 index. Base salary is targeted at the median of the market. Unless there has been a significant change in job size, increases in base salary generally do not exceed external market movements.

#### (b) Superannuation

Executives are defined contribution members of the IAG & NRMA Superannuation Plan. Employer superannuation contributions are 13% of base salary. This contribution rate is consistent with the contribution provided to other employees of IAG.

#### (c) Short term incentives

Executives have the opportunity to earn a short term incentive payment based on both IAG's performance and achievement of individual goals.

IAG uses a balanced scorecard for setting goals and measuring performance. This ensures that assessment of performance is viewed holistically and assists the development of a sustainable business that meets the performance expectations of IAG's shareholders, stakeholders and the communities in which it conducts its business.

The balanced scorecard sets goals under the following broad categories:

- financial
- customer
- people
- risk
- community/environment

At the commencement of each financial year, IAG and individual goals are set for each executive. The goals set are stretch goals and are designed to encourage executives to strive for exceptional performance. At the end of the financial year the amount of any incentive payment is determined based on measured achievement against those goals and a review of the executive's overall performance by the CEO and NRSC. The NRSC reviews the performance of the CEO and makes a recommendation to the Board in relation to any incentive payment for the CEO.

# DIRECTORS' REPORT

The following table is a summary of IAG's key goals for the current year:

CATEGORY	GOAL	REASON CHOSEN	METHOD OF ASSESSMENT
Financial	Group Insurance Margin target	Measures the profitability of the core business of IAG	Comparison of achievement against target
Customer	Improvement across customer satisfaction measures in Intermediary, Direct Sales and Claims	Meeting or exceeding customer expectations is a key part of establishing and maintaining competitive advantage	Outcome of customer satisfaction surveys and measurement of customer retention rates compared to outcomes from previous years
Risk	Improvement in risk management behaviours	Positive risk management behaviour in relation to prevention, detection and recovery from operational risks and issues is critical for a sustainable business	Outcome of annual employee survey compared to target set at the start of the year
People management	Employee engagement score target	Measures how engaged employees are with IAG's purpose, strategy and goals	Outcome of annual employee survey compared to target set at the start of the year
Community/ Environment	Reduction in workers' compensation claims per million hours worked	A safe work environment and the well being of employees is vital for growing IAG's business for the benefit of customers, shareholders and the wider community	Comparison of reduction achieved against target set at the start of the year

The methods of assessment have been selected as they can be objectively measured and verified.

The aggregate achievement level against IAG's key goals was 73%.

#### (d) Long term incentives

##### (i) Equity based remuneration

IAG utilises long term incentives to create a link between the delivery of value to shareholders, financial performance and rewarding and retaining employees. IAG's programme for delivering long term incentives is its Performance Award Rights ("PARs") Plan. Note 30(d)(i) of the financial statements sets out further details of the PARs Plan.

PARs are rights over issued shares held by a trustee. The rights are granted at no cost to executives and may be exercised for a nominal price if a performance hurdle related to IAG's Total Shareholder Return ("TSR") is met or if some specified events occur, such as a takeover bid for the Company. During the year PARs were issued to executives. Previously IAG delivered long term incentives using its Performance Share Rights ("PSRs") Plan. Note 30(d)(ii) of the financial statements sets out further details of the PSRs Plan.

Details of the terms of allocations made to executives under IAG's long term incentive plans, including those allocations that at the date of this report are not exercisable, are summarised below:

PLAN <sup>(i)</sup>	PSRs PLAN – SERIES 5	PSRs PLAN – SERIES 6	PARs PLAN 2002/2003 – SERIES 1	PARs PLAN 2003/2004 – SERIES 2	PARs PLAN 2004/2005 – SERIES 3
Grant Date	13/12/2001	05/03/2002	24/12/2002	22/09/2003 10/12/2003 26/03/2004	17/09/2004 30/11/2004
Performance Period Definition <sup>(ii)</sup>	3 – 5 years from Grant Date	3 – 5 years from Grant Date	3 – 5 years from Grant Date	3 – 5 years from Base Date <sup>(iii)</sup>	3 – 5 years from Base Date <sup>(iii)</sup>
TSR Performance Condition	IAG TSR compared to a Peer Group of companies. The Peer Group comprises the companies in the S&P/ASX 100 index with such inclusions and exclusions as the Board may determine.				
Vesting Schedule	<p>&lt; 50th percentile – 0% vesting                      = 50th percentile – 50% vesting                      &gt;=75th percentile – 100% vesting</p> <p>The percentage of PSRs or PARs which vest and become exercisable increases proportionately where IAG's performance ranks between the 50th and 75th percentile</p>				
Performance Hurdle Test Schedule	Last trading day each month in Performance Period	Last trading day each month in Performance Period	Last trading day each month in Performance Period	Quarterly – Last trading day of each calendar quarter in Performance Period	Quarterly – Last trading day of each calendar quarter in Performance Period
1st Test Day	31/12/2004	31/03/2005	30/12/2005	29/09/2006	28/09/2007
Last Test Day	30/11/2006	28/02/2007	30/11/2007	30/06/2008	30/06/2009
Last Exercise Date (continuing employees only)	13/12/2011	05/03/2012	24/12/2012	22/09/2013 10/12/2013 26/03/2014	17/09/2014 30/11/2014
Plan Exercise Status	Fully exercisable	Fully exercisable	Not exercisable	Not exercisable	Not exercisable

#### Notes:

(i) PSR Plan Series 1 to 4 are fully vested and exercisable.

(ii) The performance period will be shortened if the employee ceases employment with the Group due to redundancy or in other special circumstances.

(iii) The Base Date is the date which is the second trading day after the date on which IAG's financial results for the twelve month period ending on the 30 June that immediately precedes the Grant Date are announced to the ASX.

# DIRECTORS' REPORT

## REMUNERATION REPORT (CONTINUED)

(ii) Insurance Manufacturers of Australia Pty Limited ("IMA") – Long Term Incentive Plans

IMA is a 70% owned subsidiary of IAG.

During the year no executive received a grant under any IMA Long Term Incentive Plan. Mr RJ Jackson was granted awards under an IMA Long Term Incentive Plan during the 2002/2003 financial year. This plan is a cash based plan with performance hurdles related to IMA's operating results and IAG TSR over three consecutive financial years. At the date of this report, awards under this plan are not payable.

### 2.3 Relationship between Executive Reward and IAG's Performance

A significant component of executive remuneration is "at risk" which ensures a direct link between IAG's performance and reward for executives. For further details of the percentage of "at risk" remuneration, refer to the table in section 2.6.

The payment of short term incentives is directly linked to IAG's performance over the previous year based on a balanced scorecard of measures, which includes a measure of the profitability of IAG's core business. Non-financial measures are also used as they are lead indicators of delivering future value for shareholders. For the 2004/2005 year the aggregate achievement level against IAG's key goals was 73%. This will determine the portion of an executive's short term incentive payment that is linked to IAG's goals.

The use of the balanced scorecard to assess and reward executive performance has assisted IAG to deliver superior returns for shareholders:

	8 AUGUST 2000 <sup>(i)</sup>	YEAR ENDED 30 JUNE 2001	YEAR ENDED 30 JUNE 2002	YEAR ENDED 30 JUNE 2003	YEAR ENDED 30 JUNE 2004	YEAR ENDED 30 JUNE 2005
Closing share price (\$)	2.75	3.40	3.15	3.40	5.00	6.01
Dividends paid (cents)	n/a	10.00	10.50	11.50	22.00	26.50
Earnings per share (cents)	n/a	9.40	(1.78)	8.65	37.87	45.89
Normalised net profit after tax (\$ million)	n/a	178	294	333	455	547

(i) IAG listed on the Australian Stock Exchange on 8 August 2000. The pre-listing facility price was \$2.75.

IAG's long term incentive plans provide a direct link between return to shareholders over a 3 to 5 year period and executive reward.

IAG's share price compared to the S&P/ASX 200 index from the period since IAG's listing in August 2000 to 30 June 2005 is shown in the following graph:

### IAG Relative Share Price Performance



From listing until 30 June 2005, IAG has exceeded its objective of delivering top quartile shareholder return. Measured from 8 August 2000 until 30 June 2005, IAG's TSR is at the 82nd percentile of entities in the S&P/ASX 100 index.

In line with IAG's strong TSR performance, the portion of PSRs (for PSRs Plan Series 1 to 6) that have met the performance hurdle and become exercisable has been 100% of the number of PSRs awarded.

Grants of PARs to executives are based on an assessment of each executive against a range of factors including the executive's performance, their strategic impact and leadership capability. This process strengthens the link between individual executive reward outcomes and the creation of value for shareholders.

# DIRECTORS' REPORT

During the year the following persons were the executives with the greatest authority for the strategic direction and management of the Group:

	CURRENT TITLE
Mr MJ Hawker	Chief Executive Officer and Managing Director
Mr IF Brown	Deputy Chief Executive Officer
Mr AM Coleman	Chief Risk Officer and Group Actuary
Mr DA Issa	Chief Information Officer
Mr RJ Jackson <sup>(i)</sup>	Chief Executive Officer – Personal Insurance
Ms SJ Mostyn	Group Executive – Culture & Reputation
Mr DRA Pearce <sup>(i)</sup>	Group Executive – Insurance Strategy
Mr MJ Pirone <sup>(i)</sup>	Chief Executive Officer – CGU Insurance
Mr DJP Smith	Chief Executive Officer – IAG New Zealand
Mr G Venardos	Chief Financial Officer

(i) On 20 July 2004, IAG announced a new structure for its Australian operations. This led to a change in the executive team structure. Mr RJ Jackson, Mr DRA Pearce and Mr MJ Pirone have held their current positions since this time. Their former roles respectively, were Group Executive – Personal Insurance, Group Executive – Personal Injury and Group Executive – Asset Management and Retirement Services.

Ms KL Baylis left IAG on 1 October 2004, Mr LF Power and Mr RJ Wagstaffe left IAG on 1 September 2004. Their respective positions were Group Executive – Sales and Marketing, Group Executive – Business Partners and Group Executive – Intermediary Business.

On 28 July 2005, IAG announced Mr IF Brown will retire in December 2005 and Mr DRA Pearce will leave IAG on 31 August 2005.

## 2.4 Service Agreements

All service agreements for executives are unlimited in term but may be terminated by written notice from either party or by IAG making a payment in lieu of notice. The service agreements outline the components of remuneration paid to executives and require the remuneration of executives to be reviewed annually. The service agreements do not require IAG to increase base salary, pay a short term incentive or offer a long term incentive in any given year.

	NOTICE PERIOD, COMPANY	NOTICE PERIOD, EMPLOYEE	TERMINATION PROVISIONS	ADDITIONAL PAYMENT IF IAG INVOKES A RESTRAINT CLAUSE
Mr MJ Hawker	12 months	6 months	12 months base salary, plus payment for annual leave, long service leave and short term incentive that would have accrued had termination not occurred.	6 months base salary
Mr IF Brown	12 months	3 months	12 months base salary	6 months base salary
Mr AM Coleman	12 months	3 months	12 months base salary	6 months base salary
Mr DA Issa	12 months	3 months	12 months base salary	-
Mr RJ Jackson	12 months	6 months	12 months base salary	-
Ms SJ Mostyn	12 months	3 months	12 months base salary	-
Mr DRA Pearce	6 months	3 months	75 weeks base salary	6 months base salary
Mr MJ Pirone	12 months	3 months	12 months base salary	6 months base salary
Mr DJP Smith	12 months	3 months	12 months base salary	6 months base salary
Mr G Venardos	12 months	3 months	12 months base salary	6 months base salary

Executives are employed by Insurance Australia Group Services Pty Limited, except for Mr DJP Smith who is employed by IAG New Zealand Limited.

## Retrenchment

In the event of retrenchment, the executives listed above (except for Mr MJ Hawker and Mr DJP Smith) are entitled to the greater of:

- (a) the written notice or payment in lieu of notice as provided in their service agreement; or
- (b) the retrenchment benefits due under the relevant company retrenchment policy.

For Mr MJ Hawker and Mr DJP Smith, the retrenchment payment is in accordance with the termination provisions set out in the table above.

## Company retrenchment policy

On retrenchment, employees with less than 25 years service will receive:

- (a) at least eight weeks notice or payment in lieu of notice (calculated on the employee's base salary); and
- (b) three weeks base salary for each year of continuous service to a maximum of 75 weeks base salary.

The minimum benefit that can be received is 11 weeks base salary and the maximum benefit that can be received is 83 weeks base salary.

On retrenchment, employees with 25 or more years of service or who are over 45 years of age will receive:

- (a) at least twelve weeks notice or payment in lieu of notice (calculated on the employee's base salary); and
- (b) three weeks base salary for each year of continuous service to a maximum of 75 weeks base salary.

The minimum benefit that can be received is 15 weeks base salary and the maximum benefit that can be received is 87 weeks base salary.

## Termination of employment without notice and without payment in lieu of notice

The employment of the executives may be terminated without notice or payment in lieu of notice in some circumstances. Generally, this could occur where the executive: is charged with a criminal offence that is capable of bringing the organisation into disrepute; is declared bankrupt; breaches a provision of their employment agreement; is guilty of serious and wilful misconduct; or unreasonably fails to comply with any material and lawful direction given by the Company.

## Termination of employment with notice or payment in lieu of notice

The employment of the executives may be terminated at any time by the Company with notice or payment in lieu of notice (which also includes a pro-rata short term incentive earned but not paid). The amount of notice the Company must provide or the payment in lieu of notice is specified above.

# DIRECTORS' REPORT

## REMUNERATION REPORT (CONTINUED)

### 2.5 Remuneration Details

(a) Remuneration of executives for the IAG Group for the financial year ended 30 June 2005 was:

	PRIMARY BENEFITS							POST-EMPLOYMENT BENEFITS		EQUITY COMPENSATION		OTHER BENEFITS	TOTAL
	CASH SALARY <sup>(1)</sup>	NON-MONETARY BENEFITS <sup>(2)</sup>	BASE SALARY (SUB-TOTAL OF <sup>(1)</sup> & <sup>(2)</sup> )	LEAVE ACCRUALS <sup>(3)</sup>	SHORT TERM INCENTIVE <sup>(4)</sup>	LONG TERM INCENTIVE PLAN <sup>(5)</sup>	INCENTIVES (SUB-TOTAL OF <sup>(4)</sup> & <sup>(5)</sup> )	SUPER-ANNUATION <sup>(6)</sup>	RETIREMENT BENEFITS	VALUE OF BONUS EQUITY SHARE PLAN <sup>(7)</sup>	VALUE OF PSRs / PARs GRANTED <sup>(8)</sup>	OTHER BENEFITS	
2005	\$000	\$000	\$000	\$000	\$000	\$000	\$000	\$000	\$000	\$000	\$000	\$000	\$000
<i>CEO and Managing Director:</i>													
Mr MJ Hawker	1,151	36	1,187	36	1,270	-	1,270	157	-	-	614	-	3,264
<i>Current executives:</i>													
Mr IF Brown	566	161	727	8	171	-	171	94	-	171	127	-	1,298
Mr AM Coleman	583	7	590	(19)	434	-	434	77	-	-	145	-	1,227
Mr DA Issa	508	7	515	8	476	-	476	67	-	-	125	-	1,191
Mr RJ Jackson	554	78	632	29	402	275	677	82	-	-	109	-	1,529
Ms SJ Mostyn	478	7	485	38	366	-	366	63	-	-	167	-	1,119
Mr DRA Pearce	441	48	489	3	230	-	230	63	-	-	110	-	895
Mr MJ Pirone	520	66	586	22	520	-	520	75	-	-	135	-	1,338
Mr DJP Smith	582	-	582	51	202	-	202	77	-	-	135	130 <sup>(9)</sup>	1,177
Mr G Venardos	619	48	667	69	451	-	451	86	-	-	171	-	1,444
<i>Executives who ceased employment during the year:</i>													
Ms KL Baylis	92	24	116	(3)	76	-	76	15	-	-	141	462 <sup>(10)</sup>	807
Mr LF Power	66	8	74	9	88	-	88	5	-	-	38	600 <sup>(10)</sup>	814
Mr RJ Wagstaffe	77	6	83	16	10	-	10	6	-	-	38	-	153
Total remuneration	6,237	496	6,733	267	4,696	275	4,971	867	-	171	2,055	1,192	16,256

Refer to section (c) below for details of notes (1) to (10) referencing in the above table 2.5(a).

# DIRECTORS' REPORT

(b) Remuneration of executives for the IAG Group for the prior financial year ended 30 June 2004 was:

	PRIMARY BENEFITS		POST-EMPLOYMENT BENEFITS		EQUITY COMPENSATION		OTHER BENEFITS		TOTAL				
	CASH SALARY <sup>(1)</sup>	NON-MONETARY BENEFITS <sup>(2)</sup>	BASE SALARY (SUB-TOTAL OF <sup>(1)</sup> & <sup>(2)</sup> )	LEAVE ACCRUALS <sup>(3)</sup>	SHORT TERM INCENTIVE <sup>(4)</sup>	LONG TERM INCENTIVE PLAN <sup>(5)</sup>	INCENTIVES (SUB-TOTAL OF <sup>(4)</sup> & <sup>(5)</sup> )	SUPER-ANNUATION <sup>(6)</sup>		RETIREMENT BENEFITS	VALUE OF BONUS EQUITY SHARE PLAN <sup>(7)</sup>	VALUE OF PSRs / PARs GRANTED <sup>(8)</sup>	OTHER BENEFITS
2004	\$000	\$000	\$000	\$000	\$000	\$000	\$000	\$000	\$000	\$000	\$000	\$000	\$000
<i>CEO and Managing Director:</i>													
Mr MJ Hawker	1,107	5	1,112	21	800	-	800	146	-	-	888	-	2,967
<i>Current executives:</i>													
Ms KL Baylis	380	76	456	29	242	-	242	60	-	-	134	-	921
Mr IF Brown	581	142	723	17	185	40	225	92	-	185	136	-	1,378
Mr AM Coleman	529	5	534	(1)	325	-	325	69	-	-	153	-	1,080
Mr DA Issa	452	5	457	36	264	-	264	60	-	-	78	-	895
Mr RJ Jackson	458	63	521	(4)	350	254	604	88	-	-	18	-	1,227
Ms SJ Mostyn	449	5	454	28	235	-	235	59	-	-	123	-	899
Mr DRA Pearce	434	34	468	(8)	240	37	277	61	-	-	127	-	925
Mr MJ Pirone	438	38	476	8	183	32	215	61	-	46	127	-	933
Mr LF Power	389	50	439	32	352	-	352	32	-	-	30	-	885
Mr DJP Smith	529	-	529	5	355	30	385	70	-	-	131	124 <sup>(9)</sup>	1,244
Mr G Venardos	561	36	597	31	392	42	434	77	-	-	175	-	1,314
Mr RJ Wagstaffe	463	39	502	48	390	-	390	36	-	-	30	-	1,006
Total remuneration	6,770	498	7,268	242	4,313	435	4,748	911	-	231	2,150	124	15,674

Refer to section (c) below for details of notes (1) to (9) referencing in the above table 2.5(b).

(c) Details of notes (1) to (10) used in tables in sections 2.5 (a) and (b)

(1) Salary represents amounts paid in cash during the financial year.

(2) Non-monetary benefits are valued in accordance with the cost to IAG for provision of cars, parking and related fringe benefits tax on a salary sacrifice basis.

(3) Leave accruals includes annual leave and long service leave accruals as determined in accordance with AASB 1028 Employee Benefits.

(4) Short term incentive to be settled in cash for the current performance period accrual and prior performance periods over or under accruals.

(5) Long term incentive to be settled in cash from the IMA long term incentive plan. The amount reflects a pro-rata accrual made during the period, based on expected satisfaction of performance hurdles.

(6) Superannuation includes the employer's contributions which are recognised on a deemed basis, as for 11 months of 2005 (full year of 2004) the employer was on a contribution holiday.

(7) Executives may elect to receive some of their short term incentive in the form of IAG shares rather than cash through participation in the Bonus Equity Share Plan, which vests immediately and is valued in accordance with the market value of IAG shares at grant date. Refer to note 30(c)(i) for details.

(8) The value of Performance Share Rights ("PSRs" – related to unissued shares) and Performance Award Rights ("PARs" – related to issued shares) granted in the above table is different to the amount reported in the 2004 financial report. This is due to the change in valuation method applied in line with the introduction of AASB 1046 Amendment to Accounting Standards AASB 1046A. This results in a total reduction of \$627,000. An allocated portion of unvested PSRs and PARs is included in the total remuneration disclosure above. To determine these values the Monte Carlo model has been applied. The valuation takes into account the exercise price of the PSRs/ PARs, life of the PSRs/ PARs, current price of IAG shares, expected volatility of the IAG share price, expected dividends, risk free interest rate, the performance of the shares in the Peer Group of companies, early exercise and non transferability, and turnover.

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

(10) Represents termination payments made.

# DIRECTORS' REPORT

## REMUNERATION REPORT (CONTINUED)

### 2.6 At Risk Remuneration

(a) Total remuneration for executives is comprised of "at risk" and "not at risk" remuneration. Base salary and superannuation is "not at risk",

while short term incentives and long term incentives are "at risk". The percentage of total remuneration that is "at risk" for the executives is set out below:

	TOTAL REMUNERATION \$000	SHORT TERM INCENTIVES \$000	LONG TERM INCENTIVES (IMA LTI/PSRs/PARs) \$000	PERCENTAGE OF REMUNERATION AT RISK %
Mr MJ Hawker	3,264	1,270	614	58
Mr IF Brown	1,298	342	127	36
Mr AM Coleman	1,227	434	145	47
Mr DA Issa	1,191	476	125	50
Mr RJ Jackson	1,529	402	384	51
Ms SJ Mostyn	1,119	366	167	48
Mr DRA Pearce	895	230	110	38
Mr MJ Pirone	1,338	520	135	49
Mr DJP Smith	1,177	202	135	29
Mr G Venardos	1,444	451	171	43

#### (b) Short term incentives

The portion of the short term incentives that either vested or were forfeited during the year cannot be determined as no maximum or target amount is set. Executives may be paid a short term incentive based on IAG's performance and their own performance. The amount of short term incentive paid to an executive is recommended by the CEO and approved by the NRSC. The amount of short term incentive paid to the CEO is recommended by the NRSC and approved by the Board.

#### (c) Long term incentives

For each grant of PSRs/ PARs included in the tables as listed in section 2.2(d), the percentage of the PSRs/ PARs that vested in the financial year and the percentage that was forfeited because the person did not meet the service and performance criteria is set out below. No part of the forfeited rights are payable in future years.

LAST FINANCIAL YEAR EXERCISABLE	PSRs PLAN - SERIES 5		PSRs PLAN - SERIES 6		PARs PLAN - SERIES 1		PARs PLAN - SERIES 2		PARs PLAN - SERIES 3	
	2011/2012		2011/2012		2012/2013		2013/2014		2014/2015	
	VEST %	FORFEIT %	VEST %	FORFEIT %	VEST %	FORFEIT %	VEST %	FORFEIT %	VEST %	FORFEIT %
Mr MJ Hawker	100	-	-	-	-	-	-	-	-	-
Mr IF Brown	-	-	-	-	-	-	-	-	-	-
Mr AM Coleman	-	-	-	-	-	-	-	-	-	-
Mr DA Issa	-	-	-	-	-	-	-	-	-	-
Mr RJ Jackson	-	-	-	-	-	-	-	-	-	-
Ms SJ Mostyn	-	-	100	-	-	-	-	-	-	-
Mr DRA Pearce	-	-	-	-	-	-	-	-	-	-
Mr MJ Pirone	-	-	-	-	-	-	-	-	-	-
Mr DJP Smith	-	-	-	-	-	-	-	-	-	-
Mr G Venardos	-	-	-	-	-	-	-	-	-	-

It is not practical to provide an estimate of the maximum possible total value of long term incentives that may vest in future years because the value is directly linked to the IAG share price at the time of vesting. The minimum possible total value of long term incentives is zero.

# DIRECTORS' REPORT

## 2.7 Long Term Incentives – PARs and PSRs

Rights under the PARs Plan and PSRs Plan were issued by the Group and used as long term incentives. Refer to section 2.2(d)(i) for further details.

The following sections provide details of movements in PARs and PSRs for each executive during the financial year ended 30 June 2005.

### (a) PARs

(i) The Group has issued PARs to the executives during the financial year for nil consideration. Each executive who participates in the plan

becomes eligible to receive an ordinary share per PAR, by paying the exercise price of \$1 per tranche of PARs exercised, subject to a specific performance hurdle being met. Refer to section 2.2(d)(i) for details of the performance hurdle.

Following are details of the number of PARs granted to each executive during the financial year ended 30 June 2005:

	GRANT DATE	DATE FIRST EXERCISABLE	LAST EXPIRY DATE	VALUE PER PAR AT GRANT DATE \$	NUMBER OF PARs GRANTED DURING THE YEAR NUMBER
<i>CEO and Managing Director:</i>					
Mr MJ Hawker	30/11/2004	28/09/2007	30/11/2014	2.718	500,000
<i>Current executives:</i>					
Mr IF Brown	17/09/2004	28/09/2007	17/09/2014	2.715	60,000
Mr AM Coleman	17/09/2004	28/09/2007	17/09/2014	2.715	81,000
Mr DA Issa	17/09/2004	28/09/2007	17/09/2014	2.715	71,000
Mr RJ Jackson	17/09/2004	28/09/2007	17/09/2014	2.715	81,000
Ms SJ Mostyn	17/09/2004	28/09/2007	17/09/2014	2.715	66,000
Mr DRA Pearce	17/09/2004	28/09/2007	17/09/2014	2.715	47,000
Mr MJ Pirone	17/09/2004	28/09/2007	17/09/2014	2.715	81,000
Mr DJP Smith	17/09/2004	28/09/2007	17/09/2014	2.715	71,000
Mr G Venardos	17/09/2004	28/09/2007	17/09/2014	2.715	92,000
					1,150,000

Ms Baylis, Mr Power and Mr Wagstaffe who ceased employment during the year did not receive any grant of PARs.

(ii) Following is a summary of the movements in total number of PARs on issue by each executive:

	PARs ON ISSUE 1 JULY 2004 NUMBER	PARs GRANTED DURING THE YEAR NUMBER	PARs EXERCISED DURING THE YEAR <sup>(1)</sup> NUMBER	PARs LAPSED DURING THE YEAR NUMBER	PARs ON ISSUE 30 JUNE 2005 NUMBER
<i>CEO and Managing Director:</i>					
Mr MJ Hawker	700,000	500,000	-	-	1,200,000
<i>Current executives:</i>					
Mr IF Brown	161,716	60,000	-	-	221,716
Mr AM Coleman	177,195	81,000	-	-	258,195
Mr DA Issa	152,177	71,000	-	-	223,177
Mr RJ Jackson	80,451	81,000	-	-	161,451
Ms SJ Mostyn	148,307	66,000	-	-	214,307
Mr DRA Pearce	149,232	47,000	-	-	196,232
Mr MJ Pirone	158,881	81,000	-	-	239,881
Mr DJP Smith	167,167	71,000	-	-	238,167
Mr G Venardos	213,048	92,000	-	-	305,048
Total	2,108,174	1,150,000	-	-	3,258,174
<i>Executives who ceased employment during the year:</i>					
Ms KL Baylis	146,814	-	-	-	146,814
Mr LF Power	53,634	-	-	-	53,634
Mr RJ Wagstaffe	53,634	-	-	-	53,634
Total	254,082	-	-	-	254,082

(1) \$1 per tranche of PARs is payable to exercise.

(iii) No PARs vested during the financial year ended 30 June 2005 or in prior years.

# DIRECTORS' REPORT

## REMUNERATION REPORT (CONTINUED)

### (b) PSRs

(i) The PSRs Plan was closed for issuing further PSRs from the financial year ended 30 June 2003.

Following is a summary of the movements in total number of PSRs on issue by each executive:

	PSRs ON ISSUE 1 JULY 2004 NUMBER	PSRs EXERCISED DURING THE YEAR <sup>(1)</sup> NUMBER	PSRs LAPSED DURING THE YEAR NUMBER	PSRs ON ISSUE 30 JUNE 2005 NUMBER	PSRs VESTED AND EXERCISABLE 30 JUNE 2005 NUMBER
<i>CEO and Managing Director:</i>					
Mr MJ Hawker	1,000,000	940,000	-	60,000	60,000
<i>Current executives:</i>					
Mr IF Brown	-	-	-	-	-
Mr AM Coleman	-	-	-	-	-
Mr DA Issa	-	-	-	-	-
Mr RJ Jackson	-	-	-	-	-
Ms SJ Mostyn	68,670	-	-	68,670	68,670
Mr DRA Pearce	-	-	-	-	-
Mr MJ Pirone	28,640	28,640	-	-	-
Mr DJP Smith	-	-	-	-	-
Mr G Venardos	-	-	-	-	-
Total	1,097,310	968,640	-	128,670	128,670
<i>Executives who ceased employment during the year:</i>					
Ms KL Baylis	85,837	85,837	-	-	-
Mr LF Power	-	-	-	-	-
Mr RJ Wagstaffe	-	-	-	-	-
Total	85,837	85,837	-	-	-

(1) The exercise price was \$1 per tranche of PSRs. Nil remains unpaid per issued share acquired. For each PSR exercised, one ordinary IAG share was issued.

### (c) Analysis of movements in PARs and PSRs

Following is a summary of the movement during the financial year, by value, of PARs and PSRs by each executive:

	TOTAL VALUE OF PARs GRANTED DURING THE YEAR (1) \$000	TOTAL VALUE OF PSRs EXERCISED DURING THE YEAR (2) \$000	TOTAL VALUE OF PARs AND PSRs THAT LAPSED DURING THE YEAR (3) \$000	TOTAL OF (1) TO (3) \$000
<i>CEO and Managing Director:</i>				
Mr MJ Hawker	1,359	6,026	-	7,385
<i>Current executives:</i>				
Mr IF Brown	163	-	-	163
Mr AM Coleman	220	-	-	220
Mr DA Issa	193	-	-	193
Mr RJ Jackson	220	-	-	220
Ms SJ Mostyn	179	-	-	179
Mr DRA Pearce	128	-	-	128
Mr MJ Pirone	220	144	-	364
Mr DJP Smith	193	-	-	193
Mr G Venardos	250	-	-	250
Total	3,125	6,170	-	9,295
<i>Executives who ceased employment during the year:</i>				
Ms KL Baylis	-	517	-	517
Mr LF Power	-	-	-	-
Mr RJ Wagstaffe	-	-	-	-
Total	-	517	-	517

#### Notes:

- The value of PARs granted in the year is the fair value of the PARs calculated at grant date using a Monte Carlo model. The total value of the PARs granted is included in the table above. This amount is allocated to remuneration over the vesting period (ie in years 30 June 2005 to 30 June 2009).
- The PSRs exercised during the year by Mr Hawker, Mr Pirone and Ms Baylis were issued to them on 13 December 2001, 21 December 2000 and 5 March 2002, respectively. The respective values at grant date were allocated to their remuneration during the three years vesting period between 30 June 2001 to 30 June 2004. PSRs are exercisable only if a performance hurdle is reached in relation to IAG's TSR. IAG's TSR measured from December 2001 to June 2005 was at the 75th percentile compared to the TSR of companies in the S&P/ASX 100 index. The value of PSRs exercised during the year is calculated as the weighted average of the prices at which IAG shares were traded over 5 days before and including date of exercise after deducting the \$1 exercise price per tranche of PSRs exercised.
- No PARs or PSRs lapsed during the year.

# DIRECTORS' REPORT

## 3. NON-EXECUTIVE DIRECTORS

### 3.1 Remuneration Policy

Remuneration for Non-executive Directors is set according to external advice. As with executive remuneration, the remuneration for Non-executive Directors should:

- be sufficiently competitive to attract and retain a high calibre of Non-executive Director; and
- be consistent with IAG's values.

The aggregate limit of remuneration is approved by shareholders, and, currently, the maximum approved amount is \$1.5 million per annum. The aggregate annual remuneration is inclusive of employer superannuation contributions paid by IAG on behalf of Non-executive Directors.

BOARD / COMMITTEE	ROLE	FEE
IAG Board	Chairman	\$300,000 (includes committee fees*)
	Director	\$100,000
Audit Committee	Chairman	\$18,000
	Member	\$12,000
Risk Management & Compliance Committee	Chairman	\$18,000
	Member	\$12,000
Nomination, Remuneration & Sustainability Committee	Member	\$12,000

\* The Chairman does not receive additional fees for serving on the Nomination, Remuneration & Sustainability Committee or for serving as a director of IAG Re Limited. The Chairman is, however, paid a fee for his role as Chairman of Insurance Manufacturers of Australia Pty Limited, a 70% owned subsidiary of IAG

In addition, IAG pays a superannuation contribution of 9% of a Director's fees into a superannuation fund nominated by the Director. Directors' fees and superannuation contributions are paid monthly.

IAG has a Non-executive Directors' Expenses policy. Under this policy IAG reimburses expenses reasonably incurred by Directors in connection with the discharge of their duties.

### 3.2 Increase to Directors' Fees

Following an independent review of the remuneration of Non-executive Directors conducted recently, it is proposed that the maximum aggregate remuneration payable to the Non-executive Directors be increased from \$1,500,000 to \$2,000,000 per annum. Shareholders will be asked to approve this increase in aggregate remuneration at the 2005 Annual General Meeting.

The proposed increase takes account of the growth in board remuneration to reflect market movements and to provide the capacity to ensure that IAG can retain the best people to drive corporate performance and to deliver appropriate returns to shareholders.

The aggregate annual remuneration for Non-executive Directors of \$1,500,000 has not changed since being determined in 2000 upon demutualisation of Insurance Australia Limited (formerly NRMA Insurance Limited, a wholly owned subsidiary of IAG). Since that time, IAG has grown significantly:

- gross written premium from \$2.6 billion to \$6.6 billion;
- insurance profit from \$110 million to \$1,000 million;
- total assets from \$12.1 billion to \$17.1 billion; and
- employees from 5,338 to 11,502 measured as full time equivalent basis.

BOARD / COMMITTEE	ROLE	FEE
IAG Board	Chairman	\$360,000 (includes committee fees)
	Director	\$120,000
Audit Committee	Chairman	\$30,000
	Member	\$15,000
Risk Management & Compliance Committee	Chairman	\$30,000
	Member	\$15,000
Nomination, Remuneration & Sustainability Committee	Member	\$15,000

The current maximum annual aggregate remuneration of \$1,500,000 would be insufficient to enable IAG to pay these increased fees to the

The Board has agreed that each Non-executive Director should take a minimum of 20% and up to a maximum of 90% of their annual base fee (at the time shares are allocated), on a fee sacrifice basis, in the form of IAG shares provided under the Non-Executive Directors' Share Plan, which was approved by shareholders on 13 November 2002. IAG shares are purchased by the trustee on market and allocated to directors in December each year. Non-executive Directors may elect to restrict the disposal of these shares for a minimum period of one year and up to 10 years or until the Director retires. No other equity-based remuneration is available to Non-executive Directors.

The current elements of Non-executive Director remuneration are:

In addition, since 2000 the demands of directors of listed companies and in particular, general insurance companies, have increased through a plethora of corporate legislation and regulation and the ensuing complexities for a general insurance business, as well as from community expectations of exemplary corporate behaviour and standards. The duties and responsibilities of Non-executive Directors have expanded significantly in response to these demands.

The Board has obtained independent advice on board remuneration from Egan Associates who have assessed the remuneration for the Company's Non-executive Directors in comparison with the level of Non-executive Director remuneration payable by companies of comparable size. In accordance with the independent advice, the Board has determined that fees payable to Non-executive Directors should be increased with effect from 1 July 2005 as follows:

Non-executive Directors for a full year and would limit IAG's capacity to pay fees to attract and retain suitable candidates for the Board.

# DIRECTORS' REPORT

## REMUNERATION REPORT (CONTINUED)

### 3.3 Performance

Directors' performance is subject to evaluation by the Chairman at least every two years, by discussion between the Chairman and the individual Director. In these discussions, the individual Directors also evaluate the Chairman's performance. Performance measures for Directors considered by the Chairman and Board include:

- contribution of the Director to Board teamwork;
- contribution to debates on significant issues and proposals;
- advice and assistance given to management;
- in the case of the Chairman's performance, the fulfilment of his or her additional role as Chairman; and
- input regarding regulatory, industry and social developments surrounding the business.

The Nomination, Remuneration & Sustainability Committee has responsibility for coordinating the Board's review of the Chairman's performance.

A review of the performance of individual Directors was conducted in June 2005 with assistance and input from an independent expert on board performance.

### 3.4 Remuneration Details

(a) Remuneration of Non-executive Directors for the financial year ended 30 June 2005 was:

	PRIMARY BENEFITS			POST-EMPLOYMENT BENEFITS	EQUITY COMPENSATION	TOTAL
	BOARD FEES RECEIVED AS CASH	COMMITTEE FEES	SUPERANNUATION	RETIREMENT BENEFITS	BOARD FEES RECEIVED AS IAG SHARES	
2005	\$000	\$000	\$000	\$000	\$000	\$000
Mr JA Strong <sup>(i)</sup>	280	-	39	-	150	469
Ms YA Allen <sup>(ii)</sup>	52	8	6	-	12	78
Mr JF Astbury	80	30	12	-	20	142
Mr GA Cousins	80	12	10	-	20	122
Ms DG Fisher <sup>(iii)</sup>	18	4	4	259	18	303
Mr ND Hamilton <sup>(iv)</sup>	10	19	11	-	90	130
Ms AJ Keating <sup>(v)</sup>	29	8	4	250	7	298
Mr RA Ross	50	30	12	-	50	142
Mr B Schwartz <sup>(vi)</sup>	37	6	5	-	13	61
Total remuneration	636	117	103	509	380	1,745

Notes:

- (i) Mr Strong received \$130,000 for his service as Chairman of the Board of Insurance Manufacturers of Australia Pty Limited ("IMA").  
(ii) Ms Allen was appointed to the Board on 10 November 2004.  
(iii) Ms Fisher retired from the Board on 10 November 2004.  
(iv) Mr Hamilton received \$7,000 for his services as Director of Mutual Community General Insurance Proprietary Limited ("MCGI"), a 51% owned controlled entity of IAG.  
(v) Ms Keating retired from the Board on 10 November 2004. During the period, Ms Keating also received \$4,000 for her services as Director of MCGI.  
(vi) Mr Schwartz was appointed to the Board on 1 January 2005.

(b) Remuneration of Non-executive Directors for the prior financial year ended 30 June 2004 was:

	PRIMARY BENEFITS			POST-EMPLOYMENT BENEFITS	EQUITY COMPENSATION	TOTAL
	BOARD FEES RECEIVED AS CASH	COMMITTEE FEES	SUPERANNUATION	RETIREMENT BENEFITS	BOARD FEES RECEIVED AS IAG SHARES	
2004	\$000	\$000	\$000	\$000	\$000	\$000
Mr JA Strong <sup>(i)</sup>	264	2	39	-	131	436
Mr JF Astbury	77	29	12	-	18	136
Ms MC Callaghan <sup>(ii)</sup>	8	2	2	269	3	284
Mr GA Cousins	77	12	10	-	18	117
Ms M Easson <sup>(ii)</sup>	9	2	1	276	2	290
Ms DG Fisher	39	12	10	-	55	116
Mr ND Hamilton	16	30	11	-	79	136
Ms AJ Keating	77	24	11	-	17	129
Mr RA Ross	51	29	11	-	44	135
Total remuneration	618	142	107	545	367	1,779

Notes:

- (i) Mr Strong received \$110,000 for his service as Chairman of the Board of IMA.  
(ii) Ms MC Callaghan and Ms M Easson retired from the Board on 1 September 2003.

# DIRECTORS' REPORT

## 3.5 Retirement Benefits

IAG decided to freeze the operation of the Non-executive Director retirement benefit scheme adopted by IAG in 2001 with effect from 1 September 2003.

The terms of the retirement benefits scheme provided for:

- (i) any Non-executive Director of IAG who had completed five years' continuous service with IAG (including service with any subsidiaries) at the date of retirement, a retirement benefit equivalent to the last three years' Directors' fees, employer superannuation contributions, committee fees and fees for extra services received from IAG and its subsidiaries.
- (ii) a pro-rata retirement benefit for Non-executive Directors who have completed at least three years' service but less than five years' service at the date of their retirement, based on a specified formula.
- (iii) no retirement benefit to be paid to a Non-executive Director who had served for a period of less than three years.

IAG determined that the frozen retirement benefits would be calculated as follows:

- (i) Non-executive Directors joining the Board from 1 September 2003 would have no retirement benefit.
- (ii) for each current Non-executive Director who had served a minimum of three years, the retirement benefit was assessed as if they had retired at 31 August 2003.
- (iii) for a Non-executive Director with less than three years of service at 31 August 2003, a retirement benefit was assessed as if they had three years of service as at that date, and then reduced on a pro-rata basis based on their uncompleted period of service as a proportion of three years. The retirement benefit was not subsequently payable to such a Non-executive Director if they had less than three years of service as a Non-executive Director at the date of their retirement.

Retirement benefits of \$259,000 and \$250,000 were paid to Ms Fisher and Ms Keating, respectively, following their retirements from the Board on 10 November 2004.

The following table sets out the frozen retirement benefits of the remaining Directors who held office on 31 August 2003 and who have continued in office since then:

	SHARES HELD AT THE BEGINNING OF THE YEAR	SHARES GRANTED AS REMUNERATION DURING THE YEAR	SHARES RECEIVED ON EXERCISE OF PSRs	SHARES RECEIVED ON EXERCISE OF PARs	NET MOVEMENT OF SHARES DUE TO OTHER CHANGES <sup>(2)</sup>	TOTAL SHARES HELD AT THE END OF THE YEAR	SHARES HELD NOMINALLY AT THE END OF THE YEAR <sup>(1)</sup>
Mr IF Brown	211,769	34,560	-	-	7,362	253,691	87,904
Mr AM Coleman	127,528	-	-	-	(61,632)	65,896	65,896
Mr DA Issa	-	-	-	-	-	-	-
Mr RJ Jackson	22,351	-	-	-	(15,000)	7,351	7,351
Ms SJ Mostyn	16,083	-	-	-	-	16,083	-
Mr DRA Pearce	7,806	-	-	-	-	7,806	7,806
Mr MJ Pirone	17,748	-	28,640	-	(15,000)	31,388	17,383
Mr DJP Smith	129,591	-	-	-	-	129,591	5,951
Mr G Venardos	146,978	-	-	-	(108,689)	38,289	34,403

### Executives who ceased employment during the year:

Ms KL Baylis	-	-	-	-	-	*	-
Mr LF Power	34,134	-	-	-	-	*	-
Mr RJ Wagstaffe	-	-	-	-	-	*	-

(1) Nominally held shares are included in the column headed total shares held at the end of the year. These shares are held by the specified executives' personally-related entities.

(2) Net movement of shares relates to acquisition and disposal transactions by the executives and their personally-related entities during the year.

\* These three executives ceased employment during the financial year. Information on shares held is only disclosed up to the date of their cessation.

## RETIREMENT BENEFIT

	\$000
Mr JA Strong	295
Mr JF Astbury	184
Mr GA Cousins	169
Mr ND Hamilton	248
Mr RA Ross	232

On retirement, Directors may also be entitled to be paid a benefit from their company funded superannuation. Such a benefit would be in addition to the Director's frozen retirement benefit.

No amounts have been accrued in the accounts of the Group for the frozen retirement benefits of the remaining Directors who held office on 31 August 2003 and who have continued in office since, as the Board has not exercised its discretion to pay these retirement benefits.

## 4. OTHER BENEFITS

Remuneration does not include premiums paid by IAG for an insurance contract covering current and former Directors' and executives' liabilities and legal expenses incurred in respect of the relevant office, as the insurance policies do not specify premiums paid in respect of individual Directors and executives and the terms of contract specifically prohibited the disclosure of the premium paid. Insurance products provided by the Group are also available to all directors and executives on the same terms and conditions available to other employees.

During the financial year, the former Director (Mr N Whitlam) was paid additional retirement benefit payments for his period of service as chairman of IAG and its controlled entities. The payment amounted to approximately \$207,000, inclusive of his company funded superannuation entitlements. Mr Whitlam was also paid interest on his entitlements.

## 5. EQUITY AND DEBT INSTRUMENT DISCLOSURE

### (a) Holding of ordinary shares

The relevant interest of each specified executive and their personally-related entities in ordinary shares of IAG are:

# DIRECTORS' REPORT

## REMUNERATION REPORT (CONTINUED)

### (b) Holdings of reset preference shares

No specified executives had any interest in reset preference shares at any time during the financial year.

### (c) Holdings of reset exchangeable securities

No specified executives had any interest in reset exchangeable securities at any time during the financial year.

### (d) Holdings of ordinary shares

The relevant interest of each Director and their personally-related entities in ordinary shares of IAG is:

FOR SECTION 205G OF  
THE CORPORATIONS ACT 2001

	SHARES HELD AT THE BEGINNING OF THE YEAR	SHARES GRANTED AS REMUNERATION DURING THE YEAR	SHARES RECEIVED ON EXERCISE OF PSRs <sup>(4)</sup>	NET MOVEMENT OF SHARES DUE TO OTHER CHANGES <sup>(3)</sup>	TOTAL SHARES HELD AT THE END OF THE YEAR	SHARES HELD NOMINALLY AT THE END OF THE YEAR <sup>(1)</sup>	SHARES HELD DIRECTLY AT THE END OF THE YEAR <sup>(2)</sup>	SHARES HELD INDIRECTLY AT THE END OF THE YEAR <sup>(2)</sup>
Mr JA Strong	199,768	25,779	-	-	225,547	213,464	12,083	164,901
Ms YA Allen	*	3,437	-	1,385	4,822	4,822	-	3,437
Mr JF Astbury	48,335	3,437	-	-	51,772	41,689	10,083	41,689
Mr GA Cousins	168,252	3,437	-	-	171,689	21,689	150,000	21,689
Ms DG Fisher	60,877	-	-	(56,078)	**	-	-	-
Mr ND Hamilton	65,277	15,467	-	-	80,744	75,927	4,817	75,927
Ms AJ Keating	18,961	-	-	(18,252)	**	-	-	-
Mr RA Ross	145,507	8,593	-	-	154,100	51,543	102,557	48,646
Mr B Schwartz	*	3,906	-	-	3,906	3,906	-	3,906
Mr MJ Hawker	205,857	-	940,000	26,252	1,172,109	22,050	1,150,059	-

(1) Nominally held shares are included in the column headed total shares held at the end of the year. These shares include shares held in the Non-executive Directors' Share Plan and shares held by Directors' personally-related entities.

(2) This represents the relevant interest of each Director in ordinary shares issued by the Company, as notified by the Directors to the Australian Stock Exchange in accordance with section 205G of the Corporations Act 2001. Trading in IAG shares is covered by the restrictions which limit the ability of an IAG Director to trade in the shares of the IAG Group where they are in a position to be aware, or are aware, of price sensitive information.

(3) Net movement of shares relates to acquisition and disposal transactions by the Directors and their personally-related entities during the year. For the Directors appointed during the year, being Ms Allen and Mr Schwartz, these movements included their holdings as at appointment date.

(4) Non-executive Directors are not eligible to participate in the PSRs Plan.

\* Ms Allen and Mr Schwartz were appointed on 10 November 2004 and 1 January 2005, respectively. Shares held before their appointments (if any) were classified as acquired during the period in the column – net movement of shares due to other changes in the table above.

\*\* Ms Fisher and Ms Keating retired on 10 November 2004. Information on shares held is only disclosed up to the date of their retirement.

### (e) Holdings of reset preference shares

No Directors had any interest in reset preference shares at any time during the financial year.

### (f) Holdings of reset exchangeable securities

In respect of the relevant interest of each Director and their personally-related entities in reset exchangeable securities ("RES") of IAG Finance (New Zealand) Limited, other than Mr Hawker, no other Directors held any RES directly or through their personally-related entities.

FOR SECTION 205G OF  
THE CORPORATIONS ACT 2001

	RES HELD AT THE BEGINNING OF THE YEAR	NET MOVEMENT OF RES DUE TO OTHER CHANGES	TOTAL RES HELD AT THE END OF THE YEAR	RES HELD NOMINALLY AT THE END OF THE YEAR <sup>(1)</sup>	RES HELD DIRECTLY AT THE END OF THE YEAR <sup>(2)</sup>	RES HELD INDIRECTLY AT THE END OF THE YEAR <sup>(2)</sup>
Mr MJ Hawker	-	1,000	1,000	1,000	-	1,000

(1) Nominally held RES are included in the column headed total RES held at the end of the year. These RES are indirectly held by the Director's personally-related entities.

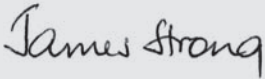
(2) This represents the relevant interest of the Director in RES issued by IAG Finance (New Zealand) Limited, as notified by the Director to the Australian Stock Exchange in accordance with section 205G of the Corporations Act 2001. Trading in RES is covered by the IAG Group's Continuous Disclosure & Insider Trading Policy.

# DIRECTORS' REPORT

## ROUNDING OF AMOUNTS

Unless otherwise stated, amounts in the financial report and Directors' report have been rounded to the nearest million dollars. The Company is of a kind referred to in the class order 98/100 dated 10 July 1998 (as amended by class order 04/667 dated 15 July 2004) issued by the Australian Securities & Investments Commission. All rounding has been conducted in accordance with that class order.

Signed at Sydney this 19th day of August 2005 in accordance with a resolution of the Directors.



**Mr J A Strong**

Director



**Mr M J Hawker**

Director

# LEAD AUDITOR'S INDEPENDENCE DECLARATION

Under Section 307C of the Corporations Act 2001

## TO: THE DIRECTORS OF INSURANCE AUSTRALIA GROUP LIMITED ("IAG")

I declare that both the Firm and I were and remain independent in accordance with professional rules and statutory requirements on auditor independence in relation to the audit for the financial year ended 30 June 2005 ("the audit").

In making this declaration I draw your attention to a contravention of Section 324CF(2) of Corporations Act 2001 ("the Act") which requires disclosure in terms of Section 307C.

During the six months to 30 June 2005 a tax partner in the Sydney office of KPMG was made aware by IAG (through the process of advising a change in address) that he had been allocated 847 shares in IAG by virtue of the demutualisation. Dividends owing to him amounted to \$559.

The shareholding was identified by the Firm's internal control system. The partner, who has never worked in any capacity on IAG, has since disposed of these shares.

To the best of my knowledge and belief, in relation to the audit the only matter which requires disclosure in relation to auditor independence requirements as set out in the Act or any applicable code of professional conduct is the situation described above.



KPMG



**Dr Andries B Terblanché**  
Partner

Sydney, 19th August 2005