

DIRECTORS' REPORT

Insurance Australia Group Limited is a publicly listed company limited by shares, incorporated and domiciled in Australia. Its registered office and principal place of business is 388 George Street, Sydney, NSW 2000.

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 2003 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 constituted by Insurance Australia Group Limited and its controlled entities.

DIRECTORS OF INSURANCE AUSTRALIA GROUP LIMITED

The following persons held office as Directors at any time during or since the financial year:

Chairman

Mr JA (James) Strong appointed 2 August 2001

Other Directors

Mr JF (John) Astbury	appointed 25 July 2000
Mrs MC (Maree) Callaghan	appointed 19 June 2000
Mr GA (Geoffrey) Cousins	appointed 25 July 2000
Mrs M (Mary) Easson	appointed 19 June 2000
Ms DG (Dominique) Fisher	appointed 19 June 2000
Mr ND (Neil) Hamilton	appointed 19 June 2000
Ms AJ (Anne) Keating	appointed 19 June 2000
Mr RA (Rowan) Ross	appointed 25 July 2000
Mr MJ (Michael) Hawker	appointed 1 December 2001

Particulars of the Directors' qualifications and experience are set out on pages 24 and 25.

PRINCIPAL ACTIVITIES

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

RESULT AND REVIEW OF OPERATIONS

The Group recorded a net profit attributable to shareholders of \$153 million (2002 – \$25 million loss). Included within these results is the 6 months performance of the CGU Insurance Australia Limited Group ("CGU") and Belves Investment Limited Group ("NZI") which were acquired in January 2003.

The underlying business continues to perform strongly, with growth in general insurance underwriting profit to \$199 million compared with \$142 million in the previous period. This is despite an expense of \$45 million for restructuring costs in respect of the acquisition of CGU/NZI, which has been included in the current year underwriting result.

Highlights of the Group's performance include:

- Premium growth: Gross written premium was \$5,150 million, representing an increase of 45% on the previous year. Growth is attributable to the acquisition of CGU/NZI and the general growth of the business.
- The combined ratio of 95.7% includes \$45 million of integration costs. Adjusted for this the combined ratio was 94.7% for the year.
- The expense ratio of 23.2% for the year compared with 19.7% in the previous year. The increase in the expense ratio is primarily due to growth of an intermediary business through the acquisition of CGU/NZI, resulting in higher commissions expense.
- Short-tail underwriting continued to perform strongly with a combined ratio (claims and underwriting expenses to net earned premium) of 93.7%, which included \$37 million of integration costs accounting for 1.2% of the combined ratio (2002 – 95.5%).
- The long-tail portfolio performed strongly with the combined ratio of 102.2%.
- Our international results were also sound with a combined ratio of 95.3%, compared to 96.5% in 2002.

Total investment revenue included in the consolidated net profit for the year was \$296 million, compared to a loss of \$110 million in 2002. The IAG Group outperformed its fixed interest and international equity benchmarks and was marginally behind the Australian equity benchmark return. The negative returns on local and overseas equity markets resulted in lower than anticipated investment returns in the period. The policy of matching insurance claims liabilities with a high proportion of fixed interest investments has enabled the positive investment returns from this class to offset or immunise the increase in insurance liabilities associated with movements in interest rates.

Further information on the Group's result and review of operations can be found in the 30 June 2003 Investor Report on the Company's website, www.iag.com.au.

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LIKELY DEVELOPMENTS AND EXPECTED RESULTS OF OPERATIONS

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. However, the Directors concur with the market perception that following structural change in the market place and current low interest rates, the coming few years are likely to be a favourable environment for general insurance in our region. We consider that the IAG Group is well placed to leverage opportunities in this environment.

The IAG Group is also exposed to significant regulatory changes over the next few years. In particular, we will be addressing:

- (a) changes to International Financial Reporting Standards;
- (b) recommendations of the HIH Royal Commission;
- (c) tax consolidation legislation change;
- (d) governance changes through recommendations of the ASX Corporate Governance Council;
- (e) recommendations from the various Corporation Law Economic Reform Programs; and
- (f) terrorism cover and tort reform.

DIVIDENDS

Details of dividends paid or declared by the Company are set out in note 10.

SIGNIFICANT CHANGES

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

- (a) On 18 October 2002, IAG announced that it had entered into an agreement to purchase the general insurance businesses in Australia and New Zealand ("the Acquisition of CGU/NZI") from Aviva plc for \$1,862 million including costs. The acquisition date was 2 January 2003. Further details of the impact on IAG from this acquisition are disclosed in note 38.
- (b) The Acquisition of CGU/NZI was funded by the issue of ordinary equity and reset preference shares, raising of long-term debt and use of existing internal funds. Fund raisings included:
 - \$500 million of ordinary share capital issued through an institutional placement at \$2.55 per ordinary shares (in two stages, completed 24 October and 19 November 2002 respectively);
 - \$300 million of domestic subordinated term notes, issued by Insurance Australia Limited (formerly NRMA Insurance Limited) (a wholly-owned subsidiary of IAG) (completed 27 November 2002);
 - \$380 million of ordinary share capital issued through an underwritten Share Purchase Plan at \$2.40 per ordinary share (completed 12 December 2002);
 - \$75 million of ordinary share capital issued through an underwritten Dividend Reinvestment Plan for ordinary shares at \$2.79 per ordinary share (completed 14 April 2003);
 - \$401 million (US\$240 million) of US subordinated term notes, issued by NRMA Insurance Funding 2003 Limited (a wholly-owned subsidiary of IAG) (completed 28 April 2003); and
 - \$200 million of reset preference shares issued which were listed on the Australian Stock Exchange on 20 June 2003.

MATTERS SUBSEQUENT TO THE END OF THE FINANCIAL YEAR

Since the end of the financial year:

- (a) On 1 July 2003, IAG announced the sale of NRMA Health Pty Limited for \$100 million to MBF, effective 25 July 2003. IAG has entered into a six-year marketing alliance, including a possible four year extension, with MBF.
- (b) On 21 August 2003, a final dividend of 7 cents per share, 100% franked, was declared by the Company. The dividend will be paid on 13 October 2003.

Other than the matters referred to above, there has not arisen in the interval between the end of the financial year and the date of this report any item, transaction or event of a material and unusual nature likely, in the opinion of the Directors of the Company, to affect significantly the operations of the IAG Group, the results of those operations, or the state of affairs of the IAG Group in future financial 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:

Directors	Board of Directors		Audit Committee		Chairman's Committee		Risk Management & Compliance Committee		Dividend Reinvestment Plan and Reinsurance Committee		IAG Board Sub-Committees	
	A	B	A	B	A	B	A	B	A	B	A	B
Mr JA Strong	23	23	–	–	5	5	–	–	3	3	10	7
Mr MJ Hawker	23	23	–	–	–	–	–	–	3	2	11	7
Mr JF Astbury	23	22	5	5	5	5	–	–	–	–	2	2
Mrs MC Callaghan	23	21	–	–	–	–	7	7	–	–	–	–
Mr GA Cousins	23	22	5	5	–	–	–	–	–	–	–	–
Mrs M Easson	23	22	5	4	–	–	–	–	–	–	–	–
Ms DG Fisher	23	20	–	–	–	–	7	6	–	–	2	2
Mr ND Hamilton	23	18	–	–	–	–	7	7	3	3	–	–
Ms AJ Keating	23	21	5	5	–	–	–	–	3	3	–	–
Mr RA Ross	23	23	–	–	5	5	7	7	3	3	8	5

A – Meetings eligible to attend as a member B – Meetings attended as a member

For the year ended 30 June 2003, the following meetings of Directors were held:

Nature of meetings	Number of meetings held during the year
Board of Directors	23
Audit Committee	5
Chairman's Committee	5
Risk Management & Compliance Committee	7
Dividend Reinvestment Plan and Reinsurance Committee	3
IAG Board Sub-Committees	11

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 Director of the Company;
- a secretary of the Company;
- a person making or participating in making decisions that affect the whole or a substantial part of the business or Company; or
- 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 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.

Under a deed of indemnity referred to above, the Company has, during the financial year ended 30 June 2003, advanced amounts totalling \$0.1 million (2002 – \$0.2 million) in respect of reasonable legal costs incurred by a former Director of the Company (Mr Nicholas Whitlam) in relation to an alleged liability. During the financial year ended 30 June 2003, that former Director has claimed additional legal costs incurred in certain proceedings. The Company has sought further information from that former Director in order to determine the amount payable to that former Director, and has not yet paid the amount claimed. Amounts advanced by the Company to the former Director are repayable under the deed of indemnity if the costs become costs for which the Company, as a matter of law, must not give the former Director an indemnity.

On 10 July 2003, the Court of Appeal of New South Wales dismissed proceedings against the former Director with costs. Unless that decision is set aside by the High Court of Australia, the advances made by the Company to the former Director will not be repayable by the former Director, but the Company will be entitled to be repaid any amount recoverable by the former Director in respect of the costs of the proceedings (so far as they concerned his conduct as a Director of the Company) awarded by the court.

DIRECTORS' REPORT

(continued)

DIRECTORS' AND EXECUTIVE OFFICERS' EMOLUMENTS

Directors

Non-executive Directors of IAG receive a base fee of \$70,000 per annum (unchanged from 2001). The Chairman receives three times the base fee.

By resolution passed at the Company's 2001 AGM, non-executive Directors are required to receive at least 20%, and are allowed to receive up to 90%, of their base fee in the form of shares under the Non-executive Directors' Share Plan, rather than in cash.

In addition to the base fee, fees are payable for participation in certain committees and some subsidiary boards of IAG. The setting of all fees is based on advice from external remuneration advisers, which takes into account the level of fees paid to directors of other substantial companies operating in the financial services sector and the responsibilities and time commitment of Directors.

The table set out below shows the fees paid by IAG Group to non-executive Directors for the year ended 30 June 2003:

Non-executive Director	Base fee			Other fees ⁽¹⁾ \$000	Superannuation contributions \$000	Total \$000
	Cash \$000	Non-executive Directors' Share Plan \$000	Total \$000			
Mr JA Strong	70	140	210	100	39	349
Mr JF Astbury	56	14	70	23	11	104
Mrs MC Callaghan	49	21	70	10	10	90
Mr GA Cousins	56	14	70	10	10	90
Mrs M Easson	56	14	70	10	7	87
Ms DG Fisher	7	63	70	10	7	87
Mr ND Hamilton	7	63	70	10	7	87
Ms AJ Keating	56	14	70	10	7	87
Mr RA Ross	35	35	70	23	8	101

(1) Separate fees are payable for some of the IAG committees and some subsidiary boards.

Executive director and officers

The Chairman's Committee is responsible for recommending remuneration policies and packages applicable to the Chief Executive Officer ("CEO") and executives who report directly to the CEO of the Company. The broad remuneration policy is to ensure the remuneration package reflects the person's duties and responsibilities and that remuneration is competitive in attracting, retaining and motivating people of the highest quality.

Executives may receive performance bonuses based on the achievement of specific goals related to the individual's business unit and the performance of the consolidated entity in the context of its business plan. A long-term incentive plan is also in place, the purpose of which is to promote improvements in areas of financial and strategic performance.

The CEO of IAG does not receive fees for his service on the Board. The responsibilities of board membership are considered in determining remuneration provided as part of his normal employment conditions.

Set out below is the remuneration of the CEO and each of the five most highly remunerated current officers of the IAG Group for the year ended 30 June 2003:

Executive director	Base pay ⁽¹⁾ \$000	Bonuses ⁽²⁾ \$000	Other compensation ⁽³⁾ \$000	Valuation of total PSRs/PARs granted ⁽⁴⁾ \$000	Total \$000	PARs granted during the year ⁽⁵⁾ Number	Date first exercisable
Chief Executive Officer:							
Mr MJ Hawker	1,004	350	135	860	2,349	300,000	24 Dec 2005
Officers							
Mr IF Brown	587	771	201	108	1,667	81,265	24 Dec 2005
Mr G Venardos	566	696	89	140	1,491	119,189	24 Dec 2005
Mr RJ Jackson	464	785	88	–	1,337	–	–
Mr DJP Smith	547	552	109	97	1,305	86,716	24 Dec 2005
Mr DRA Pearce	421	598	85	107	1,211	87,553	24 Dec 2005

- (1) Base pay includes cash salary, annual leave and long service leave.
- (2) Bonuses reflect payments made during the period in respect of the previous performance period, accrual of long-term incentive bonuses.
- (3) Other compensation includes superannuation contributions and the provision of cars, parking and related fringe benefits tax.
- (4) Performance Share Rights ("PSRs" – related to unissued shares) and Performance Award Rights ("PARs" – related to issued shares) are valued in accordance with the Australian Securities & Investments Commission ("ASIC") guidance and the Australian Accounting Standards Board Exposure Draft ED108: Request for comment on IASB ED2 share-based payment. An allocated portion of unvested PSRs and PARs is included in the total remuneration disclosure above. This is a change in measurement method which results in certain PSRs granted and disclosed in prior periods being included in the above table in valuation of PSRs/PARs. The total amount involved is \$1,099,000. To determine these values the Monte-Carlo Value model has been applied. The valuation takes into account the share price at grant date, the expected life of the option, the volatility in price of the underlying shares of IAG and expected dividends.
- (5) The Company has issued PARs to certain executives during the financial year. Each executive who participates in the PARs becomes eligible to receive a number of shares by paying \$1 per tranche of rights allocated, subject to a specific performance hurdle met.

DIRECTORS' INTERESTS

The relevant interest of each Director in the shares and/or options issued by the Company, as notified by the Directors to the Australian Stock Exchange in accordance with section 205G of the Corporations Act 2001, at the date of this report is as follows:

Directors	Ordinary shares directly held	Ordinary shares indirectly held ⁽¹⁾	Reset preference shares	Performance share rights	Performance award rights
Mr JA Strong	12,083	104,623	–	–	–
Mr JF Astbury	10,083	33,652	–	–	–
Mrs MC Callaghan	2,365	18,619	–	–	–
Mr GA Cousins	150,000	13,652	–	–	–
Mrs M Easson	5,802	8,835	–	–	–
Ms DG Fisher	4,799	44,578	–	–	–
Mr ND Hamilton	4,817	39,761	–	–	–
Ms AJ Keating	709	13,652	–	–	–
Mr RA Ross	102,557	28,553	–	–	–
Mr MJ Hawker	180,919	–	–	1,000,000	300,000

(1) Ordinary shares indirectly held include shares held in the Non-executive Directors' Share Plan.

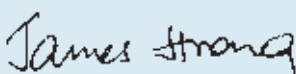
ENVIRONMENTAL REGULATION

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.

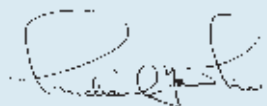
ROUNDING OF AMOUNTS

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 issued by the Australian Securities & Investments Commission. All rounding has been conducted in accordance with that class order.

Signed at Sydney this 21st day of August 2003 in accordance with a resolution of the Directors.



Mr J A Strong
Chairman



Mr M J Hawker
Director