

# 3

## EFFECT OF THE PROPOSED AMENDMENTS ON THE GROUP

### 3.1 ABOUT IAG

IAG has a portfolio of general insurance businesses, with leading and established brands across its home markets of Australia and New Zealand, a specialist underwriter in the United Kingdom and a growing presence in Asia.

IAG is headquartered in Australia and employs approximately 12,600 people worldwide on a full time equivalent basis. As at 30 June 2009, IAG's market capitalisation was \$7.3 billion with total Group assets of \$19.3 billion and insured property valued at more than \$1,225 billion.

For the year ended 30 June 2009, the Group grew gross written premium (**GWP**) by 0.63% to \$7,842 million and net profit after tax (**NPAT**) increased to \$247 million from a loss of \$226 million in the 2008 financial year. Refer to IAG's website for more information at [www.iag.com.au](http://www.iag.com.au).

#### 3.1.1 Business strategy

The Group's strategy is to manage a portfolio of high-performing, customer-focused, diverse operations that provide general insurance in a manner that delivers superior experiences for stakeholders and creates value for shareholders.

The Group's financial targets are to deliver through the cycle:

- top quartile total shareholder return; and
- return on equity (**ROE**) greater than 1.5 times the weighted average cost of capital.

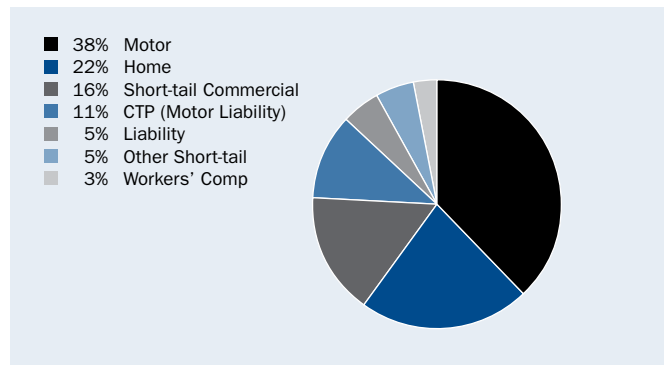
The Group's strategic priorities are to:

- continue to improve the performance of the Australian and New Zealand businesses;
- pursue selective general insurance growth opportunities; and
- drive operational performance and accountability.

### 3.1.2 Business profile

#### GWP split by product (FY09)

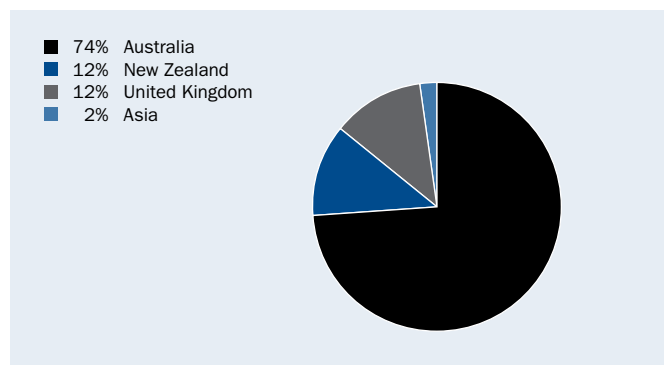
The Group offers a range of insurance products:



Source: IAG FY09 Investor Report

#### GWP split by region (FY09)

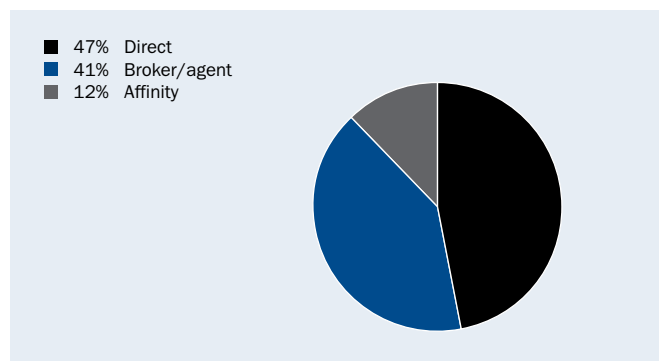
The Group's activities are conducted in four main regions: Australia, New Zealand, the United Kingdom and Asia.



Source: IAG FY09 Investor Report

### GWP split by channel (FY09)

It also offers insurance products through three distinct channels: direct, affinity and broker/agent.



Source: IAG FY09 Investor Report

#### Australia

IAG's businesses offer a range of insurance products both direct to customers, through a network of branches, agencies, call centres and online, and through intermediary channels, such as brokers, authorised representatives, business partners (including financial institutions) and motor dealers.

##### Australia Direct

Direct insurance products, which include personal insurance as well as business insurance packages targeted at sole operators and smaller businesses, are sold under the NRMA Insurance brand in NSW, the ACT, Queensland and Tasmania. SGIO is the primary brand in Western Australia, and SGIC in South Australia. In Victoria, the Group distributes home, motor and other insurance products through its joint venture with RACV.

##### Australia Intermediated

CGU, IAG's Australian intermediated insurance business, is one of Australia's leading commercial insurers, one of the largest providers of workers' compensation services and the foremost insurer to the country's regional and rural communities. CGU offers a comprehensive range of commercial, rural and personal insurance products for individuals, families, farms and businesses. CGU distributes its products through a network of over 75 branches, 1,000 insurance brokers and authorised representatives, and more than 100 business partners including financial institutions.

##### The Buzz

The Buzz was launched in May 2009 as a standalone Australian online insurance business initially focusing on car insurance. RACV has a 30% interest in The Buzz.

##### New Zealand

The New Zealand business is the leading insurance provider in New Zealand in the direct channel and a leading insurer in the broker/agent channel. The Group provides insurance products directly to customers under its State brand and indirectly, through insurance brokers and agents, under its NZI brand. The personal lines and simplified commercial products are also distributed through agents and under third party brands by corporate partners, which include large financial institutions.

##### United Kingdom

In the United Kingdom, IAG has a specialist motor underwriting operation, Equity Red Star. Commencing operations in 1946, Equity Red Star has grown to become the largest motor syndicate at Lloyd's, providing insurance to business and personal lines customers. It was acquired by IAG in 2007. The United Kingdom business also includes the Equity Broking affinity business and specialist commercial broker Barnett & Barnett.

#### Asia

The Group has interests in four businesses in Asia – controlling economic interests in NZI and Safety Insurance in Thailand; a 49% share of AmG, a general insurance joint venture in Malaysia; and 100% ownership of the Beijing Continental Automobile Association, a roadside assistance and insurance agent operation in China. In November 2008, the Group agreed to form a general insurance joint venture with State Bank of India, which is expected to commence trading in 2010.

### 3.2 FINANCIAL OVERVIEW

The following tables set out the pro forma financial information of the Group as at 30 June 2009 under two scenarios. The first scenario assumes that the Amendments are approved (**Amended RES case**) and the second scenario assumes that the Amendments are not approved and the Existing RES are Exchanged into Existing Preference Shares (**Existing Preference Shares case**).

#### 3.2.1 Balance sheet

##### 3.2.1.1 Group's pro forma balance sheet as at 30 June 2009 – Amended RES case

If the Amendments are approved, the Amended RES and the proceeds associated with the liquidated investment portfolio will be recognised on the Group's balance sheet. The existing Exchange right currently recognised on the balance sheet will have no value to IAG and is required to be written off through the income statement (reversing all the fair value movements of the Exchange right previously recognised in the income statement).

\$ million	30 June 2009	Pro forma adjustments	Pro forma
Investments	10,563	545 <sup>1</sup>	11,108
Trade and other receivables	887	(96) <sup>2</sup>	791
Goodwill and other intangibles	2,278	–	2,278
Other assets	5,587	–	5,587
<b>Total assets</b>	<b>19,315</b>	<b>449</b>	<b>19,764</b>
Claims outstanding and unearned premium	11,888	–	11,888
Interest bearing liabilities	1,053	550 <sup>3</sup>	1,603
Other liabilities	1,538	(1) <sup>4</sup>	1,537
<b>Total liabilities</b>	<b>14,479</b>	<b>549</b>	<b>15,028</b>
<b>Net assets</b>	<b>4,836</b>	<b>(100)</b>	<b>4,736</b>
Equity attributable to shareholders	4,671	(100) <sup>2,4</sup>	4,571
Minority interests	165	–	165
<b>Total equity</b>	<b>4,836</b>	<b>(100)</b>	<b>4,736</b>

Notes:

- The proceeds associated with the liquidated investment portfolio of \$550 million (which is equal to the face value of the Amended RES), net of transaction costs of \$5 million, are recognised on the balance sheet. This investment portfolio is no longer a security in favour of the Amended RES.
- The fair value of the Exchange right in the Existing RES (\$96 million) is recognised on the Group's balance sheet as at 30 June 2009 under trade and other receivables. The Exchange right will be extinguished if the Amendments are approved and thus the fair value of the Exchange right recognised since the Existing RES were issued will be written off through the income statement. Following an increase in the Existing RES price in the three months since 30 June 2009, the fair value of the Exchange right has reduced significantly.
- Represents the face value of the Amended RES.
- Transaction costs of \$5 million in relation to the proposed Amendments, net of the income tax impact of \$1 million, will be recognised through the income statement.

# 3 EFFECT OF THE PROPOSED AMENDMENTS ON THE GROUP

## 3.2.1.2 Group's pro forma balance sheet as at 30 June 2009 – Existing Preference Shares case

If the Amendments are not approved and the Existing RES are Exchanged the Group will recognise Existing Preference Shares of \$454 million and the proceeds associated with the liquidated investment portfolio on the Group's balance sheet. The fair value of the Exchange right is accounted for as a reduction in the consideration received from the issue of the Existing Preference Shares.

\$ million	30 June 2009	Pro forma adjustments	Pro forma
Investments	10,563	550 <sup>1</sup>	11,113
Trade and other receivables	887	(96) <sup>2</sup>	791
Goodwill and other intangibles	2,278	–	2,278
Other assets	5,587	–	5,587
<b>Total assets</b>	<b>19,315</b>	<b>454</b>	<b>19,769</b>
Claims outstanding and unearned premium	11,888	–	11,888
Interest bearing liabilities	1,053	–	1,053
Other liabilities	1,538	–	1,538
<b>Total liabilities</b>	<b>14,479</b>	<b>–</b>	<b>14,479</b>
<b>Net assets</b>	<b>4,836</b>	<b>454</b>	<b>5,290</b>
Equity attributable to shareholders	4,671	454 <sup>2,3</sup>	5,125
Minority interests	165	–	165
<b>Total equity</b>	<b>4,836</b>	<b>454</b>	<b>5,290</b>

Notes:

- 1 Represents the proceeds of the liquidated investment portfolio of \$550 million.
- 2 The fair value of the Exchange right in the Existing RES (\$96 million) is recognised on the Group's balance sheet as at 30 June 2009 under trade and other receivables. Upon Exchange, the fair value of the Exchange right is accounted for as a reduction in the consideration received from the issue of the Existing Preference Shares. Following an increase in the Existing RES price in the three months since 30 June 2009, the fair value of the Exchange right has reduced significantly.
- 3 Fair value of the Existing Preference Shares Exchanged are classified as equity net of the fair value of the Exchange right.
- 4 No material transaction costs would be incurred for exercising the Exchange right by IAG.

## 3.2.2 Pro forma capital adequacy

The following table sets out the Group's pro forma capital adequacy position based on the Group's audited balance sheet as at 30 June 2009 – adjusted as if the proposed Amendments are approved.

In the event that the proposed Amendments are approved, it is assumed that the Amended RES will be eligible to constitute Tier 1 Capital up to the regulatory limit for Innovative Tier 1 Capital of 15% of Net Tier 1 Capital, with the remainder constituting Upper Tier 2 Capital. The reduction in MCR represents the reversal of the investment risk charge on the fair value of the Exchange right (which is required to be written off) offset by the investment risk charge on the liquidated investment portfolio recognised on the Group's balance sheet. On this basis, the Amended RES will increase the Group's MCR multiple by approximately 0.24. This assumes no material change in the Group's capital adequacy position prior to the proposed Amendments.

## Group's pro forma capital adequacy position as at 30 June 2009

\$ million	30 June 2009	Pro forma adjustments	Pro forma
Tier 1 Capital	2,983	(3) <sup>1</sup>	2,980
Tier 2 Capital	590	453 <sup>2</sup>	1,043
<b>Regulatory capital base</b>	<b>3,573</b>	<b>450</b>	<b>4,023</b>
<b>MCR</b>	<b>1,997</b>	<b>(16)</b>	<b>1,981</b>
<b>MCR multiple (x)</b>	<b>1.79</b>	<b>0.24</b>	<b>2.03</b>

Notes:

- 1 Includes \$97 million of Amended RES eligible for inclusion within the Group's Innovative Tier 1 Capital, net of the write-off of \$96 million which represents the fair value of the Exchange right previously recognised in the income statement and the transaction costs (\$5 million) net of tax (\$1 million) which are expensed through the income statement.
- 2 Remainder of Amended RES (\$453 million) is included as Upper Tier 2 Capital.

In the event that the proposed Amendments are not approved and the Existing RES are Exchanged into Existing Preference Shares, the pro forma MCR multiple of 2.03 shown above remains unchanged. However, the regulatory capital base split between Tier 1 and Tier 2 Capital will be as follows: Tier 1 Capital \$3,097 million; and Tier 2 Capital \$930 million.

## 3.3 CREDIT RATINGS

	Issue Credit Rating	Issuer Credit Rating	IAG's Credit Rating
Amended RES <sup>1</sup>	"A–"	–	–
IAG <sup>2</sup>	–	"A+" (Stable outlook)	"AA–" (Stable outlook)

- 1 S&P has indicated that the Amended RES will retain the current Issue Credit Rating.
- 2 S&P has affirmed IAG's Issuer Credit Rating of "A+" (Stable outlook) and IAG's Credit Rating of "AA–" (Stable outlook) on 26 June 2009.

Rating definitions used by S&P are as follows:

- an Issue Credit Rating is a forward-looking opinion about the creditworthiness of an obligor with respect to a specific financial obligation, a specific class of financial obligations, or a specific financial program;
- an Issuer Credit Rating is a current opinion of an obligor's overall financial capacity (its creditworthiness) to pay its financial obligations. This opinion focuses on the obligor's capacity and willingness to meet its financial commitments as they come due. It does not apply to any specific financial obligation, as it does not take into account the nature of and provisions of the obligation, its standing in bankruptcy or liquidation, statutory preferences, or the legality and enforceability of the obligation. In addition, it does not take into account the creditworthiness of the guarantors, insurers, or other forms of credit enhancement on the obligation;
- IAG's Credit Rating is a forward-looking opinion about the financial security characteristics of an insurance organisation with respect to its ability to pay under its insurance policies and contracts in accordance with their terms; and

- a Rating Outlook assesses the potential direction of a long-term counterparty credit rating over the intermediate term (typically six months to two years). In determining a Rating Outlook, consideration is given to any changes in the economic and/or fundamental business conditions. A Rating Outlook is not necessarily a precursor of a rating change or future creditwatch action.

According to S&P:

- an Issue Credit Rating of “A” describes an obligor to be somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligations in higher-rated categories. However, the obligor’s capacity to meet its financial commitment on the obligation is still strong;
- an Issuer Credit Rating of “A” describes an obligor that has strong capacity to meet its financial commitments but is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligors in higher-rated categories;
- an IAG’s Credit Rating of “AA” describes an insurer that has very strong financial security characteristics;
- the ratings from “AA” to “CCC” may be modified by the addition of a plus (+) or minus (–) sign to show relative standing within the major rating categories; and
- a Rating Outlook “Stable” means that a rating is not likely to change in the near term.

**Ratings are statements of opinion, not statements of fact or recommendations to buy, hold or sell securities (including the Amended RES and the Amended Preference Shares).**

**Ratings are subject to revision or withdrawal at any time.**