



**INSURANCE AUSTRALIA GROUP LIMITED
HALF YEAR REPORT FOR THE PERIOD ENDED 31 DECEMBER 2018**

APPENDIX 4D (ASX Listing Rule 4.2A)

RESULTS FOR ANNOUNCEMENT TO THE MARKET

	UP / DOWN	% CHANGE	31 December 2018 \$m	31 December 2017* \$m
Revenue from ordinary activities	Up	6.7 %	8,581	8,041
Net profit after tax from ordinary activities attributable to shareholders of the Parent from continuing operations	Down	47.6 %	293	559
Net profit/(loss) after tax from ordinary activities attributable to shareholders of the Parent from discontinued operations	Up	2,687.5 %	207	(8)
Net profit attributable to shareholders of the Parent	Down	9.3 %	500	551

* Prior period comparatives have been re-presented due to the discontinued operations. Refer to Note 2.2 in Attachment A.

DIVIDENDS – ORDINARY SHARES	AMOUNT PER SECURITY	FRANKED AMOUNT PER SECURITY
Interim dividend	12.0 cents	12.0 cents

INTERIM DIVIDEND DATE

Record date	13 February 2019
Payment date	20 March 2019

The Company's Dividend Reinvestment Plan (DRP) will operate by acquiring shares on-market with no discount applied. The last date for the receipt of an election notice for participation in the Company's DRP is 14 February 2019. The DRP Issue Price will be based on a volume-weighted average price for a 10-day trading window from 18 February 2019 to 1 March 2019 inclusive.

Eligible shareholders may now lodge their DRP elections electronically by logging on to IAG's share registry, Computershare, on their website at www.computershare.com.au.

Additional Appendix 4D disclosure requirements can be found in the half year financial report of Insurance Australia Group Limited for the period ended 31 December 2018 (Attachment A). This report is also to be read in conjunction with the annual report of Insurance Australia Group Limited for the year ended 30 June 2018 and any public announcements made by Insurance Australia Group Limited during the reporting period in accordance with the continuous disclosure requirements of the *Corporations Act 2001* and the ASX Listing Rules.

The report is based on the consolidated half year financial statements which have been reviewed by KPMG.

ATTACHMENT A

INSURANCE AUSTRALIA GROUP LIMITED AND SUBSIDIARIES

HALF YEAR REPORT FOR THE PERIOD ENDED 31 DECEMBER 2018

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INSURANCE AUSTRALIA GROUP LIMITED

ABN 60 090 739 923

FINANCIAL REPORT
FOR THE HALF YEAR ENDED 31 DECEMBER 2018

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INSURANCE AUSTRALIA GROUP LIMITED
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DIRECTORS' REPORT

The Directors present their report together with the consolidated financial report of Insurance Australia Group Limited and its subsidiaries for the half year ended 31 December 2018 and the Auditor's Report.

The following terminology is used throughout the financial report:

- Company or Parent – Insurance Australia Group Limited; and
- IAG or Group – the consolidated entity consists of Insurance Australia Group Limited and its subsidiaries.

DIRECTORS OF INSURANCE AUSTRALIA GROUP LIMITED

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

INDEPENDENT NON-EXECUTIVE

Elizabeth B Bryan AM (Chairman)
 Duncan M Boyle
 Hugh A Fletcher
 Sheila C McGregor
 Jonathan (Jon) B Nicholson
 Helen M Nugent AO
 Thomas (Tom) W Pockett
 Michelle K Tredenick
 Philip J Twyman AM – Ceased 26 October 2018

EXECUTIVE

Peter G Harmer (Managing Director and Chief Executive Officer)

PRINCIPAL ACTIVITY

The principal continuing activity of IAG is the underwriting of general insurance and related corporate services and investing activities. IAG reports its financial information under the following business divisions:

DIVISION	OVERVIEW	PRODUCTS
Australia 78% of Group gross written premium (GWP)	<p>This segment is a leading provider of general insurance products to both individuals and businesses in Australia. The Australia division benefits from its access to a variety of distribution channels and an array of well-established brands, as has been summarised below.</p> <p>The Australian business provides consumer insurance products through branches, call centres, the internet and representatives, under the following brands:</p> <ul style="list-style-type: none"> ■ NRMA Insurance in NSW, ACT, Queensland and Tasmania; ■ SGIO in Western Australia; ■ SGIC in South Australia; ■ RACV in Victoria, via a distribution agreement with RACV; ■ Coles Insurance nationally, via a distribution agreement with Coles; and ■ CGU through affinity and financial institution partnerships and broker and agent channels. <p>The division also includes travel insurance, life insurance and income protection products which are underwritten by third parties.</p> <p>Business insurance products are sold through a network of around 2,000 intermediaries, such as brokers, agents and financial institutions and directly through call centre and online channels, under the following brands:</p> <ul style="list-style-type: none"> ■ CGU Insurance; ■ WFI; ■ NRMA Insurance; ■ RACV; ■ SGIO; and ■ SGIC. 	<p>Short-tail insurance</p> <ul style="list-style-type: none"> ■ Motor vehicle ■ Home and contents ■ Lifestyle and leisure, such as boat, veteran and classic car and caravan ■ Business packages ■ Farm and crop ■ Commercial property ■ Construction and engineering ■ Commercial motor and fleet motor ■ Marine <p>Long-tail insurance</p> <ul style="list-style-type: none"> ■ Compulsory Third Party (motor injury liability) ■ Workers' compensation ■ Professional indemnity ■ Directors' and officers' ■ Public and products liability

DIVISION	OVERVIEW	PRODUCTS
New Zealand 22% of Group GWP	The New Zealand business is the leading general insurance provider in the country in both the direct and broker/agent channels. Insurance products are provided directly to customers primarily under the State and AMI brands, and indirectly through insurance brokers and agents, under the NZI and Lumley Insurance brands. Personal products and simplified commercial products are also distributed through agents and under third party brands by corporate partners, which include large financial institutions.	Short-tail insurance <ul style="list-style-type: none"> ■ Motor vehicle ■ Home and contents ■ Commercial property, motor and fleet motor ■ Construction and engineering ■ Niche, such as pleasure craft, boat, caravan and travel ■ Rural and horticultural ■ Marine Long-tail insurance <ul style="list-style-type: none"> ■ Personal liability ■ Commercial liability
Corporate and other	Corporate and other comprises other activities, including corporate services, capital management activity, shareholders' funds investment activities, inward reinsurance from associates, and investment in associates in Malaysia and India.	

OPERATING AND FINANCIAL REVIEW

OPERATING RESULT FOR THE HALF YEAR

IAG's reported insurance margin of 13.7%, was lower than the prior corresponding half year (31 December 2017: 17.9%), primarily reflecting an adverse net natural peril claim cost outcome, which was \$110 million above the related allowance largely driven by the December 2018 Sydney hailstorm event. Lower prior period reserve releases and an adverse credit spread movement also had an impact on the reported insurance margin. IAG's underlying insurance margin improved to 16.2%, compared to 15.4% in the second half of the prior year. This reflected earned premium rate increases and emerging net benefits from IAG's optimisation program, with some offset from higher regulatory and compliance costs.

Overall GWP growth of 4.1% compared to the prior corresponding half year was largely rate-driven, with growth amplified by a favourable foreign exchange translation effect in respect of New Zealand. Overall volumes were relatively flat, however growth was achieved in short-tail motor, New South Wales (NSW) Compulsory Third Party (CTP) and workers' compensation lines. Commercial volumes as a whole shrank, reflecting ongoing remediation activities. Some drag on top line performance was incurred from NSW CTP scheme reform effects, as well as the absence of ceased or exited business activities, including retail warranty and consumer credit.

On 19 June 2018, IAG announced it had entered into sale agreements covering its consolidated operations in Thailand, Indonesia and Vietnam. The post-tax contribution from these operations has been aggregated in a single line item within the Statement of Comprehensive Income ('Profit/loss after income tax from discontinued operations'). The combined profit from discontinued operations (excluding non-controlling interests) was \$207 million (31 December 2017: \$8 million loss). The profit in the current half year includes a gain of \$208 million on the sale of Thailand, which was completed at the end of August 2018. It remains IAG's expectation that the agreed sales of Indonesia and Vietnam will complete before the conclusion of the 2019 financial year. Options for the Group's remaining interests in Asia (principally Malaysia and India) continue to be assessed.

On 15 August 2018, IAG announced a \$592 million capital management initiative of 25 cents per ordinary share which was completed on 26 November 2018 following shareholder approval. It comprised a capital return of 19.5 cents, a fully franked special dividend of 5.5 cents, and a share consolidation, equal and proportionate to the capital return, which reduced IAG's ordinary shares on issue by approximately 2.4%. The capital management initiative acknowledged IAG's surplus capital position to regulatory benchmarks, including cumulative quota share effects, as well as the absence of significant operational demands on its capital and the sale of the Thailand business.

Net profit after tax

The Group's profit after tax for the half year was \$525 million (31 December 2017: \$569 million). After adjusting for non-controlling interests in the Group result, net profit attributable to the shareholders of the Company was \$500 million (31 December 2017: \$551 million) and was 9.3% lower than the prior corresponding half year. This outcome included the net effect of:

- a 33% decrease in pre-tax insurance profit to \$496 million (31 December 2017: \$745 million), with adverse peril, reserve release and credit spread movements, totalling \$262 million, masking the improvement in underlying performance;
- an adverse turnaround of over \$130 million pre-tax in investment income on shareholders' funds, largely reflecting weak Australian and global equity markets;
- a substantial increase in input from discontinued operations, owing to the inclusion of a gain of \$208 million on the sale of the Thailand operations, which was completed at the end of August 2018; and
- a \$36 million reduction in amortisation and impairment expense, reflecting the absence of the impairment to certain Asian assets recognised in the first half of the prior year.

Gross written premium

Total GWP of \$5,881 million (31 December 2017: \$5,649 million) represented a 4.1% increase compared to the prior corresponding half year. This increase encompassed:

- growth of 3.4% in Australia (to \$4,606 million); and
- growth of 6.6% in New Zealand (to \$1,268 million), aided by a favourable foreign exchange translation effect of over 100bps.

Insurance margin

IAG's current half year reported insurance profit of \$496 million (31 December 2017: \$745 million) was 33% lower than the prior corresponding half year. The resultant reported insurance margin was 13.7% (31 December 2017: 17.9%). Contributing to this outcome were:

- approximately 250bps of uplift from the 12.5% quota share agreements which commenced on 1 January 2018;
- \$414 million (31 December 2017: \$262 million) of net claim costs arising from natural peril events, which exceeded the period's allowance by \$110 million and was in line with the range indicated in IAG's perils update issued on 21 December 2018. This contrasted with a favourable outcome against allowance of \$77 million in the prior corresponding half year, and in isolation this movement reduced the reported insurance margin by over 500bps;
- lower net prior period reserve releases of \$83 million (31 December 2017: \$122 million), which were broadly in line with expectations and which represented 2.3% of Net Earned Premium (NEP) compared to 2.9% in the prior corresponding half year; and
- an unfavourable swing in credit spread impact of over \$70 million, with an adverse effect of \$24 million in the current half year contrasting with a favourable impact of \$47 million in the prior corresponding half year.

Underlying margin

IAG's underlying insurance margin of 16.2% (31 December 2017: 13.0%), also included approximately 250bps of uplift from the 12.5% quota share agreements, compared to the prior corresponding half year. Short-tail personal lines' profitability has remained strong, as earned rate increases at least match ongoing increases in average claim costs. Further improvement in commercial lines' profitability has been recorded, as rate and remediation activity was complemented by subsiding large loss experience in Australian property classes, back to more normal levels. Long-tail CTP profitability was lower than the prior corresponding half year, reflecting the capped profitability of the new scheme in NSW.

Across IAG, the business is beginning to increasingly benefit from the outcomes of the group-wide optimisation program, as related one-off costs dissipate. While reported gross underwriting expenses increased during the period, this was driven by increases in levies, particularly the Excess Profit or Loss Adjustment (TEPLA) associated with the capped profitability of the new CTP scheme in NSW. A net reduction in gross operating costs (excluding commission and levies) of around \$40 million, spread across the underwriting expense, claims expense and fee-based business lines, was realised in the current half year. This is measured relative to the Group's 2016 financial year gross operating cost position, which formed the basis for the optimisation program targets. The majority of the reduction attaches to the insurance profit. A countervailing force was increased regulatory and compliance costs, which are expected to be an ongoing feature of future periods. In the current half year an approximately \$15 million increase in regulatory and compliance costs was incurred compared to the prior corresponding half year, including those stemming from the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry and the APRA-requested risk governance self-assessment.

IAG defines its underlying margin as the reported insurance margin adjusted for:

- net natural peril claim costs less the related allowance for the period;
- reserve releases in excess of 1% of NEP; and
- credit spread movements.

	31 December 2018		31 December 2017*	
	\$m	%	\$m	%
INSURANCE MARGIN				
Reported insurance margin*	496	13.7	745	17.9
Net natural peril claim costs in excess of/(below) allowance	110	3.1	(77)	(1.8)
Reserve releases in excess of 1% of NEP	(47)	(1.3)	(80)	(2.0)
Credit spread movements	24	0.7	(47)	(1.1)
Underlying insurance margin	<u>583</u>	<u>16.2</u>	<u>541</u>	<u>13.0</u>

* Reported insurance margin is the insurance profit as a percentage of NEP as disclosed in the Statement of Comprehensive Income. Prior period comparatives have been re-presented due to the discontinued operations.

Tax expense

IAG reported a tax expense of \$123 million in the current half year compared to \$211 million in the prior corresponding half year, representing an effective tax rate of 27.9% (31 December 2017: 26.7%).

Contributory elements reconciling the current half year's effective tax rate to the Australian corporate rate of 30% are:

- differences in tax rates applicable to IAG's foreign operations, principally in New Zealand, Singapore and Malaysia; and
- franking credits generated from IAG's investment portfolio.

Investment income on shareholders' funds

Net investment income on shareholders' funds was a loss of \$7 million, compared to a profit of \$129 million in the prior corresponding half year. This decline embraced:

- negative returns from equity markets, notably in the second quarter;
- some mitigation from a portfolio bias towards defensive stocks within international equities; and
- a positive return from alternative investments.

In the current half year, the broader Australian index (S&P ASX200 Accumulation) delivered a negative return of 6.8% (31 December 2017: +8.4%) and the MSCI World Total Return Index (AUD Hedged) contracted by 8.7% (31 December 2017: +10.0%).

At 31 December 2018, the weighting to defensive assets (fixed interest and cash) within shareholders' funds was 52%, compared to 57% at the end of the prior financial year.

DIVISIONAL HIGHLIGHTS

A. AUSTRALIA

Australia accounted for 78% of Group GWP with a lower reported insurance margin of 10.7% (31 December 2017: 18.8%) after adverse peril and credit spread movements, and reduced reserve releases. Australia's underlying performance remained sound, with an underlying insurance margin of 14.8% (31 December 2017: 11.4%).

I. Premiums

Australia reported GWP of \$4,606 million (31 December 2017: \$4,453 million) in the current half year, an increase of 3.4%. The overall Australian GWP outcome includes:

- largely rate-driven growth in short-tail motor, broadly in line with claims inflation pressures;
- home GWP growth of nearly 4%;
- ongoing average rate momentum of approximately 6% in commercial lines, with some offset from lower volumes;
- an approximately \$25 million reduction from exiting smaller business areas, such as consumer credit and retail warranty; and
- modestly lower CTP GWP, where NSW post-scheme reform effects were countered by volume gains.

II. Insurance profit

Australia reported an insurance profit of \$304 million, compared to \$625 million in the prior corresponding half year. This equates to a lower reported insurance margin of 10.7%, compared to the 18.8% attained in the prior corresponding half year. This outcome includes the net effect of:

- lower prior period reserve releases;
- significantly higher net natural peril claim costs; and
- an unfavourable swing in credit spread impact of over \$70 million; partially offset by
- an approximately 250bps uplift from the combined 12.5% quota shares which took effect from 1 January 2018.

III. Underlying margin

Australia's underlying performance remained sound, with an underlying insurance margin of 14.8% (31 December 2017: 11.4%).

In addition to the favourable quota share impact, contributory factors to the overall improvement were:

- an easing of pressure on motor profitability, as higher earned rates offset increased claim costs;
- further flow-through of average rate increases across commercial portfolios;
- lower large loss levels in the commercial property portfolio;
- some offset from lower current year profitability in NSW CTP, owing to the capped profitability of the new scheme; and
- emerging benefits from the optimisation program.

IV. Fee-based business

The principal source of fee income is IAG's role as agent under the Victorian workers' compensation scheme, which is underwritten by the state government. This financial year is the third year of a five-year contract term.

IAG withdrew from the NSW workers' compensation scheme as at 31 December 2017 after assessment of associated risks and returns. Some minor run-off expense was incurred in the current half year.

Fee and other income was \$67 million (31 December 2017: \$94 million) with the reduction in the period driven by loss of fee income associated with withdrawal from the NSW workers' compensation scheme. Total net income from fee-based operations in the current half year was a profit of \$9 million, compared to \$5 million in the prior corresponding half year.

A secondary source of fee income has been the division's interest in authorised representative brokers, Community Broker Network. IAG disposed of its interest in this business with effect from early October 2018.

B. NEW ZEALAND

New Zealand accounted for 22% of Group GWP and produced a higher reported insurance margin of 24.9% (31 December 2017: 14.2%) and a higher underlying insurance margin of 20.0% (31 December 2017: 17.4%).

I. Premiums

New Zealand's reported current half year GWP rose by 6.6% to \$1,268 million, compared to the prior corresponding half year GWP of \$1,190 million. This increase includes a favourable foreign exchange translation effect, with local currency GWP increasing by 5.5% in the current half year, to NZ\$1,371 million (31 December 2017: NZ\$1,299 million). This result encompassed:

- sustained GWP growth in Consumer products, led by the private motor vehicle and home portfolios, driven largely by higher rates; and
- solid GWP growth in Business products, as rate increases in both commercial and personal lines were partially offset by some volume loss as the business maintained its strong underwriting disciplines.

II. Insurance profit

The New Zealand business produced a significantly higher insurance profit of \$193 million in the current half year, compared to \$119 million in the prior corresponding half year. This equates to a reported insurance margin of 24.9% (31 December 2017: 14.2%) with the improvement reflecting a combination of:

- the impact from the combined 12.5% quota shares which took effect from 1 January 2018, adding approximately 250bps to the current half year margin;
- an increase in gross earned premium, driven by cumulative GWP growth in both Consumer and Business products;
- an absence of prior period reserve strengthening;
- a reduction in large claims compared with the prior corresponding half year; and
- emerging net benefits from optimisation activities.

Negligible prior period reserve releases occurred in the current half year, a significant difference to the prior corresponding half year which saw over \$50 million of reserve strengthening owing to the adverse development of prior year storm events and an allowance for potential claims under architect/engineer professional indemnity policies relating to residual risk (e.g. negligence) from post-earthquake building damage and rebuild activity.

III. Earthquake settlements

Steady progress continues to be made with the settlement of claims associated with the financial year 2011 Canterbury earthquake events. At 31 December 2018, nearly NZ\$6.8 billion of claim settlements had been completed, and fewer than 1,200 claims remained open out of more than 90,000 received.

During the current half year there was no change to IAG's gross reserved position on the three major earthquakes in financial year 2011, with considerable legacy reinsurance protection available for the September 2010 and June 2011 events, and approximately NZ\$540 million of adverse development cover available for the February 2011 event.

Outstanding Canterbury earthquake claims include those subject to dispute and litigation or involving high customer utilisation of independent expert advice, as well as recently-received over-cap claims from the Earthquake Commission (EQC). It remains IAG's expectation that finalisation of all residual claims will take several years given associated complexity.

The settlement of claims associated with the November 2016 Kaikoura earthquake is well-advanced. As at 31 December 2018, 96.7% of all claims by number had been fully settled, and all residential dwelling assessments were complete.

C. CORPORATE AND OTHER

A pre-tax loss of \$66 million was reported, which compares to a profit of \$38 million in the prior corresponding half year. The movement primarily reflects the reduction in net investment income on shareholders' funds of \$136 million in the current half year, partially offset by the absence of any write-down of Asian assets in the current half year. Following the classification of IAG's consolidated businesses in Thailand, Vietnam and Indonesia as discontinued operations in the second half of the prior year, the interests in Malaysia and India which continue to be treated as associates have been reclassified to the Corporate and other segment. Further details on the operating segments are set out in Note 1.3 within the financial statements.

I. Share of net profit/(loss) of associates

The Group's share of net profit of associates was a profit of \$18 million (31 December 2017: \$18 million), including allocated regional development costs and amortisation. This result is largely derived from IAG's interests in AmGeneral Holdings Berhad (AmGeneral) in Malaysia and SBI General Insurance Company Limited (SBI General) in India. IAG continues to assess future options for these Asian assets.

IAG's share of AmGeneral's profit for the current half year increased to \$17 million (31 December 2017: \$13 million). The positive outcome comprised the net effect of:

- the benefit of continued pricing actions and portfolio management;
- higher bodily injury-related prior period reserve releases; and
- higher investment returns.

IAG's share of SBI General's profit for the current half year increased to \$13 million (31 December 2017: \$11 million). This improved outcome comprised the net effect of:

- a favourable effect from exchange commission recognition in the long-term home portfolio;
- higher investment income; partially offset by
- higher seasonal losses, primarily from the Kerala floods.

REVIEW OF FINANCIAL CONDITION

A. FINANCIAL POSITION

The total assets of the Group as at 31 December 2018 were \$28,766 million compared to \$29,766 million as at 30 June 2018.

Movements within the overall net decrease in assets of \$1,000 million include:

- a decrease in investments of \$402 million associated with funds outflow for the payments of the 2018 final dividend of \$473 million, \$592 million capital management initiative, and net settlements of the whole-of-account quota share arrangements, partially offset by \$506 million of net consideration received from the sale of IAG's operations in Thailand and operating earnings for the half year;
- a \$592 million decrease in assets held for sale, predominantly related to the completion of the sale of the Thailand operations, which was completed at the end of August 2018;
- a \$174 million decrease in trade and other receivables associated with a \$71 million decrease in premiums receivable primarily due to the seasonality of renewals in the commercial business, a \$69 million reduction in unsettled investment transactions and a \$52 million decrease largely due to reduction in fees and commissions receivable following the sale of Australia division's interest in authorised representative brokers, Community Broker Network; offset by
- an increase of \$47 million in reinsurance and other recoveries on outstanding claims primarily relating to the continued run-on of whole-of-account quota share arrangements and recoveries in relation to current half year period natural peril events, offset by receipt of recoveries on prior period events; and
- a \$162 million increase in deferred insurance expenses associated with the catastrophe reinsurance cover renewal for the 2019 calendar year.

The total liabilities of the Group as at 31 December 2018 were \$22,425 million compared with \$22,825 million as at 30 June 2018. Movements within the overall net decrease in liabilities of \$400 million include:

- a \$417 million decrease in liabilities held for sale predominantly related to the completion of the sale of IAG's interest in the operations in Thailand;
- a \$120 million reduction in current tax liabilities from the final settlement of the liability relating to the 2018 financial year, with the Group now being in a current tax asset position resulting from a higher monthly instalments paid for the 2019 financial year compared to the current tax expense;
- a decrease in outstanding claims liability of \$58 million primarily due to reduction in long-tail reserves driven by prior year reserve releases, settlement of prior period natural peril events, including the Canterbury and Kaikoura earthquakes, offset by an increase in reserves for current period natural peril events; offset by
- an increase in trade and other payables of \$243 million primarily due to premiums payable on the catastrophe reinsurance cover which was renewed on 1 January 2019.

IAG shareholders' equity (excluding non-controlling interests) decreased from \$6,669 million as at 30 June 2018 to \$6,110 million as at 31 December 2018, reflecting the combined effect of:

- current year net profit attributable to shareholders of \$500 million, which is predominantly comprised of a \$293 million profit from continuing operations and a \$208 million gain from the divestment of the Thailand operations; and
- payments totalling \$1,065 million in respect of the 2018 final dividend, capital return and special dividend.

B. CASH FROM OPERATIONS

The net cash inflows from operating activities for the half year ended 31 December 2018 were \$365 million compared with \$23 million for the prior corresponding half year. The movement is mainly attributable to the net effect of:

- an increase in outwards reinsurance premium expense paid of \$690 million, predominantly related to payments made on the combined 12.5% quota share agreements, partially offset by reductions in payments on the catastrophe reinsurance covers due to reduced placements following the increase in the share ceded through the combined quota share agreements;
- an increase in reinsurance and other recoveries received of \$140 million, predominantly relating to the continued run-on of whole-of-account reinsurance quota share arrangements;
- a decrease in claim costs paid of \$287 million, predominantly pertaining to lower payments on the Canterbury and Kaikoura earthquakes, and lower payments relating to natural peril events in Australia, partially offset by the payments on prior year large losses; and
- an increase in other operating amounts of \$438 million, including reinsurance commissions received in respect of the combined 12.5% quota share agreements.

C. INVESTMENTS

The Group's investments totalled \$10,605 million as at 31 December 2018, excluding investments held in joint venture and associates, with over 57% represented by the technical reserves portfolio. Total investments at 30 June 2018 were \$11,007 million. The decrease in total investments since 30 June 2018 reflects the combined effect of:

- a \$149 million reduction in technical reserves, in response to further quota share and prior period reserve release effects; and
- a \$253 million decrease in shareholders' funds, reflecting the net effect of the \$592 million capital management initiative, payment of the final dividend of \$473 million, net receipt of \$506 million of sale proceeds from the divestment of the Thailand operations, and operating earnings during the period.

IAG's overall investment allocation is conservatively positioned, with nearly 80% of total investments in fixed interest and cash as at 31 December 2018. Technical reserves were 100% invested in fixed interest and cash, while the equivalent figure for shareholders' funds was 52%. IAG's allocation to growth assets was 48% of shareholders' funds at 31 December 2018, compared to 43% at 30 June 2018.

D. INTEREST-BEARING LIABILITIES

IAG's interest-bearing liabilities stood at \$1,976 million at 31 December 2018, compared to \$1,960 million at 30 June 2018. The small net movement in the period largely reflects foreign exchange translation effects.

E. CAPITAL MIX

IAG measures its capital mix on a net tangible equity basis, i.e. after deduction of goodwill and intangibles, giving it strong alignment with regulatory and rating agency models. IAG targets the following ranges:

- ordinary equity (net of goodwill and intangibles) 60-70%; and
- debt and hybrids 30-40%.

At 31 December 2018, debt and hybrids represented 38.4% (30 June 2018: 34.3%) of total tangible capitalisation, towards the upper end of IAG's targeted range. The increase since the prior financial year reflects the impact of the equity capital management initiative conducted in November 2018.

IAG intends to redeem \$350 million of subordinated notes on their first issuer call date of 19 March 2019. This will be financed via the funds raised through the similar-sized subordinated note issue in March 2018. In addition, the \$550 million Reset Exchangeable Securities (RES) issue has a reset date in December 2019, after which it ceases to be eligible for regulatory capital purposes. Subject to market conditions, IAG may seek to issue a new Tier 2 instrument prior to 30 June 2019 to assist in refinancing the RES.

F. CAPITAL POSITION

IAG remains strongly capitalised under the Australian Prudential Regulatory Authority's (APRA) Prudential Standards, with regulatory capital of \$4,659 million at 31 December 2018 (30 June 2018: \$5,018 million). IAG has set the following related targeted benchmarks:

- a total capital position equivalent to 1.4 to 1.6 times the Prescribed Capital Amount (PCA), compared to a regulatory requirement of 1.0 times; and
- a Common Equity Tier 1 (CET1) target range of 0.9 to 1.1 times the PCA, compared to a regulatory requirement of 0.6 times.

At 31 December 2018, IAG had a PCA multiple of 2.00 (30 June 2018: 2.03) and a CET1 multiple of 1.18 (30 June 2018: 1.26). The reduction in the CET1 multiple since 30 June 2018 reflects the various capital management initiatives totalling approximately \$1.1 billion, including the 2018 final dividend (\$473 million), capital return (\$462 million) and special dividend (\$130 million). These effects were partially offset by the profit for the period of \$500 million, which includes \$208 million gain from the sale of the Thailand business.

STRATEGY AND RISK MANAGEMENT
A. STRATEGY



At IAG, our purpose is to make your world a safer place: IAG's purpose means that whether you are a customer, partner, employee, shareholder or part of the communities IAG serves, IAG exists to 'make your world a safer place'. IAG believes its purpose will enable it to become a more sustainable business over the long term, and deliver stronger and more consistent returns for its shareholders.

IAG's strategy is to optimise its core insurance business while creating future growth options.

Financial targets

IAG is focused on delivering through-the-cycle targets of:

- cash return on equity (ROE) 1.5 times weighted average cost of capital (WACC);
- a dividend payout of 60-80% of full year cash earnings;
- top quartile total shareholder return (TSR); and
- approximately 10% compound earnings per share (EPS) growth.

Strategic priorities

IAG has identified three key strategic priorities, supported by organisational capabilities, to deliver the strategy:

I. Customer – world-leading customer experiences:

- Create a delivery platform that transforms customer experiences;
- Better connect customers and automate processes enabling IAG to reach more customers in a timely manner;
- Develop an innovation approach which provides the ability to think differently and deliver quickly;
- Embed cognitive capabilities and artificial intelligence (AI) that anticipate customers' needs; and
- Use data to power decision making, allowing IAG to better understand its customers.

II. Simplification – simplified, modular and lower cost operating model:

- Reduce organisational complexity by consolidating technology platforms, harmonising products, simplifying processes and systems, and executing the technology strategy;
- Leverage operational partners to optimise the operating model and drive scale economies across the value chain; and
- Improve allocation and maximise utilisation of the preferred repairer network to reduce average claim size.

III. Agility – an agile organisation distinguished by innovation, speed and execution skills:

- Create a disciplined approach to IAG's management and leadership, including building stronger role clarity and introducing agile ways of working;
- Build a talent pipeline based on the skills required to deliver IAG's strategy and help IAG people transition to the future of work; and
- Be recognised as a purpose-led organisation that shapes its internal and external environment.

IAG's recent strategic investment has been focused on building a lean, efficient and modular insurance operation, through its simplification priority. It has also invested in creating a customer-focused organisation and building capabilities in data, digital, analytics and AI, brand and innovation, while making considerable progress towards creating an agile organisation. IAG will continue developing these programs of work in 2019.

Over the course of 2019, IAG will extend its strategic partnerships to offer products and services that are adjacent to its insurance business, enabling IAG to make its customers and the community feel safer on the road, in their homes and at work. IAG will leverage its assets – including its data, customer reach and brands – to launch and scale new digital businesses in markets that complement these adjacent products and services.

The goals of IAG's strategy are centred around building deeper engagement with its customers and growing the number of customers in the IAG network of brands. IAG seeks to create more value for its customers by making their world a safer place and to increase the lifetime value of its customer relationships.

B. BUSINESS RISK AND RISK MANAGEMENT

IAG acknowledges that it has to take risk in an informed manner in pursuit of its strategic objectives and to meet customer, stakeholder, industry and regulatory expectations. IAG clearly articulates the levels, boundaries and nature of risk IAG is willing to accept, actively manage or avoid in pursuit of IAG's strategic objectives.

IAG uses an enterprise approach to risk and its risk management framework is a core part of the governance structure, which includes internal policies, key management processes and culture. The Group Risk Management Strategy (RMS) details the IAG principles, risk appetite, policies, key controls, monitoring and governance processes for managing key risk. The RMS is reviewed annually, or as required by the Risk Committee, before being recommended for approval by the Board. IAG's Group Risk function provides regular reports to the Risk Committee on the operation of and any changes to IAG's risk management framework, the status of material risks, risk and compliance incidents, risk trends and IAG's risk profile. IAG's Internal Audit function provides reports to the Audit Committee on significant audit findings and other audit related matters.

Roles and responsibilities of the Board and its standing committees, the Audit Committee, the Risk Committee, the People and Remuneration Committee and the Nomination Committee, are set out in the Corporate Governance section of the IAG website.

IAG is exposed to multiple risks relating to its general insurance business. The risks noted below are not meant to represent an exhaustive list, but outline those risks faced by IAG that have been identified in IAG's RMS:

- strategic risk – the risk of not achieving corporate or strategic goals due to poor business decisions regarding future business plans and strategies, failing to meet customer expectations and/or a lack of responsiveness to changes in the business environment;
- insurance risk – the risk of loss as a result of inadequate or inappropriate underwriting; product design and pricing; reserving including unforeseen, unknown or unintended liabilities that may eventuate; claims management; and insurance concentration risk (e.g. by locality, segment, or distribution channel);
- reinsurance risk – the risk of loss as a result of insufficient or inappropriate reinsurance coverage, inadequate underwriting and/or pricing of reinsurance exposures retained, inadequate or inappropriate reinsurance recovery management, reinsurance arrangements not being legally binding, reinsurance concentration risk and credit counterparty concentration risk to reinsurers;
- financial risk – the risk of adverse movements in market prices (foreign exchange, equities, credit spreads, interest rates, etc) or inappropriate concentration within the investment funds, a counterparty failing to meet its obligations (credit risk), inadequate liquidity or inappropriate capital management;
- operational risk – the risk of loss resulting from inadequate or failed internal processes, people and/or systems or from external events; and
- regulatory risk and compliance – the failure or inability to comply with applicable laws, regulations or codes excluding failure of staff to adhere to internal policies/procedures and meeting contractual obligations.

A disciplined approach to risk management has been adopted and IAG believes this approach provides the greatest long-term likelihood of being able to meet the objectives of all stakeholders, including policyholders, lenders, regulators and shareholders.

IAG's purpose is to make your world a safer place and the Group is committed to managing the risks and opportunities from Environmental, Social and Governance issues. IAG's access to natural peril data, combined with its research, gives a unique insight into the impact extreme weather events have on the community and its business. IAG has long recognised that it needs to play a role in climate change adaptation as well as reducing the emissions that are driving it. IAG has developed a three-year Climate Action Plan to do both these things, with the Plan being publicly launched in July 2018. Reducing carbon emissions is increasingly urgent to avoid the potential impact of catastrophic climate change and the attendant longer term commercial impacts. To manage its impact, IAG has announced Science Based Emission targets. IAG is also committed to continuing to enhance its understanding of climate risk and has commenced disclosure consistent with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), which embrace: governance; strategy; risk management; and metrics and targets. Expanded TCFD disclosure will be provided by the conclusion of the 2019 financial year. This will be informed by IAG's participation in the global UNEP FI-led pilot, which commenced in August 2018. Such disclosure will consider the most appropriate analysis of the physical and transitional risks faced by IAG in various global warming scenarios, and material potential financial implications for the Group.

Detail of IAG's overall risk management framework, which is outlined in the RMS, is set out in Note 3.1 within the 30 June 2018 Annual Report and in the Corporate Governance Statement, which is available at www.iag.com.au/about-us/corporate-governance.

OUTLOOK

IAG's GWP growth guidance for the current financial year has been maintained at 2-4%. Ongoing growth is expected in the second half of the current financial year, but at a slightly more subdued pace than that seen in the current half year. Contributory factors are expected to be:

- further rate increases across short-tail personal and commercial classes;
- modest volume increases in personal line categories, notably motor;
- further decline in commercial volumes, including those from ongoing remediation activity;
- lower NSW CTP rates, following a planned rate reduction of 3.6% from March 2019; and
- lower growth in workers' compensation GWP, after the unexpectedly large increase in the current half year on wage and rate factors.

IAG has reaffirmed its reported insurance margin guidance range for the year ended 30 June 2019 of 16.0-18.0%. This follows the improvement in underlying insurance margin in the current half year, and includes the absorption of an anticipated full year increase in regulatory and compliance costs of around \$20 million (pre-quota share) compared to the prior financial year.

All other margin-related assumptions are unchanged and comprise:

- a net improvement in pre-tax profit of approximately \$100 million from optimisation program initiatives, as implementation costs dissipate;
- net losses from natural perils in line with allowance of \$608 million, taking into account \$101 million of protection from the financial year-based stop-loss reinsurance cover which is available immediately above \$608 million;
- prior period reserve releases of around 2% of NEP; and
- no material movement in foreign exchange rates or investment markets in the second half of the current financial year.

DIVIDENDS

Details of dividends paid or determined to be paid by the Company and the dividend policy employed by the Group are set out in Note 2.4 within the financial statements.

Cash earnings are used for the purposes of targeted ROE and dividend payout policy and are defined as:

- net profit after tax attributable to shareholders of the Parent;
- plus amortisation and impairment of acquired identifiable intangibles; and
- excluding any unusual items (non-recurring in nature).

	31 December 2018	31 December 2017
	\$m	\$m
CASH EARNINGS		
Net profit after tax	500	551
Acquired intangible amortisation and impairment	29	79
	529	630
Non-recurring items:		
Corporate expenses ⁽¹⁾	(5)	-
Tax effect on corporate expenses	(1)	-
Gain on sale of Thailand	(208)	-
Loss of diversification benefit on sale of Thailand	4	-
Cash earnings ⁽²⁾	319	630
Interim dividend	277	331
Cash payout ratio ⁽²⁾	86.8%	52.5%

(1) Corporate expenses in the current half year amounted to a profit of \$5 million. The main contributory factor was the profit on sale of Australia's interest in authorised representative brokers, Community Broker Network. This was sold with effect from early October 2018.

(2) Cash earnings and cash payout ratio represent non-IFRS financial information.

IAG's full year dividend payout policy is to pay dividends equivalent to approximately 60-80% of reported full year cash earnings in respect of any given financial year.

The Board has determined to pay an interim fully franked dividend of 12.0 cents per ordinary share (cps) (31 December 2017: 14.0 cps). The interim dividend is payable on 20 March 2019 to shareholders registered as at 5pm Australian Eastern Daylight Time (AEDT) on 13 February 2019.

During the current half year IAG paid a special dividend of 5.5 cents per share as part of the capital management initiative announced in August 2018 and approved by shareholders at the AGM on 26 October 2018. Payment occurred on 26 November 2018.

As at 31 December 2018, and after allowance for payment of the interim dividend, IAG's franking balance was \$42 million, giving it the capacity to fully frank a further \$99 million of distributions. IAG's franking balance includes its 70% entitlement to franking held by Insurance Manufacturers of Australia Pty Limited.

IAG's franking credit balance has reduced in recent years, owing to past capital management measures and the move to a higher dividend payout policy. As originally indicated in August 2018, it is IAG's expectation that it may not be in a position to fully frank distributions on its securities from the second half of calendar 2019 onwards, with franking from that date expected to be in the range of 70% to 100%.

The dividend reinvestment plan (DRP) will operate for the interim dividend for shareholders registered for the DRP as at 5pm AEDT on 14 February 2019. The issue price per share will be the Average Market Price as defined in the DRP terms with no discount for participants. Shares allocated under the DRP are purchased on-market. Information about IAG's DRP is available at <http://www.iag.com.au/shareholder-centre/dividends/reinvestment>.

SIGNIFICANT CHANGES IN STATE OF AFFAIRS

During the half year, the following changes became effective:

- On 26 November 2018, IAG completed its capital management initiative amounting to 25.0 cents per ordinary share, or \$592 million, which comprised a 19.5 cents capital return and a 5.5 cents fully franked special dividend, alongside a share consolidation that reduced the Company's ordinary issued shares by 2.4%.
- On 31 August 2018, IAG completed the sale of its Thailand operations for a consideration of \$515 million, which resulted in the recognition of a gain of \$208 million, net of tax.

EVENTS SUBSEQUENT TO REPORTING DATE

Detail of matters subsequent to the end of the half year are set out below and in Note 3.7 within the financial statements. These include:

- The Board determined to pay an interim dividend of 12.0 cents per share, 100% franked. The dividend will be paid on 20 March 2019. The dividend reinvestment plan will operate by acquiring shares on market for participants with no discount applied.

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

The lead auditor's independence declaration is set out on page 12 and forms part of the Directors' Report for the half year ended 31 December 2018.

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 ASIC Corporations Instrument 2016/191 dated 24 March 2016 issued by the Australian Securities & Investments Commission. All rounding has been conducted in accordance with that instrument.

Signed at Sydney this 6th day of February 2019 in accordance with a resolution of the Directors.



Peter Harmer
Director

LEAD AUDITOR'S INDEPENDENCE DECLARATION

UNDER SECTION 307C OF THE CORPORATIONS ACT 2001

TO THE DIRECTORS OF INSURANCE AUSTRALIA GROUP LIMITED

I declare that, to the best of my knowledge and belief, in relation to the review of Insurance Australia Group Limited for the half year ended 31 December 2018 there have been:

- no contraventions of the auditor independence requirements as set out in the *Corporations Act 2001* in relation to the review; and
- no contraventions of any applicable code of professional conduct in relation to the review.

KPMG

KPMG



Andrew Yates
Partner

Sydney
6 February 2019

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KPMG, an Australian partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. Liability limited by a scheme approved under Professional Standards Legislation.

CONSOLIDATED FINANCIAL STATEMENTS

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CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

FOR THE HALF YEAR ENDED 31 DECEMBER 2018

	NOTE	31 December 2018 \$m	31 December 2017* \$m
Gross earned premium		5,984	5,780
Outwards reinsurance premium expense		(2,373)	(1,613)
Net earned premium (i)		3,611	4,167
Claims expense		(4,183)	(4,039)
Reinsurance and other recoveries revenue		1,825	1,534
Net claims expense (ii)		(2,358)	(2,505)
Commission expense		(487)	(491)
Underwriting expense		(945)	(893)
Reinsurance commission revenue		573	344
Net underwriting expense (iii)		(859)	(1,040)
Underwriting profit (i) + (ii) + (iii)		394	622
Investment income on assets backing insurance liabilities		111	133
Investment expenses on assets backing insurance liabilities		(9)	(10)
Insurance profit		496	745
Investment income on shareholders' funds		3	138
Fee and other income		67	94
Share of net profit of associates		18	18
Finance costs		(48)	(39)
Fee-based, corporate and other expenses		(92)	(166)
Net loss attributable to non-controlling interests in unitholders' funds		(3)	(1)
Profit before income tax from continuing operations		441	789
Income tax expense		(123)	(211)
Profit after income tax from continuing operations		318	578
Profit/(loss) after income tax from discontinued operations	2.2	207	(9)
Profit for the period		525	569
OTHER COMPREHENSIVE INCOME/(EXPENSE)			
Items that may be reclassified subsequently to profit or loss:			
Net movement in foreign currency translation reserve, net of tax		36	(28)
Items that will not be reclassified to profit or loss:			
Remeasurements of defined benefit plans, net of tax		(7)	(2)
Other comprehensive income/(expense) from continuing operations, net of tax		29	(30)
Other comprehensive income/(expense) from discontinued operations, net of tax	2.2	20	(1)
Total comprehensive income for the period, net of tax		574	538
PROFIT/(LOSS) FOR THE PERIOD ATTRIBUTABLE TO			
Shareholders of the Parent - continuing operations		293	559
Shareholders of the Parent - discontinued operations	2.2	207	(8)
Non-controlling interests - continuing operations		25	19
Non-controlling interests - discontinued operations	2.2	-	(1)
Profit for the period		525	569
TOTAL COMPREHENSIVE INCOME/(LOSS) FOR THE PERIOD ATTRIBUTABLE TO			
Shareholders of the Parent - continuing operations		322	529
Shareholders of the Parent - discontinued operations	2.2	227	(9)
Non-controlling interests - continuing operations		25	19
Non-controlling interests - discontinued operations	2.2	-	(1)
Total comprehensive income for the period, net of tax		574	538

* Prior period comparatives have been re-presented due to the discontinued operations. Refer to Note 2.2.

STATEMENT OF COMPREHENSIVE INCOME (CONTINUED)

	NOTE	31 December 2018 cents	31 December 2017* cents
EARNINGS PER SHARE – CONTINUING AND DISCONTINUED OPERATIONS			
Basic earnings per ordinary share	3.3	<u>21.31</u>	<u>23.32</u>
Diluted earnings per ordinary share	3.3	<u>20.48</u>	<u>22.60</u>
EARNINGS PER SHARE – CONTINUING OPERATIONS			
Basic earnings per ordinary share	3.3	<u>12.49</u>	<u>23.66</u>
Diluted earnings per ordinary share	3.3	<u>12.39</u>	<u>22.92</u>

* Prior period comparatives have been re-presented due to the discontinued operations. Refer to Note 2.2.

The above consolidated statement of comprehensive income should be read in conjunction with the notes to the financial statements.

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CONSOLIDATED BALANCE SHEET

AS AT 31 DECEMBER 2018

	NOTE	31 December 2018 \$m	30 June 2018 \$m
ASSETS			
Cash held for operational purposes		431	448
Investments	3.1	10,605	11,007
Trade and other receivables		3,911	4,085
Current tax assets		99	17
Assets held for sale	2.2	63	655
Reinsurance and other recoveries on outstanding claims		5,469	5,422
Deferred insurance expenses		3,605	3,443
Deferred levies and charges		131	136
Deferred tax assets		499	544
Property and equipment		177	180
Other assets		86	89
Investment in joint venture and associates	3.5	517	557
Goodwill and intangible assets		3,173	3,183
Total assets		<u>28,766</u>	<u>29,766</u>
LIABILITIES			
Trade and other payables		2,835	2,592
Current tax liabilities		-	120
Liabilities held for sale	2.2	27	444
Unearned premium liability		6,227	6,217
Outstanding claims liability		10,352	10,410
Non-controlling interests in unitholders' funds		211	239
Provisions		283	327
Other liabilities		514	516
Interest-bearing liabilities	3.2	1,976	1,960
Total liabilities		<u>22,425</u>	<u>22,825</u>
Net assets		<u>6,341</u>	<u>6,941</u>
EQUITY			
Share capital	2.3	6,617	7,082
Treasury shares held in trust		(49)	(27)
Reserves		39	(4)
Retained earnings		(497)	(382)
Parent interest		6,110	6,669
Non-controlling interests		231	272
Total equity		<u>6,341</u>	<u>6,941</u>

The above consolidated balance sheet should be read in conjunction with the notes to the financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

FOR THE HALF YEAR ENDED 31 DECEMBER 2018

	SHARE CAPITAL	TREASURY SHARES HELD IN TRUST	FOREIGN CURRENCY TRANSLATION RESERVE	SHARE-BASED REMUNERATION RESERVE	RETAINED EARNINGS	NON-CONTROLLING INTERESTS	TOTAL EQUITY
	\$m	\$m	\$m	\$m	\$m	\$m	\$m
31 December 2018							
Balance at the beginning of the financial period	7,082	(27)	(33)	29	(382)	272	6,941
Profit for the period	-	-	-	-	500	25	525
Other comprehensive income/(expense)	-	-	56	-	(7)	-	49
Total comprehensive income for the period	-	-	56	-	493	25	574
Transactions with owners in their capacity as owners							
Capital return, including transaction costs	(465)	-	-	-	-	-	(465)
Share-based remuneration	-	(22)	-	(13)	(5)	-	(40)
Dividends determined and paid	-	-	-	-	(603)	(66)	(669)
Additional investment in subsidiaries	-	-	-	-	-	2	2
Disposal of subsidiaries	-	-	-	-	-	(2)	(2)
Balance at the end of the financial period	<u>6,617</u>	<u>(49)</u>	<u>23</u>	<u>16</u>	<u>(497)</u>	<u>231</u>	<u>6,341</u>
31 December 2017							
Balance at the beginning of the financial period	7,082	(38)	(19)	36	(499)	230	6,792
Profit for the period	-	-	-	-	551	18	569
Other comprehensive expense	-	-	(29)	-	(2)	-	(31)
Total comprehensive income/(expense) for the period	-	-	(29)	-	549	18	538
Transactions with owners in their capacity as owners							
Share-based remuneration	-	8	-	(14)	(5)	-	(11)
Dividends determined and paid	-	-	-	-	(473)	(21)	(494)
Balance at the end of the financial period	<u>7,082</u>	<u>(30)</u>	<u>(48)</u>	<u>22</u>	<u>(428)</u>	<u>227</u>	<u>6,825</u>

The above consolidated statement of changes in equity should be read in conjunction with the notes to the financial statements.

CONSOLIDATED CASH FLOW STATEMENT

FOR THE HALF YEAR ENDED 31 DECEMBER 2018

	31 December 2018	31 December 2017
	\$m	\$m
CASH FLOWS FROM OPERATING ACTIVITIES		
Premium received	6,020	5,971
Reinsurance and other recoveries received	1,730	1,590
Claim costs paid	(4,273)	(4,560)
Outwards reinsurance premium expense paid	(2,317)	(1,627)
Dividends, interest and trust distributions received	299	230
Finance costs paid	(45)	(46)
Income taxes paid	(243)	(291)
Other operating receipts	1,000	794
Other operating payments	(1,806)	(2,038)
Net cash flows from operating activities	<u>365</u>	<u>23</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Net cash flows on disposal/(acquisition) of subsidiaries and associates	370	2
Net cash flows from sale/(purchase) of investments and plant and equipment	211	174
Net cash flows from investing activities	<u>581</u>	<u>176</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Outlays for capital return, including transaction costs	(465)	-
Repayment of borrowings	-	(2)
Net cash flow from issue and redemption of trust units	(30)	9
Dividends paid to shareholders of the Parent	(603)	(473)
Dividends paid to non-controlling interests	(66)	(21)
Net cash flows from financing activities	<u>(1,164)</u>	<u>(487)</u>
Net movement in cash held	(218)	(288)
Effects of exchange rate changes on balances of cash held in foreign currencies	8	(3)
Cash and cash equivalents at the beginning of the financial period	<u>1,345</u>	<u>1,480</u>
Cash and cash equivalents at the end of the financial period*	<u><u>1,135</u></u>	<u><u>1,189</u></u>

* Includes \$431 million (31 December 2017: \$436 million) of cash held for operational purposes, \$661 million (31 December 2017: \$753 million) of cash and short-term money held for investments, and \$43 million of cash and cash equivalents in discontinued operations (31 December 2017: nil).

The above consolidated cash flow statement should be read in conjunction with the notes to the financial statements.

NOTES TO THE FINANCIAL STATEMENTS

1. OVERVIEW

NOTE 1.1 INTRODUCTION

The financial report is structured to provide prominence to the disclosures that are considered most relevant to the users' understanding of the operations, results and financial position of IAG.

The financial report has been organised into the following sections:

1. Overview – contains information that impacts the financial report as a whole, as well as segment reporting disclosures.
2. Significant events and transactions – disclosure of significant changes in the Group's financial position and performance.
3. Interim disclosures – disclosures required to comply with Australian Accounting Standard AASB 134 *Interim Financial Reporting*.

NOTE 1.2 ABOUT THIS REPORT

A. CORPORATE INFORMATION

Insurance Australia Group Limited (Company or Parent), the ultimate parent entity in the Group, is a for-profit company incorporated and domiciled in Australia and limited by shares publicly traded on the Australian Securities Exchange (ASX). Its registered office and principal place of business is Level 13, Tower Two, Darling Park, 201 Sussex Street, Sydney, NSW 2000, Australia. This financial report covers the consolidated financial statements for the Company and its subsidiaries (IAG or Group) for the half year ended 31 December 2018.

This report is also to be read in conjunction with the annual report for the year ended 30 June 2018 and any public announcements made by Insurance Australia Group Limited during the reporting period in accordance with the continuous disclosure requirements of the *Corporations Act 2001* and the ASX Listing Rules.

A description of the nature of IAG's operations and its principal activities is included in the Directors' Report.

B. STATEMENT OF COMPLIANCE

This general purpose half year financial report was authorised by the Board of Directors for issue on 6 February 2019 and complies with Australian Accounting Standard AASB 134 *Interim Financial Reporting* and the recognition and measurement requirements of other applicable Australian Accounting Standards adopted by the Australian Accounting Standards Board (AASB), the *Corporations Act 2001* and the ASX Listing Rules.

The current IFRS standard for insurance contracts does not include a comprehensive set of recognition and measurement criteria. The International Accounting Standards Board (IASB) has issued a new standard (*IFRS 17 Insurance Contracts* – adopted as AASB 17 *Insurance Contracts* in an Australian context) that does include such criteria, with the current effective date of 1 January 2021. However since issuing the standard, the IASB has agreed to propose a one year delay to the effective date to 1 January 2022, the agreement of which is subject to public consultation.

C. BASIS OF PREPARATION

The financial statements have been prepared on the basis of historical cost principles, as modified by certain exceptions, with the principal exceptions being the measurement of all investments and derivatives at fair value and the measurement of the outstanding claims liability and related reinsurance and other recoveries at present value. All values are rounded to the nearest million dollars, unless otherwise stated, in accordance with ASIC *Corporations Instrument 2016/191*.

The balance sheet is prepared with the assets and liabilities presented broadly in order of liquidity.

The financial report is presented in Australian dollars, which is the functional currency of the Company.

D. SIGNIFICANT ACCOUNTING POLICIES ADOPTED

The accounting policies adopted in the preparation of this financial report have been applied consistently by all entities in IAG and are the same as those applied for the previous reporting year, unless otherwise stated. The financial statements of entities operating outside Australia that maintain accounting records in accordance with overseas accounting principles are adjusted where necessary to comply with the significant accounting policies of IAG. The significant accounting policies adopted in the preparation of this financial report are set out within the relevant note in the annual report for the year ended 30 June 2018.

I. Changes in accounting policies

The following new Australian Accounting Standards and Interpretations are applicable for the current reporting period.

TITLE	DESCRIPTION
AASB 9	Financial Instruments
AASB 15	Revenue from Contracts with Customers
AASB 2016-5	Classification and Measurement of Share-based Payment Transactions
AASB 2017-1	Amendments to Australian Accounting Standards – Transfers of Investment Property, Annual Improvements 2014-2016 Cycle and Other Amendments
AASB 2017-3	Amendments to Australian Accounting Standards – Clarifications to AASB 4
AASB Interpretation 22	Foreign Currency Transactions and Advance Consideration

Adoption of the new and amended accounting standards had no material financial impact on the Group.

AASB 9 Financial Instruments

For IAG, *AASB 9 Financial Instruments* became effective for periods beginning on 1 July 2018, replacing the existing accounting requirements for financial instruments under *AASB 139 Financial Instruments: Recognition and Measurement*. *AASB 9* introduces changes to the classification and measurement of financial instruments, replaces the 'incurred loss' impairment model with a new 'expected loss' model when recognising expected credit losses on financial assets, and new general hedge accounting requirements.

IAG has applied *AASB 9* retrospectively, with no material change to the carrying amount of its financial instruments when measured under the requirements of *AASB 9*. From a classification perspective, there was no impact to IAG's financial instruments as reflected in the table below. IAG's investments continue to be designated as at fair value through profit or loss on initial recognition and subsequently remeasured to fair value at each reporting date, reflecting the business model applied by IAG to manage and evaluate its investment portfolio. An analysis has been performed of the expected credit losses associated with IAG's in-scope financial assets and note that the provisions raised under *AASB 139* are sufficient when considering the lifetime expected credit losses associated with these assets. *AASB 9* specifically excludes from its scope the rights and obligations arising from insurance contracts, as defined under *AASB 4 Insurance Contracts*.

The measurement bases of IAG's financial assets and liabilities under *AASB 139* and *AASB 9* are as follows:

Asset/liability	Measurement basis under AASB 139	Measurement basis under AASB 9	Carrying amount of asset/(liability) under AASB 9 and AASB 139 \$m
Interest-bearing investments ⁽¹⁾	Fair value through profit or loss	No change	8,743
Equity investments	Fair value through profit or loss	No change	1,607
Other trusts	Fair value through profit or loss	No change	252
Derivatives without hedge accounting applied	Fair value through profit or loss	No change	(48)
Derivatives with hedge accounting applied	Fair value through profit or loss	No change	(17)
Cash	Amortised cost	No change	431
Trade and other receivables ⁽²⁾	Amortised cost	No change	285
Interest-bearing liabilities	Amortised cost	No change	(1,976)

(1) Interest-bearing investments includes assets held to back insurance liabilities (policyholder funds) and those that form part of shareholders' funds, with each portfolio managed separately. Policyholder funds are available for future settlement of claims and can generally be readily sold or exchanged for cash to settle claims. IAG invests policyholder funds, wherever possible, in securities with interest rate sensitivities that align to the underlying insurance liabilities. To significantly reduce any accounting mismatch with movements in insurance liabilities from changes in interest rate, IAG adopted the option available under *AASB 9* to designate policyholder funds to be measured at fair value through profit or loss. IAG invest shareholders' funds to maximise the return on risk-based capital, consistent with IAG's risk appetite and flexibility requirements, which results in the portfolio being measured at fair value through profit or loss.

(2) This excludes receivables arising from IAG's insurance contracts as these are out of scope of *AASB 9*.

AASB 15 Revenue from Contracts with Customers

AASB 15 Revenue from Contracts with Customers also became effective for periods beginning on 1 July 2018, with no material impact to IAG. *AASB 15* introduces a single model for the recognition of revenue based on when an entity satisfies the contractual performance obligations by transferring a promised good and service to a customer. It does not apply to insurance contracts and financial instruments. Hence the majority of IAG's revenue is not impacted by this change. Revenue from contracts with customers, as defined by *AASB 15*, is disclosed as 'Fee and other income' in the statement of comprehensive income, there has been no material change in the measurement of 'Fee and other income' on implementation of *AASB 15* as the existing recognition and measurement of revenue under the applicable contracts meets the requirements under the new standard.

II. Critical accounting estimates and judgements

In the process of applying the significant accounting policies, certain critical accounting estimates and assumptions are applied and judgements are made by management, the results of which affect the amounts recognised in the financial statements. The estimates and related assumptions are based on experience and other factors that are considered to be reasonable, and are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which they are revised, and future periods if relevant. The areas where material estimates and judgements are applied are set out below, with further details provided within the relevant note in the annual report for the year ended 30 June 2018.

AREAS OF CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

Claims and reinsurance and other recoveries on outstanding claims
Liability adequacy test
Intangible assets and goodwill impairment testing, initial measurement and useful life
Income tax and related assets and liabilities
Investment in joint venture and associates impairment testing

NOTE 1.3 SEGMENT REPORTING

IAG has identified its operating segments based on the internal reports that are reviewed and used by the Group Chief Executive Officer (being the chief operating decision maker) in assessing performance and in determining the allocation of resources.

A. REPORTABLE SEGMENTS

IAG has general insurance operations in Australia and New Zealand. Each division has end-to-end responsibility for delivering the customer experience, with responsibility for the customer, product, distribution and operations functions. IAG's operating model was refined in the 2018 financial year to create a single Australian division. During the intervening period, the model has continued to evolve. As a result of further operational changes implemented during the current reporting period, including changes in the internal reports reviewed by the Group Chief Executive Officer, IAG has revised its reportable segments to reflect this combined Australian division, with the prior period segment information re-presented accordingly.

Further, following the classification of IAG's consolidated businesses in Thailand, Vietnam and Indonesia as discontinued operations at 30 June 2018, Asia is no longer disclosed as a distinct operating segment. For further details refer to Note 2.2. IAG's ongoing interests in Malaysia and India continue to be treated as associates, within the Corporate and other segment.

The reportable segments for the period ended 31 December 2018 comprise the following business divisions:

i. Australia

This segment provides general insurance products to individuals, families and business throughout Australia, primarily through NRMA Insurance, SGIO, SGIC and CGU brands, the RACV brand in Victoria (via a distribution and underwriting relationship with RACV), the Coles Insurance brand nationally (via a distribution agreement with Coles) and the WFI brand through intermediaries including brokers, authorised representatives and distribution partners.

ii. New Zealand

This segment provides general insurance business underwritten in New Zealand. Insurance products are sold directly to customers predominantly under the State and AMI brands, and through intermediaries (insurance brokers and authorised representatives) primarily using the NZI and Lumley Insurance brands. Personal and commercial products are also distributed by corporate partners, such as large financial institutions, using third party brands.

iii. Corporate and other

This segment comprises other activities, including corporate services, capital management activity, shareholders' funds investment activities, inward reinsurance from associates, and investment in associates in Malaysia and India. IAG's captive reinsurance operation (captive) is a corporate function that acts as the interface between the external providers of reinsurance capital and the operating business divisions. IAG does not manage or view the captive as a separate business. Consequently, the operating results of the captive are systematically allocated to the operating business segments.

B. FINANCIAL INFORMATION

	AUSTRALIA \$m	NEW ZEALAND \$m	CORPORATE AND OTHER \$m	TOTAL \$m
31 December 2018				
I. Financial performance				
Total external revenue ⁽¹⁾	<u>6,889</u>	<u>1,651</u>	<u>41</u>	<u>8,581</u>
Underwriting profit/(loss)	<u>215</u>	<u>184</u>	<u>(5)</u>	<u>394</u>
Net investment income on assets backing insurance liabilities	<u>89</u>	<u>9</u>	<u>4</u>	<u>102</u>
Insurance profit/(loss)	<u>304</u>	<u>193</u>	<u>(1)</u>	<u>496</u>
Net investment loss on shareholders' funds	-	-	<u>(7)</u>	<u>(7)</u>
Share of net profit of associates	<u>1</u>	-	<u>17</u>	<u>18</u>
Finance costs	-	-	<u>(48)</u>	<u>(48)</u>
Other net operating result	<u>9</u>	-	<u>(27)</u>	<u>(18)</u>
Total segment result from continuing operations	<u>314</u>	<u>193</u>	<u>(66)</u>	<u>441</u>
Income tax expense				<u>(123)</u>
Profit for the period from continuing operations				<u>318</u>
II. Other segment information				
Capital expenditure ⁽²⁾	<u>-</u>	<u>-</u>	<u>71</u>	<u>71</u>
Depreciation and amortisation expense	<u>54</u>	<u>26</u>	<u>-</u>	<u>80</u>
<p>(1) Total external revenue comprises premium revenue, reinsurance and other recoveries, reinsurance commission revenue, investment income on assets backing insurance liabilities, investment income on shareholders' funds, fee and other income and share of net profit/(loss) of associates.</p> <p>(2) Capital expenditure includes acquisitions of property and equipment, intangibles and other non-current segment assets.</p>				

	AUSTRALIA \$m	NEW ZEALAND \$m	CORPORATE AND OTHER \$m	TOTAL \$m
31 December 2017⁽³⁾				
I. Financial performance				
Total external revenue ⁽¹⁾	<u>6,265</u>	<u>1,604</u>	<u>172</u>	<u>8,041</u>
Underwriting profit/(loss)	<u>505</u>	<u>118</u>	<u>(1)</u>	<u>622</u>
Net investment income on assets backing insurance liabilities	<u>120</u>	<u>1</u>	<u>2</u>	<u>123</u>
Insurance profit	<u>625</u>	<u>119</u>	<u>1</u>	<u>745</u>
Net investment income on shareholders' funds	-	-	<u>129</u>	<u>129</u>
Share of net profit of associates	<u>2</u>	-	<u>16</u>	<u>18</u>
Finance costs	-	-	<u>(39)</u>	<u>(39)</u>
Other net operating result	<u>5</u>	-	<u>(69)</u>	<u>(64)</u>
Total segment result from continuing operations	<u>632</u>	<u>119</u>	<u>38</u>	<u>789</u>
Income tax expense				<u>(211)</u>
Profit for the period from continuing operations				<u>578</u>
II. Other segment information				
Capital expenditure ⁽²⁾	<u>-</u>	<u>-</u>	<u>72</u>	<u>72</u>
Depreciation and amortisation expense	<u>55</u>	<u>26</u>	<u>-</u>	<u>81</u>
<p>(1) Total external revenue comprises premium revenue, reinsurance and other recoveries, reinsurance commission revenue, investment income on assets backing insurance liabilities, investment income on shareholders' funds, fee and other income and share of net profit/(loss) of associates.</p> <p>(2) Capital expenditure includes acquisitions of property and equipment, intangibles and other non-current segment assets.</p> <p>(3) Prior period comparatives have been re-presented due to the revision to reportable segments and the discontinued operations. Refer to Note 2.2.</p>				

2. SIGNIFICANT EVENTS AND TRANSACTIONS

SECTION INTRODUCTION

This section comprises disclosures on the events and transactions that are significant to an understanding of the changes in the Group's financial position and performance since the end of the last annual reporting period. Information disclosed in relation to those events and transactions provides an update on the relevant information presented in the most recent annual financial report.

NOTE 2.1 DISPOSAL OF SUBSIDIARIES

THAILAND OPERATIONS

On 31 August 2018, IAG completed the sale of its Thailand operations, which included Safety Insurance Public Company Limited. Details of the sale are as follows:

	31 December 2018 \$m
Consideration received:	
Cash consideration	515
Withholding tax and stamp duty	<u>(9)</u>
Net cash consideration received	<u>506</u>
Carrying amount of net assets disposed of	(209)
Non-controlling interests	2
Other transaction-related expenses, net of tax	<u>(80)</u>
Gain on sale before income tax and reclassification of foreign currency translation reserve	<u>219</u>
Reclassification of foreign currency translation reserve	<u>(11)</u>
Gain on sale after income tax	<u>208</u>

The carrying amounts of assets and liabilities as at the date of sale (31 August 2018) were:

	31 August 2018 \$m
Cash held for operational purposes	25
Investments*	270
Trade and other receivables	70
Reinsurance and other recoveries on outstanding claims	81
Deferred insurance expenses	112
Other assets	32
Goodwill and intangible assets	<u>65</u>
Total assets held for sale	<u>655</u>
Trade and other payables	78
Outstanding claims liability	154
Unearned premium liability	200
Other liabilities	<u>14</u>
Total liabilities held for sale	<u>446</u>
Net assets	<u>209</u>

* Includes cash and short-term money held in investments of \$98 million.

NOTE 2.2 DISCONTINUED OPERATIONS

On 19 June 2018, IAG announced it had entered into a sale agreement with Tokio Marine & Nichido Fire Insurance Co., Ltd. (Tokio Marine) for IAG's operations in Thailand and Indonesia. Separate to the transactions with Tokio Marine, IAG has reached an agreement to sell its interest in AAA Assurance Corporation, based in Vietnam. As a result of the sale agreements, these consolidated Asian businesses have been identified as discontinued operations in the current financial period and comparative figures have been re-presented accordingly. The sale of IAG's Thailand operations was completed on 31 August 2018, with the performance of this operation being included up to this date. The remaining transactions with regards to the sale of IAG's operations in Vietnam and Indonesia are expected to conclude in the financial year ending 30 June 2019, subject to the receipt of requisite regulatory approvals and/or notifications.

	31 December 2018	31 December 2017
	\$m	\$m
A. RESULTS OF DISCONTINUED OPERATIONS		
Revenue	109	231
Expenses	(109)	(238)
Loss before income tax	-	(7)
Income tax expense	(1)	(2)
Loss after income tax of discontinued operations	(1)	(9)
Gain on sale of subsidiaries after income tax (see Note 2.1)	208	-
Profit/(loss) from discontinued operations	207	(9)
Other comprehensive income/(expense), net of tax	20	(1)
Total comprehensive income/(loss) from discontinued operations	227	(10)
Profit/(loss) for the year attributable to shareholders of the Parent	207	(8)
Loss for the year attributable to non-controlling interests	-	(1)
Profit/(loss) for the year from discontinued operations	207	(9)
Total comprehensive income/(loss) for the year attributable shareholders of the Parent	227	(9)
Total comprehensive loss for the year attributable non-controlling interests	-	(1)
Total comprehensive income/(loss) from discontinued operations	227	(10)
B. EARNINGS PER SHARE FROM DISCONTINUED OPERATIONS		
Basic earnings per share, from discontinued operations – cents per share	8.82	(0.34)
Diluted earnings per share, from discontinued operations – cents per share	8.09	(0.32)
C. CASH FLOW FROM DISCONTINUED OPERATIONS		
Net cash flows from operating activities	(17)	(7)
Net cash flows from investing activities*	383	10
Net cash flows from financing activities	22	-
Net cash flows for the period from discontinued operations	388	3

* The net cash flows from investing activities for the half year ended 31 December 2018 includes a net inflow of \$383 million from the sale of IAG's Thailand operations, which is comprised of the net cash consideration received of \$506 million and the cash and cash equivalents disposed of totalling \$123 million.

D. ASSETS AND LIABILITIES HELD FOR SALE

As at 30 June 2018, the assets and liabilities that were classified as held for sale related to IAG's consolidated businesses in Thailand, Vietnam and Indonesia. As a result of the sale of the operations in Thailand on 31 August 2018, the assets and liabilities classified as held for sale as at 31 December 2018 relate to the businesses in Vietnam and Indonesia.

	31 December 2018	30 June 2018
	\$m	\$m
Cash held for operational purposes	14	32
Investments	31	282
Trade and other receivables	2	72
Reinsurance and other recoveries on outstanding claims	3	52
Deferred insurance expenses	3	111
Other assets	9	41
Goodwill and intangible assets	1	65
Total assets held for sale	<u>63</u>	<u>655</u>
Trade and other payables	6	65
Outstanding claims liability	9	157
Unearned premium liability	11	206
Other liabilities	1	16
Total liabilities held for sale	<u>27</u>	<u>444</u>

E. RECOGNITION AND MEASUREMENT

Non-current assets (or disposal groups) are classified as held for sale if their carrying amount will be recovered principally through a sale transaction rather than through continuing use and a sale is considered highly probable. They are measured at the lower of their carrying amount and fair value less costs to sell, except for assets such as deferred tax assets, assets arising from employee benefits, financial assets and contractual rights under insurance contracts, which are specifically exempt from this requirement. Assets and liabilities classified as held for sale are presented separately in the balance sheet.

An impairment loss is recognised for any initial or subsequent write-down of the asset (or disposal group) to fair value less costs to sell. A gain is recognised for any subsequent increases in fair value less costs to sell of an asset (or disposal group), but not in excess of any cumulative impairment loss previously recognised. A gain or loss not previously recognised by the date of the sale of the non-current asset (or disposal group) is recognised at the date of derecognition.

Non-current assets (including those that are part of a disposal group) are not depreciated or amortised while they are classified as held for sale. Interest and other expenses attributable to the liabilities of a disposal group classified as held for sale continue to be recognised.

A discontinued operation is a component of the entity that has been disposed of or is classified as held for sale and that represents a separate major line of business or geographical area of operations, is part of a single co-ordinated plan to dispose of such a line of business or area of operations, or is a subsidiary acquired exclusively with a view to resale. The results of discontinued operations are presented separately in the statement of profit or loss. When an operation is classified as a discontinued operation, the comparative statement of profit or loss and other comprehensive income is re-presented as if the operation had been discontinued from the start of the comparative period.

NOTE 2.3 NOTES TO THE STATEMENT OF CHANGES IN EQUITY

	31 December 2018	30 June 2018	31 December 2018	30 June 2018
	Number of shares in millions	Number of shares in millions	\$m	\$m
SHARE CAPITAL				
I. Ordinary shares				
Balance at the beginning of the financial period	2,367	2,367	7,082	7,082
Capital return and share consolidation, including transaction costs	<u>(56)</u>	<u>-</u>	<u>(465)</u>	<u>-</u>
Balance at the end of the financial period	<u>2,311</u>	<u>2,367</u>	<u>6,617</u>	<u>7,082</u>

All ordinary shares on issue are fully paid and have no par value. Ordinary shares entitle the holder to a vote at the general meeting of the Company and to participate in the dividends and the proceeds on winding up of the Company in proportion to the number of, and amounts paid on, the shares held. Dividends, if declared, are subject to there being distributable profits available and not breaching APRA capital adequacy requirements.

II. Changes during the period

On 26 November 2018, IAG completed its capital management initiative amounting to 25.0 cents per ordinary share, or \$592 million, which comprised a 19.5 cents capital return and a 5.5 cents fully franked special dividend, with a share consolidation that reduced the Company's ordinary issued shares by 2.4%.

NOTE 2.4 DIVIDENDS

	31 December 2018		31 December 2017	
	Cents per share	\$m	Cents per share	\$m
A. ORDINARY SHARES				
Special dividend paid on 26 November 2018 fully franked at 30%	5.5	130	-	-
2018 final dividend paid on 27 September 2018 (31 December 2017: 2017 final dividend) fully franked at 30% ⁽¹⁾	20.0	<u>473</u>	20.0	<u>473</u>
		<u>603</u>		<u>473</u>
B. DIVIDEND NOT RECOGNISED AT REPORTING DATE				
2019 interim dividend (31 December 2017: 2018 interim dividend) fully franked at 30% to be paid on 20 March 2019 ⁽²⁾	12.0	<u>277</u>	14.0	<u>331</u>

(1) Of the total 2018 final dividend declared of \$474 million, right and entitlement of \$1 million (2017 final dividend: \$1 million) to dividends on unallocated treasury shares was waived during the year by the trustee of the IAG Share and Rights Plans Trust.

(2) Of the total 2018 interim dividend declared of \$331 million, right and entitlement of \$1 million to dividends on unallocated treasury shares was waived during the year by the trustee of the IAG Share and Rights Plans Trust.

C. DIVIDEND REINVESTMENT

A Dividend Reinvestment Plan (DRP) generally allows eligible shareholders with ordinary shares to elect to receive their dividend entitlement in the form of ordinary shares of the Company. The price of DRP shares is the volume-weighted average share price (VWAP), less a discount if determined by the Directors, calculated over the pricing period (which is at least five trading days) as determined by the Directors for each dividend payment date. A copy of the terms and conditions for the DRP is available at www.iag.com.au/shareholder-centre/dividends/reinvestment.

The DRP for the 2018 final dividend paid on 27 September 2018 was settled with the on-market purchase of 10.2 million shares priced at \$7.60 share (based on a daily VWAP for 10 trading days from 27 August 2018 to 7 September 2018 inclusive, with no discount applied).

3. INTERIM DISCLOSURES

SECTION INTRODUCTION

This section includes information to be disclosed in accordance with the interim reporting Accounting Standard (AASB 134), Corporations Act and ASX Listing Rules, and which are relevant to understanding the changes in IAG's financial position and performance since the end of the last annual reporting period.

NOTE 3.1 INVESTMENTS

The inputs used to determine the fair value for securities recognised under each level of the fair value hierarchy are set out below.

I. Level 1 quoted prices

The fair value is determined by reference to quoted prices (mid-market) in active markets for identical assets and liabilities. For IAG, this category includes government securities and listed equities.

II. Level 2 other observable inputs

The fair value is determined by reference to quoted prices in active markets for similar assets or liabilities or by reference to other significant inputs that are not quoted prices but are based on observable market data, for example interest rate yield curves observable at commonly quoted intervals. For IAG, this category primarily includes corporate and other fixed interest securities where the market is considered to be lacking sufficient depth to be considered active.

III. Level 3 unobservable inputs

The fair value is determined using valuation techniques in which a number of the significant inputs are not based on observable market data. Level 3 investments are primarily unlisted private equity funds where the fair value of investments is determined on the basis of published redemption values of those funds. This category also includes IAG's unlisted equity interest in Bohai Property Insurance Company Limited (Bohai). The fair value of Bohai is supported by comparable transaction multiples observed in the local market.

The table below separates the total investment balance by hierarchy category:

	LEVEL 1 \$m	LEVEL 2 \$m	LEVEL 3 \$m	TOTAL \$m
31 December 2018				
Interest-bearing investments	1,648	6,860	235	8,743
Equity investments	987	320	300	1,607
Other investments	3	252	-	255
	<u>2,638</u>	<u>7,432</u>	<u>535</u>	<u>10,605</u>
30 June 2018				
Interest-bearing investments	2,169	6,998	1	9,168
Equity investments	1,049	341	342	1,732
Other investments	-	107	-	107
	<u>3,218</u>	<u>7,446</u>	<u>343</u>	<u>11,007</u>

NOTE 3.2 INTEREST-BEARING LIABILITIES

Final Maturity Date	Principal Amount	31 December 2018		30 June 2018	
		Carrying Value \$m	Fair Value \$m	Carrying Value \$m	Fair Value \$m
A. COMPOSITION					
I. Capital nature					
a. ADDITIONAL TIER 1 REGULATORY CAPITAL ⁽¹⁾					
Reset exchangeable securities					
No fixed date	\$550 million	<u>550</u>	568	<u>550</u>	565
Capital notes					
No fixed date	\$404 million	<u>404</u>	425	<u>404</u>	423
b. TIER 2 REGULATORY CAPITAL					
AUD subordinated convertible term notes					
19 March 2040	\$350 million	350	351	350	354
15 June 2044	\$350 million	<u>350</u>	349	<u>350</u>	353
		<u>700</u>		<u>700</u>	
NZD subordinated convertible term notes ^{(2),(3)}					
15 June 2043	NZ\$350 million	<u>333</u>	342	<u>320</u>	332
II. Operational nature					
Less: capitalised transaction costs			<u>(11)</u>	<u>(14)</u>	
			<u>1,976</u>	<u>1,960</u>	

(1) Instruments issued prior to 1 January 2013 are eligible for inclusion in the relevant category of regulatory capital up to limits prescribed by APRA under transitional arrangements. Any capital that is ineligible to be included in Additional Tier 1 Capital as a consequence may be included in Tier 2 capital to the extent there is residual capacity within Tier 2 transitional limits.

(2) At the reporting date, the Company recognised accrued interest of \$1 million (30 June 2018: \$1 million) which is presented within trade and other payables.

(3) IAG is a "dual listed issuer" that is listed on both the ASX and the NZX Debt Market. As such, IAG is subject to some, but not all of the NZX Main Board/Debt Market Listing Rules ("NZX Listing Rules"). In particular, the rules set out in Appendix 17 to the NZX Listing Rules do not apply to IAG.

B. RECOGNITION AND MEASUREMENT

Interest-bearing liabilities are initially measured at fair value (net of transaction costs) and subsequently measured at amortised cost. Based on market conditions at any point in time, the carrying value of the liabilities may not be representative of the fair value of the liabilities. The fair value for all interest-bearing liabilities is calculated using their quoted market price (fair value hierarchy level 1).

NOTE 3.3 EARNINGS PER SHARE

	31 December 2018	31 December 2017 ⁽³⁾
	cents	cents
A. REPORTING PERIOD VALUES		
Continuing and discontinued operations		
Basic earnings per ordinary share ⁽¹⁾	<u>21.31</u>	<u>23.32</u>
Diluted earnings per ordinary share ⁽²⁾	<u>20.48</u>	<u>22.60</u>
Continuing operations		
Basic earnings per ordinary share ⁽¹⁾	<u>12.49</u>	<u>23.66</u>
Diluted earnings per ordinary share ⁽²⁾	<u>12.39</u>	<u>22.92</u>

(1) The basic earnings per ordinary share is determined by dividing the profit or loss attributable to shareholders of the Parent by the weighted average number of shares of the Parent on issue during the reporting period. The treasury shares held in trust are deducted, but earnings attributable to those shares are included.

(2) Diluted earnings per share is determined by dividing the profit or loss attributable to shareholders of the Parent, adjusted for the finance costs of dilutive convertible instruments, by the weighted average number of ordinary shares and dilutive potential ordinary shares, primarily as a result of debt instruments that possess a conversion feature.

(3) Prior period comparatives have been re-presented due to the discontinued operations. Refer to Note 2.2.

	31 December 2018	31 December 2017
	\$m	\$m
B. RECONCILIATION OF EARNINGS USED IN CALCULATING EARNINGS PER SHARE		
Profit attributable to shareholders of the Parent which is used in calculating basic and diluted earnings per share	500	551
Finance costs of convertible securities, net of tax	<u>24</u>	<u>18</u>
Profit attributable to shareholders of the Parent which is used in calculating diluted earnings per share	<u>524</u>	<u>569</u>
Profit from continuing operations attributable to shareholders of the Parent	293	559
Profit/(loss) from discontinued operations attributable to shareholders of the Parent	207	(8)
	31 December 2018	31 December 2017
	Number of shares in millions	Number of shares in millions
C. RECONCILIATION OF WEIGHTED AVERAGE NUMBER OF ORDINARY SHARES USED IN CALCULATING EARNINGS PER SHARE		
Weighted average number of ordinary shares on issue (adjusted for treasury shares held in trust) used in the calculation of basic earnings per share	2,346	2,363
Weighted average number of dilutive potential ordinary shares relating to:		
Convertible securities	208	150
Unvested share-based remuneration rights supported by treasury shares held in trust	<u>4</u>	<u>5</u>
	<u>2,558</u>	<u>2,518</u>

NOTE 3.4 DERIVATIVES

	31 December 2018			30 June 2018		
	Notional contract amount	Fair value asset	Fair value liability	Notional contract amount	Fair value asset	Fair value liability
	\$m	\$m	\$m	\$m	\$m	\$m
A. REPORTING DATE POSITIONS						
I. Net investment hedges (hedge accounting applied)						
Forward foreign exchange contracts	837	1	(18)	1,223	11	(15)
II. Investment-related derivatives (derivatives without hedge accounting applied)						
Bond futures	2,472	-	-	2,559	-	-
Share price index futures	49	-	-	(28)	-	-
Forward foreign exchange contracts	3,447	3	(57)	3,394	-	(53)
III. Treasury-related derivatives (derivatives without hedge accounting applied)						
Forward foreign exchange contracts	751	8	(7)	754	6	(8)
Interest rate swaps	333	5	-	320	1	-

B. RECOGNITION AND MEASUREMENT

I. Hedge accounting

The foreign currency exposures arising on translation of net investments in foreign operations are hedged (net investment hedge) using forward exchange contracts and the designation of certain foreign currency borrowings as hedging instruments. The fair value is determined using observable inputs (level 2 in the fair value hierarchy).

II. Derivatives without hedge accounting applied

The fair value of the bond futures, share price index futures and options are measured using a quoted price in an active market (level 1 in the fair value hierarchy), whilst the fair value of the interest rate swaps and forward foreign exchange contracts are determined using observable inputs (level 2 in the fair value hierarchy).

NOTE 3.5 INVESTMENT IN JOINT VENTURE AND ASSOCIATES

Summarised information of interests in material joint venture and associates accounted for on an equity basis is as follows:

	COUNTRY OF INCORPORATION/ FORMATION	PRINCIPAL ACTIVITY	CARRYING VALUE		OWNERSHIP INTEREST	
			31 December 2018 \$m	30 June 2018 \$m	31 December 2018 %	30 June 2018 %
AmGeneral Holdings Berhad (AmGeneral)	Malaysia	Insurance underwriting	335	392	49.00	49.00
SBI General Insurance Company Limited (SBI General)	India	Insurance underwriting	157	139	26.00	26.00
Other			25	26		
			<u>517</u>	<u>557</u>		

NOTE 3.6 CONTINGENCIES

There have been no material changes in IAG's contingent liabilities or contingent assets since 30 June 2018.

NOTE 3.7 EVENTS SUBSEQUENT TO REPORTING DATE

As the following matters occurred after reporting date and did not relate to conditions existing at reporting date, no account has been taken of them in the financial statements for the current half year ended 31 December 2018. These include:

- The Board determined to pay an interim dividend of 12.0 cents per share, 100% franked. The dividend will be paid on 20 March 2019. The dividend reinvestment plan will operate by acquiring shares on market for participants with no discount applied.

NOTE 3.8 NET TANGIBLE ASSETS

	31 December 2018 \$	30 June 2018 \$
Net tangible assets per ordinary share	<u>1.27</u>	<u>1.47</u>

Net tangible assets per ordinary share have been determined using the net assets on the balance sheet adjusted for non-controlling interests, intangible assets and goodwill.

DIRECTORS' DECLARATION

In the opinion of the Directors of Insurance Australia Group Limited:

- the financial statements and notes 1 to 3.8 are in accordance with the *Corporations Act 2001* including:
 - giving a true and fair view of the financial position of the Group as at 31 December 2018 and of its performance, as represented by the results of its operations and its cash flows, for the half year ended on that date; and
 - complying with Australian Accounting Standard *AASB 134 Interim Financial Reporting* and the *Corporations Regulations 2001*; and
- there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.

Signed at Sydney this 6th day of February 2019 in accordance with a resolution of the Directors.



Peter Harmer
Director

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INDEPENDENT AUDITOR'S REVIEW REPORT

TO THE SHAREHOLDERS OF INSURANCE AUSTRALIA GROUP LIMITED

Conclusion

We have reviewed the accompanying half year financial report of Insurance Australia Group Limited.

Based on our review, which is not an audit, we have not become aware of any matter that makes us believe that the half year financial report of Insurance Australia Group Limited is not in accordance with the *Corporations Act 2001*, including:

- giving a true and fair view of the Group's financial position as at 31 December 2018 and of its financial performance for the half year ended on that date; and
- complying with Australian Accounting Standard AASB 134 *Interim Financial Reporting* and the *Corporations Regulations 2001*.

The half year financial report comprises:

- Consolidated balance sheet as at 31 December 2018;
- Consolidated statement of comprehensive income, Consolidated statement of changes in equity, and Consolidated cash flow statement for the half year ended on that date;
- Notes 1 to 3.8 comprising a summary of significant accounting policies and other explanatory information; and
- Directors' declaration.

The Group comprises Insurance Australia Group Limited (the Company) and the entities it controlled at the half year's end or from time to time during the half year.

Responsibilities of the Directors for the half year financial report

The Directors are responsible for:

- the preparation of the half year financial report that gives a true and fair view in accordance with Australian Accounting Standards and the *Corporations Act 2001*; and
- for such internal control as the Directors determine is necessary to enable the preparation of the half year financial report that is free from material misstatement, whether due to fraud or error.

Auditor's responsibility for the review of the half year financial report

Our responsibility is to express a conclusion on the half year financial report based on our review. We conducted our review in accordance with Auditing Standard on Review Engagements *ASRE 2410 Review of a Financial Report Performed by the Independent Auditor of the Entity*, in order to state whether, on the basis of the procedures described, we have become aware of any matter that makes us believe that the half year financial report is not in accordance with the *Corporations Act 2001* including: giving a true and fair view of the Group's financial position as at 31 December 2018 and its performance for the half year ended on that date; and complying with Australian Accounting Standard AASB 134 *Interim Financial Reporting* and the *Corporations Regulations 2001*. As auditor of Insurance Australia Group Limited, *ASRE 2410* requires that we comply with the ethical requirements relevant to the audit of the annual financial report.

A review of a half year financial report consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Australian Auditing Standards and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

In conducting our review, we have complied with the independence requirements of the *Corporations Act 2001*.

KPMG

Andrew Yates

Partner
Sydney
6 February 2019

Ian Moyser

Partner

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