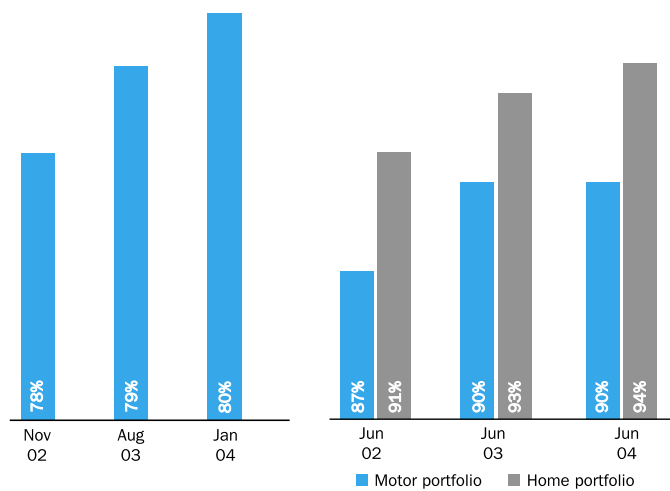


A RISK BUSINESS



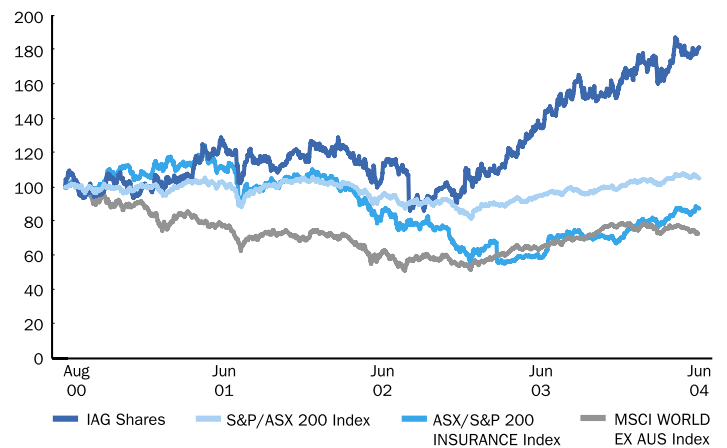
IAG CEO, **Michael Hawker**

This Annual Report is 'part one' of an ongoing risk management story, because we consider long-term thinking as key to running a business that deals in risk. Results for the 12-month period show the Group has exceeded key targets.



OVERALL CUSTOMER SATISFACTION

CUSTOMER RETENTION RATES



IAG ORDINARY SHARE PRICE PERFORMANCE VERSUS OTHER SHAREMARKET INDICES

A RECORD PERFORMANCE

I am pleased to report another solid year of performance by your company, Insurance Australia Group Limited. In the past 12 months, we have improved customer satisfaction, sales, employee engagement and our risk management practices, and we experienced favourable economic conditions, all of which contributed to a record profit.

We reported a record insurance profit of \$792 million for the year ended 30 June 2004. Our net profit attributable to shareholders of \$665 million was also boosted by a pre-tax return on our shareholders' funds of \$434 million. This was a significant turnaround for this portfolio, which recorded a loss of \$120 million in the prior year. Although investing in equities creates volatility in our earnings, we believe they generate the best long-term return for our shareholders.

This performance underpinned our strong capital position and saw us maintain our very strong Standard & Poor's 'AA' insurer financial strength ratings for key operating entities, currently the highest of any Australian-based financial institution.

We also rewarded shareholders with a 91% increase in our dividend.

This was despite major challenges in our operating environment.

SEVERE STORMS IN A YEAR OF DROUGHT

In February, New Zealand experienced the worst storm in its history. Many of our customers were left homeless or with significant damage to their property. This followed a storm in Melbourne which ranked among the 15 worst insurance events in Australia's history, as well as a number of severe storms in Queensland.

Damage from these storms totalled around \$265 million, and put pressure on our people and suppliers, who responded wonderfully well, receiving much praise from our customers.

These storms are further evidence of the increasing effect of global warming on weather patterns. We believe the increasingly severe weather is the key reason the Australian industry has only reported an underwriting profit on home insurance in three of the past 10 years for which data is published.

Despite the impact of the storms, prolonged dry weather on the east coast of Australia saw claims frequency significantly below our long-term forecasts for our motor portfolio.

Our ability to produce a strong profit, despite these contrasting effects, demonstrates the real value of a diversified portfolio of risks.

Apart from the impact of the weather-induced catastrophes, our insurance portfolios have been trading satisfactorily with prices reflecting risk. The rate of growth in commercial premiums has slowed as commercial markets are now appropriately priced after many years of underpricing.

In the long-tail insurance classes, premiums in workers' compensation and compulsory third party (CTP) are falling, reflecting reduced claims frequency, while public liability premiums are stabilising as the benefits of tort law reform impact these portfolios.

REGULATORY ENVIRONMENT

The reform of tort law in each State of Australia and at the Federal Government level was one element in another year of significant legislative and regulatory change.

In May, we launched a home warranty product in New South Wales and Victoria following industry reform, and we're currently looking to do the same in Western Australia and South Australia.

APRA issued its draft Stage 2 regulatory reforms of prudential supervision of general insurers. The Davis report into the merits of financial system guarantees, and the Potts report into the regulation of direct offshore foreign insurers and discretionary mutual funds, both prompted Federal Government response.

In Western Australia, the fire services levy was removed leading to lower insurance premiums in that State, a new interpretation on stamp duty application was introduced, and stamp duty on workers' compensation insurance was removed on 1 July 2004.

We began operating under new financial services laws, which required new licensing and training for a significant number of our Australian-based employees, agents, brokers and business partners, as well as a complete renewal of much of our product documentation.

Although the rate of regulatory and legislative change is slowing, compliance remains a significant cost to the Group.

FOCUS ON GENERAL INSURANCE

This year was also a busy one for the Group in terms of corporate activity. During the year, we sold both our health insurance underwriting operations and ClearView Retirement Solutions. This completed our transition from a more diversified financial services provider to a pure general insurance group.

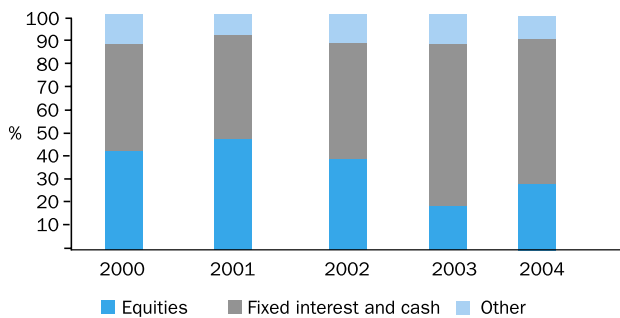
At the same time, we sold our 50% stake of Associated Marine and our 25% stake of RACT Insurance in Tasmania, due to the acquisition of CGU triggering a change in ownership clause in these joint ventures. In response, we established our own marine insurance operation and launched NRMA Insurance in Tasmania to provide personal lines insurance.

INTEGRATION OF CGU AND NZI COMPLETE

Internally, our major focus was to successfully integrate the businesses of CGU and NZI into the Group. I'm pleased with the success of the integration programme which was completed during the year which will ensure we will deliver annual synergy benefits of \$160 million (pre-tax) and added significantly to our ability to provide insurance services to the rural and business communities.

During the year, CGU was again judged the No.1 commercial insurer in Australia among major brokers and middle market brokers.

The integration of NZI in New Zealand has been equally successful and we now have the premier insurance business in both the commercial and consumer sectors of the New Zealand market.



TOTAL INVESTMENTS MIX

STRONG INVESTMENT RETURNS

The Group's investment portfolio, totalling \$10.2 billion at year end, returned 8.1% for the year, outperforming the underlying benchmarks. This outperformance added approximately \$86 million to the pre-tax profit.

The majority of our claims reserves are invested in very high credit quality fixed interest and cash securities. At year end, 76% of the cash and fixed interest portfolio was invested in either government securities or securities rated 'AAA'. Over the year, investment income from claims reserves contributed \$244 million before tax to the Group's insurance result.

A strategic asset allocation review targeting risk reduction through greater diversity in the shareholders' funds across both asset classes and managers is being implemented. The Group's shareholders' funds, predominantly invested in equities, contributed \$434 million before tax to the Group's results.

We continue to seek to generate consistent active returns while at all times understanding and managing the investment risk within an insurance operation.

BUILDING A COHESIVE CULTURE

Considerable effort is being made to align our people around a common culture and set of values. We have a strong view that the sustainability of our business is directly linked to the ongoing benefit we offer our customers and the community. We see those benefits being the following:

1. Paying claims

Customers expect their claims will be paid. That's the point of insurance. But we need to ensure there is no misalignment between what we pay our customers when they claim and what they perceived we would pay when they initially entered into the policy.

2. Understanding and pricing risk

We price our products before we know their cost. So it's important we are expert in assessing and pricing risk accurately and fairly.

3. Managing our costs

Our operating costs are included in the price of a premium, so we must be as efficient as possible. We are responsibly using our scale to keep our costs per policy down.

4. Reducing the likelihood of a claim from occurring in the first place

None of us wants to experience the hardship that leads to making a claim, so we use our knowledge to help reduce the likelihood of a claim occurring in the first place. We concentrate on reducing environmental risks, crime, and workplace injury.

By unifying our people behind this purpose, we are generating a common culture which is focused, customer and community caring, and motivated.

IAG'S STRATEGIC GOALS

- Top quartile shareholder return
- Return on equity of at least 1.5 times weighted average cost of capital
- Establish an Asian foothold
- Maintain an 80:20 mix of short-tail : long-tail premiums
- Maintain a 'AA' category rating

It's hard to measure the impact of this cultural alignment other than to say our customer service levels are improving, complaints are falling, errors are reducing and employee engagement is accelerating. All of which are leading to increased brand value.

LOOKING AHEAD

In looking to the future, the Group has good momentum. Both the Australian and New Zealand economies are sound.

Our strategic position is strong. With the diversity of our business and our low cost, scale franchise, the Group is well positioned to compete effectively should operating conditions become less favourable.

We believe further value can be derived from our Australian and New Zealand businesses. We'll also continue our search for suitable opportunities to expand our business into Asia.

Finally, I would like to take this opportunity to thank my management team and all the wonderful people employed in the Group who have worked tirelessly to generate this performance.

Michael Hawker
Chief Executive Officer

INSURANCE AUSTRALIA GROUP'S AWARD WINNING PERFORMANCE

Winner, Best General Insurance Company

Australian Banking & Finance Magazine Awards 2004

Winner, Service to the Community Award

Australia and New Zealand Insurance Industry Awards 2004

Winner, Sustainable Company of the Year

Annual Ethical Investor Sustainability Awards 2003

Winner, Best Non-bank Financial Institution

Australian Banking & Finance Magazine Awards 2003

Winner, Merit Award for Labour Relations

Annual Ethical Investor Sustainability Awards 2003

Winner, SEDA Sustainable Energy Ambassador Award

2003 Energy Smart Green Globe Awards

A CONVERSATION WITH THE CEO

Answers to some commonly asked questions.

Q. Insurers' profitability is good for shareholders, but what about customers?

A. Australia needs a strong and profitable insurance sector. Customers must have certainty that insurers have the financial strength to pay claims. At the same time, shareholders require returns commensurate with the risks associated with their investments.

Favourable conditions aligned for us this year from both an investment and underwriting perspective, helping us improve our profit. That's not always been the case – two years ago we reported a net loss of \$25 million.

The size of our profit should also be viewed in context – we paid about \$4.2 billion in claims during the year and we insure more than \$800 billion in property assets.

Q. What are the key drivers of your improved profit?

A. Our profit was boosted significantly by the \$434 million return we made from investing our shareholders' funds. This was a record return since we listed and a \$554 million turnaround from the \$120 million loss we incurred on the portfolio last year. In addition, sales (risks in force) increased 5.2%, we entered new markets, and our operating efficiencies improved. Our result included a full 12-months performance of the CGU/NZI acquisition, compared with only six months in the previous year. These businesses added more than \$2.5 billion in annual revenue to the Group. Finally, the sale of ClearView Retirement Solutions also contributed around \$61 million in pre-tax profits.

Q. Why should insurers' performance be viewed over longer than a 12-month period?

A. Like most companies, we deal with a range of issues such as competition, economic conditions, customer service and brand awareness. However, there are four areas that, when combined, are unique to insurance companies and provide additional complexity. These are:

- three different insurance cycles, which affect our personal, commercial and statutory insurance lines;
- investment cycles, which influence the size of the financial returns we generate from investing the money we put aside to pay claims and our shareholders' funds;
- the regulatory environment, which moulds the legislation guiding the insurance industry; and
- weather, which influences the frequency and severity of property claims.

Q. What happened in each of the insurance cycles in Australia during the year?

A. The **personal insurance cycle** is relevant to our home and motor vehicle insurance portfolios, which represent around 50% of our total revenue. In recent years, this stream of our business has benefited

from significant cost reductions generated by more than a decade of industry consolidation and privatisation along with a much-improved focus on appropriate risk management processes. Premium rates are driven predominantly by the cost of claims, and the volatility in premiums has diminished significantly due to the diversification and scale of the insurance industry today. For motor vehicle insurance in Australia, where the frequency of claims has decreased due to drier weather, average premiums have reduced in real terms and are now more affordable than they've been in five years. On the other hand, in home insurance, the increasing frequency of storm damage means premiums have had to rise in real terms.

The **commercial insurance cycle** impacts around 25% of our revenue, which is derived from our insurance classes which are written for businesses. This cycle is heavily influenced by the global capacity for insurance and reinsurance. Over the past few years, lack of capacity and accelerating payouts on liability business saw premiums increase in almost all classes of commercial insurance. However, these increases have slowed following tort law reform and an increased allocation of capital to this market, and moved closer to matching the rate of inflation. We believe our commercial operation will continue to be influenced by global insurance cycles but, as most of the local insurers focus on domestic businesses, the cycle is unlikely to be as extreme in Australia.

The **statutory insurance cycle** impacts our CTP motor liability and workers' compensation portfolios, which account for around 14% of our revenue. In our business structure, CTP now sits within our personal insurance operation, and workers' compensation within our commercial insurance operation. However, as these insurance classes are heavily regulated, we consider them separately when looking at cycles. Tort law reform has stabilised the statutory cycle. Consequently, premiums have reduced in the two largest schemes in which we participate, NSW CTP and Western Australian workers' compensation. We're confident these changes will also bring reductions in other premium classes in the medium term, provided there are no adverse changes in experience or regulation.

Q. Where will business growth come from?

A. We grow our business in two key ways – organically, by increasing the number of policies we sell in existing products or by offering new products; and acquisitively, by buying other insurance companies. Our most significant recent acquisition was the purchase of CGU and NZI in January 2003. Since that time, we've concentrated on consolidating our group of businesses and extracting the benefits of the combined operation.

Moving forward, we'll derive further value from our Australian and New Zealand operations through initiatives that continue to improve customer service and retention, and enable us to tailor our products to suit different customer segments. At the same time, we'll continue our search to build a foothold in Asia at the right time and price.