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INVESTMENT RISKS

This Section describes the risks:

- 1. of holding the Amended RES and the Amended Preference Shares (if issued) if the proposed Amendments are approved;**
- 2. of holding the Existing RES and the Existing Preference Shares (if issued) on their existing terms, if the proposed Amendments are not approved;**
- 3. that are common to holding the securities regardless of whether the Amendments are approved; and**
- 4. associated with the Group and the general insurance industry.**

Before deciding whether, or how, to vote, you should consider whether the Amended RES and the Amended Preference Shares (if issued) is a suitable investment for you. There are risks associated with holding the Amended RES as well as continuing to hold the Existing RES and the Existing Preference Shares (if issued) on their existing terms, many of which are outside the control of the Issuer or IAG. These risks include those in this Section and other matters referred to in this Explanatory Statement.

4.1 RISKS SPECIFIC TO HOLDING THE AMENDED RES AND THE AMENDED PREFERENCE SHARES IF THE PROPOSED AMENDMENTS ARE APPROVED

Set out below are certain risks associated with holding the Amended RES and the Amended Preference Shares. You should also consider the other risks in this Section as they relate to the Ordinary Shares into which the Amended RES or the Amended Preference Shares may be Converted and risks associated with the Group and the general insurance industry.

4.1.1 Loss of rights associated with the Existing RES

If the proposed Amendments are approved, then your rights will be governed by the Amended RES Terms from the Amendment Date and Amended Preference Share Terms (if the Amended Preference Shares are issued). This means you will lose your right to request Redemption of your Existing RES on 15 March 2010, which is the

initial Reset Date under the Existing RES Terms, and the benefit of the security over the Portfolio. However, if the proposed Amendments are not approved, IAG will Exchange the Existing RES for Existing Preference Shares under the Existing RES Terms by 15 March 2010. Under the Existing Preference Share Terms, you have no right to request Redemption or Conversion and no benefit of any security. See Section 4.2 for the risks specific to holding the Existing RES and the Existing Preference Shares.

4.1.2 No remedies for non-payment and no events of default

Under the Existing RES Terms, if an Interest Payment is not paid other than due to the Interest Payment Tests not being met, then a Trigger Event occurs and you are entitled to request Redemption in respect of some or all of your Existing RES. There are also certain events of default under the Trust Deed (including non-payment of an amount owing under the Existing RES) which allow the Trustee to enforce the security over the Portfolio.

In contrast, under the Amended RES Terms, if the Issuer does not pay an Interest Payment either because the Interest Payment Tests are failed or because of any applicable law, then the Issuer has no liability to pay the unpaid amount of the Interest Payment and you have no claim in respect of such non-payment. Such non-payment does not constitute an event of default and you have no right to initiate a winding-up of, an administration in respect of, or the appointment of a receiver or a receiver and manager to, the Issuer for such non-payment. However, if an Interest Payment is not paid, then distribution restrictions apply so that IAG is restricted from paying dividends or distributions on capital or returning capital on Ordinary Shares without the approval of RES Holders subject to certain exceptions. See Sections 1.3.7 and 1.3.8.

The Directors may pass a resolution at any time resolving not to pay any Interest Payment.

However, under the Amended RES Terms, IAG must Exchange your Amended RES for Amended Preference Shares if an Interest Payment is not paid in full within 40 Business Days of the scheduled Interest Payment Date for any reason other than due to an APRA Condition existing on the relevant Interest Payment Date.

Like the Existing Preference Share Terms, the Amended Preference Share Terms do not have any remedies for non-payment of a Dividend. However, like the Amended RES, if a Dividend is not paid, restrictions on IAG paying dividends or distributions on capital or returning capital on Ordinary Shares, without the approval of Preference Shareholders, apply. These restrictions under the Amended Preference Share Terms will also apply where the Amended RES have been Exchanged for Amended Preference Shares due to the non-payment of Interest Payments.

However, if the proposed Amendments are not approved, IAG will Exchange the Existing RES for Existing Preference Shares under the existing RES Terms by 15 March 2010. If this occurs, you will also lose the remedies for non-payment of Interest Payments available to you under the Existing RES Terms.

4.1.3 Ability to make Interest Payments and/or pay Dividends

Interest Payments will only be paid on the Amended RES if the Interest Payment Tests are satisfied – see Section 1.3.4. Dividends will only be paid on the Amended Preference Shares if the Dividend Payment Tests for Amended Preference Shares are satisfied; see Section 1.3.5. In order to meet APRA's Tier 1 Capital criteria as APRA applies those criteria to the Group, the Interest Payment Tests and the Dividend Payment Tests are more restrictive than the Interest Payment Tests on the Existing RES.

There is a risk that one or more of the Interest Payment Tests or the Dividend Payment Tests may not be satisfied and therefore the Interest Payment or Dividend will not be paid. The Issuer or IAG (as applicable) is required to satisfy certain APRA requirements in order to make Interest Payments or pay Dividends. These requirements do not apply to Interest Payments on the Existing RES, however, Dividend Payment Tests (which include certain APRA requirements) would apply to Existing Preference Shares as set out in the Existing Preference Share Terms.

Interest Payments and Dividends are non-cumulative, and therefore any Interest Payment which is not paid or Dividend which is not declared is not required to be made up in subsequent periods. Like other insurance and financial services groups, due to the Group's volatility of earnings, there can be no guarantee that in certain years IAG will have sufficient profits to satisfy APRA's requirements.

See Section 4.4 for an outline of the major risks affecting the level of financial performance of the Group.

4.1.4 Conversion upon your request may not occur

As a RES Holder or Preference Shareholder, you may request Conversion of some or all of your Amended RES or Amended Preference Shares into Ordinary Shares on a Reset Date or following the occurrence of an Acquisition Event. Upon receiving the Conversion request, the Issuer or IAG (as the case may be) must choose to Redeem (subject to prior written approval from APRA), Convert or Resell the Amended RES or the Amended Preference Shares which are the subject of the request. As a result, you may not receive Ordinary Shares as intended under the Conversion request, although you may receive an approximately equivalent amount in cash. This may be disadvantageous to you in light of market conditions or individual circumstances at the time of Conversion, Redemption or Resale.

Unlike the Existing RES where the initial Reset Date is five years after the issue date and any subsequent Reset Dates can be set at the Issuer's discretion, under the Amended RES the initial Reset Date is 10 years after the Amendment Date and any subsequent Reset Dates must be 10 years from the immediately preceding Reset Date, unless APRA otherwise approves – see Section 1.6.1 for further details.

However, if the proposed Amendments are not approved, IAG will Exchange the Existing RES for Existing Preference Shares under the Existing RES Terms by 15 March 2010. The Existing Preference Shares do not have any reset mechanisms, which means that Preference Shareholders will have to wait for IAG to initiate Conversion or Redemption of their Existing Preference Shares. See Section 4.2 for the risks specific to holding the Existing RES and the Existing Preference Shares.

4.1.5 Early Exchange

Under the Amended RES Terms, IAG may Exchange the Amended RES at any time and must Exchange the Amended RES if an Exchange Event occurs. An Exchange Event includes a Liquidation Event in relation to the Issuer or IAG, an Issuer Change of Control Event, failure to make an Interest Payment in certain circumstances, failure to Redeem or Convert and in certain circumstances required by APRA. As a result, if Exchange occurs, it will occur at a time outside of your control.

4.1.6 Issuer/IAG Redemption, Conversion or Resale rights

Under the Amended RES Terms and the Amended Preference Share Terms, the Issuer or IAG (as applicable) has certain rights to initiate a Redemption, Conversion or Resale. See Section 1.9 for further details on these rights.

Because of these rights, your investment in the Amended RES or the Amended Preference Shares is subject to the occurrence of events outside of your control, including actions by APRA with respect to the regulatory classification of the Amended RES or the Amended Preference Shares, the taxation classification or treatment of the Amended RES or the Amended Preference Shares, the occurrence of a Potential Acquisition Event or an Acquisition Event or the discretion the Issuer or IAG (as applicable) where there are less than one million Amended RES on issue at any time or less than one million Amended Preference Shares on issue or within a specified number of days prior to a Reset Date.

In these circumstances, you will have no control over when or if the Issuer or IAG will initiate a Redemption, Conversion or Resale. If the Issuer or IAG does initiate one of these events, you could receive cash in place of your Amended RES or Amended Preference Shares at a time when it is difficult to reinvest that amount to receive a return which is comparable to that which you were receiving on the Amended RES or the Amended Preference Shares. You could receive Ordinary Shares at a time in which it is disadvantageous to hold Ordinary Shares.

4.1.7 Regulatory classification

APRA has confirmed that the Amended RES and the Amended Preference Shares (if issued) will qualify as Innovative Tier 1 Capital. Not all Amended RES will count towards the Group's Innovative Tier 1 Capital on the Amendment Date due to the current limit on the Group's Innovative Tier 1 Capital. The surplus portion of Amended RES will initially count towards the Group's Upper Tier 2 Capital – see Section 1.1.4. However, if IAG determines that the Group is not or will not be entitled to treat the Amended RES as Innovative Tier 1 Capital or, in the case of the surplus portion, Upper Tier 2 Capital, the Issuer or IAG (as applicable) may decide that a Regulatory Event has occurred and may elect to Redeem (subject to prior written approval from APRA), Convert or Resell all or some of the Amended RES or the Amended Preference Shares. This may be at a time when it is difficult to reinvest that amount to receive a return which is comparable to that which you were receiving on the Amended RES or the Amended Preference Shares or you could receive Ordinary Shares at a time which is disadvantageous to hold Ordinary Shares.

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4.1.8 Ranking of the Amended RES and the Amended Preference Shares

Unlike the Existing RES which are unsubordinated obligations of the Issuer and have the benefit of the security over the Portfolio, the Amended RES will be subordinated and unsecured debt obligations of the Issuer. IAG does not guarantee or provide other credit support for the Amended RES.

However, if the proposed Amendments are not approved, IAG will Exchange the Existing RES for Existing Preference Shares under the Existing RES Terms by 15 March 2010. The Existing Preference Shares do not have the benefit of the security over the Portfolio.

If a Liquidation Event occurs in relation to the Issuer or IAG, this will cause an Exchange Event to occur automatically and the RES Holder will receive an Amended Preference Share for each Amended RES.

On a winding-up of IAG, Preference Shareholders will rank behind policyholders and creditors of IAG (and equally with holders of RPS1 in all respects), but in priority to Ordinary Shareholders to the extent of the Liquidation Sum. In the event of a shortfall of funds on a winding-up, there is a risk that Preference Shareholders will not receive the full amount, or any, of the Liquidation Sum.

Unlike the Existing Preference Share Terms, under the Amended Preference Share Terms, IAG may issue preference shares which rank in priority to the Amended Preference Shares without the consent of Preference Shareholders.

4.1.9 The RES Margin and the Preference Share Margin may be reset below the RES Margin applicable on the Amendment Date

On each Reset Date, the Issuer or IAG can change certain Amended RES Terms or Amended Preference Share Terms including the RES Margin or the Preference Share Margin (as applicable). This could mean that the rate of return on your investment is not as favourable as the rate of return available on comparable instruments at the same time.

However, under the Amended RES or Amended Preference Shares, you can request Conversion for some or all of your Amended RES or Amended Preference Shares on a Reset Date if you are unsatisfied with the new RES Margin or the Preference Share Margin.

4.1.10 Resale may not complete

If the Issuer or IAG chooses to Resell either the Amended RES or Amended Preference Shares (as applicable), the Issuer or IAG will appoint one or more Nominated Purchasers to acquire all or some of the Amended RES or Amended Preference Shares for cash equal to the Resale Price based on the terms and conditions agreed between the Issuer or IAG and the Nominated Purchaser. It will be the Nominated Purchaser's obligation to pay the consideration to you. The obligation of a Nominated Purchaser to pay the aggregate Resale Price to you may be subject to conditions. Although the Issuer or IAG will reasonably endeavour to minimise these conditions, the Issuer or IAG can give no assurance as to the details of any such conditions. The Issuer and IAG will have no obligation to pay this amount if it is not paid by the Nominated Purchaser (whether because a condition is not satisfied or otherwise). Accordingly, there is a risk that despite the Issuer or IAG appointing the Nominated Purchaser, they may not deliver cash equal to the Resale Price. The Issuer or IAG may only appoint a Nominated Purchaser if that Nominated Purchaser has a long-term counterparty credit rating from S&P of not less than the Issue Credit Rating assigned to the Amended RES or the Amended Preference Shares at that time.

If a Nominated Purchaser does not pay cash equal to the Resale Price, or the Resale otherwise does not complete, the relevant Amended RES or Amended Preference Shares will not be Redeemed, Converted or Resold on that date and you will continue to hold them until they are otherwise Redeemed, Converted or Resold in accordance with their terms. See Section 1.12.2.

If the Issuer or IAG (as applicable) initiated the Resale then they may choose to Redeem, Convert or Resell all (but not some only) of the Amended RES or Amended Preference Shares referable to the defaulting Nominated Purchaser at a later date. The new timing and option chosen by the Issuer or IAG may be disadvantageous to you in light of market conditions or individual circumstances at the time of Conversion, Redemption or Resale.

4.1.11 Taxation consequences of the Amendments

A summary of the potential Australian taxation consequences for RES Holders and Preference Shareholders is in the Taxation Letter in Section 5. This Taxation Letter is in general terms and is not intended to provide specific advice in relation to the circumstances of any particular investor. Accordingly, you should seek independent advice in relation to your own individual taxation position.

4.1.12 Future issues of securities

IAG or one of its controlled entities may issue other securities, including other notes or preference shares which rank equally with, behind or ahead of any of the Amended RES and the Amended Preference Shares, without the approval of RES Holders or Preference Shareholders. In addition, IAG may also issue other securities that rank equally, behind or ahead of any of the Amended RES and the Amended Preference Shares for interest, dividends or repayment of capital in a winding-up of IAG. Such issues could impact the ability of IAG or other members of the Group to make interest payments or pay dividends on any of the existing or amended securities or the sufficiency of funds on a winding-up. The issue of such securities could negatively affect the price that any of the Amended RES and the Amended Preference Shares could trade on ASX.

4.1.13 Withholding tax changes

Under the Amended RES Terms, the Issuer will no longer gross up for any deductions made from payments to a RES Holder because of a New Zealand withholding required by reason of that RES Holder having a connection with New Zealand or a political subdivision of New Zealand. See Section 1.3.11.

RES Holders who are liable to such withholding will need to advise the Issuer of the information described in Section 7.7 to avoid deductions being made at the highest withholding tax rate applicable to such RES Holder.

4.1.14 ATO view on franking credits and certain convertible notes

Since the Existing RES were issued, the anti-avoidance provisions of the Tax Act relating to franking credits have been amended. Following that amendment, the Commissioner of Taxation (**Commissioner**) has recently issued a public ruling, TR 2009/3 which calls into question the availability of franking credits to holders of certain convertible notes. It is also possible that the amendments may be the subject of litigation with the Commissioner by issuers of instruments which have certain features in common with the Existing RES and Amended RES. Whilst it is considered that the issues raised by the amendments have no application to the Amended RES if litigation eventuates and the Commissioner's views are upheld then the franking credits attaching to the Amended RES may be affected and a Tax Event entitling the Issuer to Redeem (subject to APRA's prior written approval) or Convert or Resell Amended RES may occur.

4.2 RISKS OF HOLDING THE EXISTING RES AND THE EXISTING PREFERENCE SHARES IF THE PROPOSED AMENDMENTS ARE NOT APPROVED

Set out below are certain risks associated with holding the Existing RES and the Existing Preference Shares if the proposed Amendments are not approved. You should also consider the other risks in this Section as they relate to the Ordinary Shares into which the Existing RES or the Existing Preference Shares may be Converted and risks associated with the Group and the general insurance industry.

4.2.1 Exchange into Existing Preference Shares

Under the Existing RES Terms, IAG may elect to Exchange all or some Existing RES into Existing Preference Shares at any time. If the proposed Amendments are not approved, then IAG will exercise its right under the Existing RES Terms to Exchange Existing RES into the Existing Preference Shares by 15 March 2010. These Existing Preference Shares will bear Dividends, subject to their terms, based on the Bank Bill Rate plus the RES Margin of 1.20% per annum. A one-time step-up of the RES Margin to 2.20% applies 10 years after their issuance.

4.2.2 Conversion or Redemption of the Existing Preference Shares

Under the Existing Preference Share Terms, the Existing Preference Shares are perpetual securities and have no maturity date. If the Existing RES are Exchanged for Existing Preference Shares, Preference Shareholders cannot request Conversion or Redemption. This means that Preference Shareholders will have to wait for IAG to initiate Conversion or Redemption of their Existing Preference Shares.

4.2.3 Investment losses from the Portfolio

The Existing RES are exposed to any losses on the Portfolio. If a loss occurs on the Portfolio, for example, because an obligor of a Portfolio security defaults in its obligations, then:

- Net Portfolio Income per Existing RES may be less than an Interest Payment on an Interest Payment Date; or
- Net Portfolio Proceeds per Existing RES may be less than the Issue Price on Redemption, Conversion or Exchange.

4.2.4 Effect on Interest Payments

If on account of a loss on the Portfolio, the Distributable Portfolio Income Amount is less than a scheduled Interest Payment on an Interest Payment Date, you may not receive the scheduled Interest Payment in full.

4.2.5 Effect on capital investment

If there is a default or loss on a Portfolio Security, the Redemption Amount to be received by RES Holders on Redemption, Conversion or Exchange will be reduced to the extent the loss of default reduces the proceeds of realisation of the Portfolio. For these reasons, a loss or default on a Portfolio Security can result in a reduction in the capital value of your investment in the Existing RES if there is a Redemption, Conversion or Exchange.

4.2.6 Ability to make Interest Payments and/or pay Dividends

Interest Payments on the Existing RES will only be paid if the Interest Payment Tests are satisfied. These Interest Payment Tests are less restrictive than the Interest Payment Tests on the Amended RES and Dividend Payment Tests on the Amended Preference Shares. However, Interest Payments on the Existing RES are subject to the Distributable Portfolio Income Amount as described above.

Dividends on the Existing Preference Shares will only be payable if the Dividend Payment Tests are satisfied. These Dividend Payment Tests are similar to the Interest Payment Tests on the Amended RES and Dividend Payment Tests on the Amended Preference Shares.

There is a risk that one or more of the Interest Payment Tests on the Existing RES or the Dividend Payment Tests on the Existing Preference Shares may not be satisfied and therefore the Interest Payment or Dividend will not be paid.

Interest Payments and Dividends are non-cumulative and therefore any Interest Payment which is not paid or Dividend which is not declared is not required to be made up in subsequent periods. Like other insurance and financial services groups, due to the Group's volatility of earnings, there can be no guarantee that in certain years IAG will have sufficient profits to satisfy the requirements.

See Section 4.4 for an outline of the major risks affecting the level of financial performance of the Group.

4.3 RISKS THAT ARE COMMON TO HOLDING THE SECURITIES REGARDLESS OF WHETHER THE AMENDMENTS ARE APPROVED

Set out below are the risks associated with Existing RES, Existing Preference Shares, Amended RES or Amended Preference Shares. RES Holders are currently exposed to these risks.

4.3.1 Market price and liquidity of all of the existing and amended securities

The Issuer and IAG are not able to predict the market price or liquidity of any of the Existing RES, Existing Preference Shares, Amended RES or Amended Preference Shares. The ASX market for any of these securities may be less liquid than the ASX market for Ordinary Shares.

It is possible that these securities could trade on ASX at a price below the original issue price (being \$100 for the Existing RES). Their market value also may be affected by the market price of Ordinary Shares. RES Holders or Preference Shareholders who wish to sell any of these securities may be unable to do so at all if insufficient liquidity exists in the market for the security.

Existing RES price and volume



Note: Historical performance is not necessarily indicative of future performance. Volume indicates number of Existing RES traded.

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4.3.2 Interest Rate and Dividend Rate

All Interest Rates and Dividend Rates are calculated by reference to the Bank Bill Rate each quarter, which is influenced by a number of factors and varies over time. These rates will fluctuate (both increasing and decreasing) with movements in the three-month Bank Bill Rate as depicted in the chart below covering movements over a 20 year period.

Three-month Bank Bill Rate (% per annum)



Note: Historical performance is not necessarily indicative of future performance.

4.3.3 Interest Payments or Dividends may not be fully franked

IAG expects Interest Payments and Dividends on all of the Existing RES, Existing Preference Shares, Amended RES or Amended Preference Shares to be fully franked. However, there is no guarantee that IAG will have sufficient franking credits in the future to fully frank Interest Payments or Dividends.

If an Interest Payment or Dividend is unfranked or partially franked, it will be increased to compensate for the unfranked component.

The value and availability of franking credits to a RES Holder or a Preference Shareholder will differ depending on the RES Holder's or Preference Shareholder's particular tax circumstances. RES Holders or Preference Shareholders should be aware that the potential value of any franking credits does not accrue at the same time as the receipt of any cash Interest Payment or Dividend. RES Holders or Preference Shareholders should also be aware that the ability to use the franking credits, either as an offset to a tax liability or by claiming a refund after the end of the year of income, will depend on the individual tax position of each RES Holder or Preference Shareholder. RES Holders or Preference Shareholders should also refer to the Taxation Letter in Section 5 and seek professional advice in relation to their tax position.

4.3.4 Financial position and performance of IAG

The value of your investment in any of the Existing RES, Existing Preference Shares, Amended RES or Amended Preference Shares will depend on the financial position and operating performance of IAG.

IAG may Convert any of the Existing RES, Existing Preference Shares, Amended RES or Amended Preference Shares into Ordinary Shares in certain circumstances. Therefore, if IAG's financial condition declines, or if market participants anticipate that IAG's financial condition may decline, your investment could decline in value, even if IAG has not yet exercised its option to Convert.

Accordingly, when you evaluate whether, or how, to vote on the proposed Amendments, you should carefully evaluate the risks associated with an investment in the Group as set out in Section 4.4.

4.3.5 Financial market conditions

The market price of any of the Existing RES, Existing Preference Shares, Amended RES or Amended Preference Shares will fluctuate due to various factors, including interest rates, general movements in the Australian and international equity markets, investor sentiment, perceived credit spreads, the number of buyers and sellers at that time, worldwide or regional economic conditions and factors which may affect the general insurance industry. The market price of any of the Existing RES, Existing Preference Shares, Amended RES or Amended Preference Shares may be more sensitive than Ordinary Shares to changes in interest rates.

4.3.6 Fluctuation in Ordinary Share price

On Conversion, you will receive approximately \$102.56 (including the 2.50% conversion discount) worth of Ordinary Shares for each Existing RES, Existing Preference Share, Amended RES or Amended Preference Share (as applicable). The number of Ordinary Shares that would be issued is based on the VWAP of Ordinary Shares during the 20 Business Days before the date on which Conversion occurs. The market price of Ordinary Shares will fluctuate due to various factors, including investor perceptions, domestic and worldwide economic conditions and IAG's financial performance and position – see Section 4.4. As a result, the value of Ordinary Shares received upon Conversion may be greater than or less than approximately \$102.56 for Existing RES, Existing Preference Share, Amended RES or Amended Preference Share.

Ordinary Share price



Note: Historical performance is not necessarily indicative of future performance.

4.3.7 Early Redemption or Conversion

The Issuer or IAG may Redeem (subject to prior written approval of APRA) or Convert the Existing RES, Amended RES, Existing Preference Shares and Amended Preference Shares (as applicable) according to their terms, including in response to changes in tax laws, changes in the treatment by APRA, on the occurrence of certain takeovers or schemes of arrangement or if there are less than one million of the relevant security on issue. The Issuer or IAG may also Resell the Amended RES or Amended Preference Shares (as applicable) in these circumstances. This could occur at a time prior to a Reset Date and before you wish to dispose of your investment. This may have negative consequences depending on your individual circumstances.

Depending on when you acquired any of the existing or Amended RES or Preference Shares, the value of what you receive on a Redemption, Conversion or Resale, could be higher or lower than the original price you paid on ASX.

4.3.8 Credit ratings

As a result of changes in the Group's operating performance or capital structure, there is a risk that credit ratings of the Group or any of the existing or amended RES or Preference Shares could change adversely in the future. This could affect the market price and liquidity of any of the existing or amended RES or Preference Shares and the Ordinary Shares.

In addition, although IAG's Credit Rating is "AA-" from S&P, the existing and amended RES or Preference Shares are not guaranteed by those entities or by IAG itself. Despite this, any downgrading of the credit ratings of one or more of those entities could affect the sentiment of market participants, thereby causing the market price of any of the existing or amended RES or Preference Shares to fall.

4.3.9 Taxation policy may change

A general description of the Australian taxation consequences of the Amendments, including a holder's ability to claim franking credits, is set out in the Taxation Letter from Mallesons Stephen Jaques in Section 5. This discussion is in general terms and is not intended to provide specific advice in relation to the circumstances of any particular investor. Accordingly, investors should seek independent advice in relation to their individual tax position.

If there is a change of law, policy or practice that adversely affects the tax position of the Issuer or IAG (as applicable), or a holder's ability to claim franking credits, a Tax Event may occur. This would give the Issuer or IAG (as applicable) the right to elect to Redeem (subject to prior written approval by APRA), Convert or Resell the Amended RES or Amended Preference Shares (as applicable).

4.3.10 Amendment, substitution and other powers

Like the Existing RES, the terms of the Amended RES and the Trust Deed contain provisions for calling meetings of RES Holders to consider matters affecting their interests generally. These provisions permit defined majorities of RES Holders to agree to amendments to the Amended RES Terms which are binding on all RES Holders including RES Holders who do not attend and vote at the relevant meeting and RES Holders who voted in a manner contrary to the majority.

The Amended RES Terms also provide that the Issuer and the Trustee may, without the consent of RES Holders, agree to any amendment of the Amended RES or the substitution of another company as issuer under any Amended RES in place of the Issuer, in the circumstances described in clauses 11.1 and 13.1 of the Amended RES Terms.

Similarly, if Amended RES are Exchanged for Amended Preference Shares, under the terms of the Amended Preference Shares defined majorities of Preference Shareholders may agree to amendments to the Amended Preference Share Terms which are binding on all Preference Shareholders including holders who did not attend and vote at the relevant meeting and holders who voted in a manner contrary to the majority.

The Amended Preference Share Terms also provide that IAG may, without the consent of Preference Shareholders, amend the Amended Preference Share Terms in circumstances described in clause 9.1 of the Amended Preference Share Terms.

Amended Preference Shares are also subject to the powers of IAG to vary or buy back or return capital on or acquire those Amended Preference Shares under applicable law, including the Corporations Act.

4.4 RISKS ASSOCIATED WITH THE GROUP AND THE GENERAL INSURANCE INDUSTRY

Set out below are risks associated with the Group and the general insurance industry generally. These are relevant to an investment in the existing or amended RES or Preference Shares and in Ordinary Shares as the value of your investment will depend on the financial performance and position of the Group, regardless of when or if the Amended RES are Exchanged into Amended Preference Shares or the Issuer or IAG exercises its right to Convert into Ordinary Shares.

Most of these risks are risks that RES Holders are currently exposed to but they have been updated for current market conditions.

4 INVESTMENT RISKS

4.4.1 Global market and economic environment

The financial performance of the Group is significantly affected by changes in investment markets and economic conditions both globally and in Australia, New Zealand, the United Kingdom and Asia, being the primary jurisdictions in which the Group conducts business. These changes may influence the performance of those businesses, the value of investments supporting Shareholders' Funds and investments held on behalf of customers. Such changes may also influence the availability of credit and the debt funding needs of the Group and its businesses, the level of capital specific to the Group and its regulated entities, the operating margins of the Group and its businesses and the demand for the Group's financial products and services.

Markets are subject to periods of volatility which can have the effect of reducing activity in a range of industry sectors. This can then adversely impact the financial performance and position of the Group. Market volatility may also impact the ability to continue to fund the Group's various businesses in a similar manner, at similar costs and from similar sources.

Since the second half of 2007, global markets, particularly markets in the United States and Europe, have experienced difficult and volatile conditions. These challenging market conditions have resulted in significantly reduced availability of funds, increased volatility, a significant widening of credit spreads, the unavailability of funds in certain markets or for certain industry sectors or specific companies, forced sales of assets and a lack of price transparency in many markets. These conditions have affected the global economy contributing to slower or negative economic growth, increasing unemployment, increasing credit defaults and a generally worsening economic climate.

The financial performance and position of the Group have been and continue to be affected by the changes in general economic conditions in the markets in which it operates. It is also possible that new risks might emerge as a result of markets experiencing extreme stress or existing risks may manifest themselves in ways that are not currently foreseeable.

4.4.2 Investment performance

Investment performance can significantly affect the Group's financial performance and position. The Group's investment portfolio consists of assets, which support:

- Shareholders' Funds; and
- outstanding claims and Unearned Premium liabilities (together also referred to as Technical Reserves).

In early financial year 2009, the Group undertook a review of its investment strategy, which resulted in the following key changes:

- reduced risk and enhanced flexibility and efficiency in the investment portfolios;
- more cost effective active return management; and
- consideration of the new APRA risk capital charges and asset co-mingling rules.

This resulted in the Group reducing the exposure of its Shareholders' Funds to equities. Accordingly, the majority of Shareholders' Funds are invested in fixed interest and cash assets, with just over 20% in Australian and international equities as at 30 June 2009. Technical Reserves are fully invested in fixed interest and cash investments. The level and volatility of investment income derived from equity securities are much greater than the level of volatility experienced with fixed interest and cash investments. The assets backing the Technical Reserves are subject to fluctuations in interest rates.

However, the impact of interest rate movements on the market value of the Group's fixed interest portfolio is largely offset by the corresponding change in the discount rate applied to the Group's outstanding claims reserves. The duration of the assets backing the Group's Technical Reserves is broadly matched to the duration of the underlying claims liabilities.

4.4.3 Foreign exchange exposure

Foreign exchange risk is the risk of the Group sustaining loss through adverse movements in exchange rates. Such losses can impact the Group's financial position and performance and the level of capital supporting the Group's businesses. From an operational perspective, the Group faces exposure to foreign exchange risks through direct foreign income and expenses, the settlement of foreign currency denominated assets and liabilities and the translation of the net investment and earnings of non-Australian subsidiaries. Foreign exchange losses can also impact the Group's investment portfolio, which in turn can affect the Group's reputation, asset values, financial performance and position.

4.4.4 Market position

The Group's business is concentrated in Australia, New Zealand and the United Kingdom, which respectively accounted for 74%, 12% and 12% of reported GWP for the year ended 30 June 2009. This means the Group's performance is largely dependent on the insurance sector performance in these countries. A description of the Group's business operations is provided in Section 3.

Currently, the structure of personal insurance business in Australia and New Zealand is such that the vast bulk of the business is written by a small number of industry participants. The focus of these participants on generating a reasonable return on capital, their well known brands and the benefits of scale in operating costs and data management, together with APRA requirements in Australia designed to ensure prudential levels of capital, reduce the risk of irrational competition. However, should this occur, the Group's leading market shares would make it an obvious target for aggressive competitive action.

Commercial insurance is heavily influenced by the international insurance cycle. The degree of influence is strongest for large corporate business where international capital flows easily in and out of the local market, generally through large brokers. The speed and extent of the cycle decrease with the size of the business being insured. At the current stage of the cycle in Australia, insurers continue to compete aggressively for market share. However, the market is experiencing a slow hardening of rates although this is far from uniform across the market segments.

In New Zealand, which until recently had been in recession for more than a year, poor sentiment and rising unemployment are expected to exert pressure on growth throughout the 2010 financial year and potentially lead to an increase in claims. However, while the market remains competitive in selected areas, most participants are seeking rate increases to counter the reduced profitability which has been felt across the industry.

The United Kingdom's operating environment remains challenging. Whilst the insurance sector has not suffered significant effects from the recession, there are particular concerns around the small business sector and broker credit. While dynamics in the private motor segment continue to be driven by the online aggregators, placing considerable pressure on profitability, the speciality motor classes, where IAG concentrates its operations, continue to trade profitably with signs across all classes of business that rates are rising at levels in excess of claims inflation.

4.4.5 Competition

The Group's position as the second largest general insurer in Australia and New Zealand is an important factor in it being able to achieve strong and scaleable insurance margins. Further industry consolidation could result in other competitors improving their scale, increasing pressure on the Group's ability to maintain its insurance margins.

There is significant competition within the general insurance industry in Australia, New Zealand and the United Kingdom. There is pressure on insurance premium rates arising from legislative developments, or general competitive factors such as new entrants or more aggressive strategies by existing participants to grow market share. These pressures could adversely affect the Group's Underwriting Results, market share and financial performance and position.

4.4.6 Estimation of claims provisions

The Group maintains provisions for unpaid claims and related expenses, which reflect estimates of future claims, inflation trends and other factors. Although the Group seeks to maintain claims provisions at a minimum level of 90% Probability of Sufficiency, the establishment of appropriate provisions is an inherently uncertain process, especially for Long-tail classes of business. There can be no assurance that the Group's current claims provisions will be sufficient.

4.4.7 Reinsurance

The Group enters into a significant number of Reinsurance treaties to limit its risk exposure to any one claim, class of business or occurrence of specific events. There can be no assurance that the Group's current Reinsurance coverage is adequate, that Reinsurance coverage will be available at adequate rates and levels in the future, or that reinsurers will pay valid claims.

There are risks associated with the determination of proper levels of outwards Reinsurance protection, the cost of such Reinsurance and the financial security of reinsurers. There can be no assurance that the Group's current Reinsurance coverage is adequate, that it matches the underlying risks assumed or that increases in Reinsurance costs will be recovered through premium rates.

The Group is also exposed to the risk that its reinsurers default on their obligation to pay valid claims. In addition, the Group may take a considerable period to collect on Reinsurance receivables, and reinsurers may dispute its claims, even if valid. Despite Reinsurance, the Group is primarily liable to policyholders, and so a failure by a reinsurer to make payment, for whatever reason, could adversely affect the Group's financial performance and position.

4.4.8 Catastrophes

General insurers are subject to the risk of large-scale claims arising out of catastrophes, which may have a significant impact on their earnings and financial condition. Catastrophes may include cyclones, earthquakes, wind, hail, floods, fire, volcanic eruptions and explosions, which are inherently unpredictable with regard to incidence and severity. While the Group has historically managed its exposure to catastrophes through, among other things, the purchase of Reinsurance, there can be no assurance that Reinsurance coverage will continue to be available at acceptable rates and levels or that existing coverage will prove adequate.

4.4.9 Changes in government policy, regulation or legislation

The general insurance industry is subject to extensive legislation, regulation and supervision by federal and state regulatory organisations, including APRA. Insurance-specific regulation and supervision are primarily directed to the benefit of policyholders and not RES Holders or Preference Shareholders. Future legislation and regulatory change may affect the general insurance and financial services industry and may adversely affect the Group's financial performance and position.

4.4.10 Operational exposure

Whilst the Group has management and operational risk practices, its profitability will continue to be subject to a variety of strategic and business decisions (including acquisitions/divestments) and operational risks such as: Fraud and other dishonest activities; Management practices; Workplace Safety; Project And Change Management; Compliance; Business Continuity and Crisis Management; Information & Systems Integrity, and; Outsourcing.

4.4.11 Loss of personnel

The Group has a large base of qualified and experienced management personnel. The Group's future success will depend on its continued ability to attract and retain highly-skilled and qualified personnel. There can be no assurance that key personnel will continue to be employed by, or contracted to, the Group or that the Group will be able to attract and retain qualified personnel in the future. Failure to retain or attract key personnel could have a material adverse impact on the Group's business, reputation, financial performance and position.

4.4.12 Mergers and acquisitions

The Group regularly examines a range of corporate opportunities, including mergers and acquisitions. Any of these opportunities which are pursued could, for a variety of reasons, have a material impact on the financial performance and position of the Group.

Any acquisitions may require assimilation of new operations and new personnel and may cause dissipation of the Group's management resources. Changes in ownership and management may result in impairment of relationships with employees and customers of the acquired businesses. Depending on the type of transaction, it could take a substantial period of time for the Group to realise the financial benefits of the transaction, if any. During the period immediately following this type of transaction, the Group's operating results may be adversely affected.

As a potential target in any future merger or acquisition activity, the issues identified above may also be relevant.

The Group's failure to adequately manage the risks associated with any mergers or acquisitions could have a material adverse effect on its financial performance or position.

4.4.13 Litigation

The Group is from time to time involved in legal proceedings relating to policies underwritten by entities in the Group or arising from its operations generally. While there are no material legal proceedings that are current or known to be threatened against the Group, there can be no assurance that the outcome of legal proceedings from time to time will not have a material effect on the Group's business, financial performance or position.

The summary of risks in this Section is not exhaustive and you should read this Explanatory Statement in its entirety and consult your accountant, stockbroker, lawyer or other professional adviser before deciding whether, or how, to vote on the proposed Amendments.