INSURANCE AUSTRALIA GROUP LIMITED
HALF YEAR REPORT FOR THE PERIOD ENDED 31 DECEMBER 2017

APPENDIX 4D (ASX Listing Rule 4.2A)

RESULTS FOR ANNOUNCEMENT TO THE MARKET

	UP / DOWN	% CHANGE	31 December 2017 $m	31 December 2016 $m
Revenue from ordinary activities	Up	1.1 %	**8,272**	8,179
Net profit after tax from ordinary activities attributable to shareholders of the Parent	Up	23.5 %	**551**	446
Net profit attributable to IAG shareholders	Up	23.5 %	**551**	446

DIVIDENDS – ORDINARY SHARES	AMOUNT PER SECURITY	FRANKED AMOUNT PER SECURITY
Interim dividend	14.0 cents	14.0 cents

INTERIM DIVIDEND DATE	
Record date	21 February 2018
Payment date	29 March 2018

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 22 February 2018. The DRP Issue Price will be based on a volume-weighted average price for a 10-day trading window from 26 February 2018 to 9 March 2018 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 2017 (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 2017 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 2017

INSURANCE AUSTRALIA GROUP LIMITED

ABN 60 090 739 923

FINANCIAL REPORT
FOR THE HALF YEAR ENDED 31 DECEMBER 2017

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 2017 and the Auditor's Report.

The following terminology is used throughout the financial report:

- IAG, Parent or Company – Insurance Australia Group Limited; and
- Group or Consolidated – 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
Catriona A Deans (Alison Deans) – Retired 20 October 2017
Hugh A Fletcher
Jonathan (Jon) B Nicholson
Helen M Nugent AO
Thomas (Tom) W Pockett
Philip J Twyman AM

EXECUTIVE

Peter G Harmer (Managing Director and Chief Executive Officer)

PRINCIPAL ACTIVITY

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

DIVISION	OVERVIEW	PRODUCTS
Consumer division (Australia) 52% of Group gross written premium (GWP)	Consumer insurance products are sold in Australia through branches, call centres, the internet and representatives, under the following brands: ■ 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. Consumer division also includes travel insurance, life insurance and income protection products which are underwritten by third parties.	Short-tail insurance ■ Motor vehicle ■ Home and contents ■ Lifestyle and leisure, such as boat, veteran and classic car and caravan Long-tail insurance ■ Compulsory Third Party (motor injury liability)
Business division (Australia) 24% of Group GWP	Business insurance products are sold in Australia through a network of around 2,000 intermediaries, such as brokers, agents and financial institutions and directly through call centre and online channels. Business division is a leading provider of business and farm insurance in Australia. Business division operates across Australia under the following brands: ■ CGU Insurance; ■ WFI; ■ NRMA Insurance; ■ RACV; ■ SGIO; and ■ SGIC.	Short-tail insurance ■ Business packages ■ Farm and crop ■ Commercial property ■ Construction and engineering ■ Commercial motor and fleet motor ■ Marine Long-tail insurance ■ Workers' compensation ■ Professional indemnity ■ Directors' and officers' ■ Public and products liability

DIVISION	OVERVIEW	PRODUCTS
New Zealand 21% 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 ■ 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 ■ Personal liability ■ Commercial liability
Asia 3% of Group GWP	The Group has interests in five general insurance businesses in Asia, comprising the direct and intermediated insurance business underwritten through subsidiaries in Thailand, Vietnam and Indonesia and the share of the operating result from the investment in associates in Malaysia and India. The businesses offer personal and commercial insurance products through local brands.	
Corporate and other	Corporate and other comprises other activities, including corporate services, capital management activity, shareholders' funds investment activities and inward reinsurance from associates.	

OPERATING AND FINANCIAL REVIEW

OPERATING RESULT FOR THE HALF YEAR

IAG reported a headline insurance margin of 17.3% for the half year ended 31 December 2017 and an improved underlying performance consistent with the expectations held and guidance provided at the outset of the year. Underlying margin improved to 12.6% compared to 11.2% in the second half of the prior year. This reflected the earn-through of past and ongoing rate increases, as well as a return to more normal large loss experience in Australian commercial property and maintenance of improved NSW Compulsory Third Party (CTP) profitability post initial reform measures.

Reported GWP growth was 0.6%, after absorbing the effects of discontinued business, changes to the Emergency Services Levy (ESL) in NSW, lower GWP from NSW CTP owing to scheme reform measures and an adverse foreign exchange translation effect. Like-for-like GWP growth was approximately 4% as commercial pricing continued to improve in Australia and New Zealand and rate increases in short-tail personal lines countered claim inflation pressures.

Across Australia and New Zealand, short-tail personal lines' GWP growth was largely rate-driven, supplemented by modest volume growth in motor. Positive rate momentum in short-tail commercial lines continued, partially offset by reduced volumes as remediation actions and maintained underwriting discipline tempered GWP growth.

IAG's reported insurance margin of 17.3% (31 December 2016: 13.5%) was significantly higher than the corresponding half year owing to a favourable net natural peril claims experience against allowance, which accounted for 370 basis points (bps) of improvement. A higher favourable credit spread outcome also contributed, while net prior period reserve releases were lower than the corresponding half year, but exceeded expectations.

Asia reported an improvement in its divisional result to $15 million (31 December 2016: $2 million). IAG has announced it is conducting a strategic review to assess the options available for its Asian businesses. Separately, a $50 million write-down to the collective carrying value has also been recognised.

In the current half year, IAG announced further quota share agreements with three reinsurers covering 12.5% of IAG's consolidated business. The quota shares commenced on 1 January 2018 and have an average initial term in excess of five years. They improve IAG's capital mix through greater use of more efficient reinsurance capital, serving to reduce earnings volatility, lower exposure to catastrophe reinsurance rates and reduce regulatory capital requirements. The new quota share arrangements have not impacted the Group's reported earnings for the current reporting period, but balance sheet effects have been recognised to reflect the portion of the unearned premium reserve, and related balances, that will inure to the benefit of the new reinsurance counterparties. This has resulted in the recognition of deferred outwards reinsurance expense, partly offset by related expense recoveries ('Other liabilities'), with the net reinsurance premium payable presented within 'Trade and other payables'.

IAG is on track to achieve its 'low single digit' GWP growth guidance for the year ended 30 June 2018 and has increased its reported margin guidance, relative to the updated position provided in December 2017 after announcement of the new quota share agreements, to 15.5-17.5%. This reflects a higher prior period reserve release assumption of around 3% of Net Earned Premium (NEP) and the favourable credit spread effect recorded in the half year ended 31 December 2017.

Net profit after tax

The Group's profit after tax for the half year was $569 million (31 December 2016: $491 million). After adjusting for non-controlling interests in the Group result, net profit attributable to the shareholders of the Company was $551 million (31 December 2016: $446 million) and was over 23% higher than the corresponding half year. In addition to the significant increase in insurance profit, this outcome included the net effect of:

- a higher contribution from investment income on shareholders' funds, incorporating strong equity market returns;
- a higher effective tax rate of 27.2%, owing to the absence of the favourable tax effect on 2011 Canterbury earthquake reinsurance recoveries by an offshore captive vehicle which reduced the 31 December 2016 effective tax rate to 18.2%; and
- a $50 million increase in 'Fee-based, corporate and other expenses', representing the write-down of Asian asset carrying values.

Gross written premium

Total GWP of $5,834 million represented a 0.6% increase compared to the corresponding half year. This translates to like-for-like growth of approximately 4%. This increase was primarily driven in both Australia and New Zealand by:

- further rate response to claim cost pressures in short-tail personal lines;
- ongoing favourable momentum in average commercial rates, with advances of approximately 5% in Australia and over 10% in New Zealand; and
- modest volume effects, with growth in personal motor and CTP countered by slightly lower home and commercial levels of business.

Insurance margin

IAG's current half year reported insurance profit of $743 million (31 December 2016: $571 million) was over 30% higher than the corresponding half year. The reported insurance margin of 17.3% (31 December 2016: 13.5%) included:

- net natural peril claim costs of $262 million (31 December 2016: $420 million), which were $78 million lower than allowance, as IAG benefited from its aggregate reinsurance cover which, in particular, limited the impact of the major Melbourne hailstorm event in December 2017 to $20 million;
- higher than expected net prior period reserve releases of $121 million, equivalent to 2.8% of NEP, down from $155 million (3.7% of NEP) in the corresponding half year. These were derived from Australian long-tail classes, principally CTP, partially offset by over $50 million of strengthening in New Zealand; and
- a more favourable credit spread impact of $47 million, compared to $5 million in the corresponding half year.

Underlying margin

IAG's underlying margin of 12.6% (31 December 2016: 12.6%), while similar to the corresponding half year, was a marked improvement on the second half of the prior year. This favourable reversal in trend included:

- the earned-through effect of past and ongoing rate increases in both personal and commercial short-tail lines;
- associated reduction of claim cost pressures in short-tail motor, as rate increases at least matched increases in average claim costs;
- more normal large loss experience in Australian commercial property, after the adverse severity experienced in the second half of the prior year; and
- maintenance of the improved CTP profitability seen in the second half of the prior financial year, as initial reform measures in NSW result in lower small claims frequency.

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 2017		31 December 2016	
INSURANCE MARGIN	**$m**	**%**	$m	%
Reported insurance margin*	**743**	**17.3**	571	13.5
Net natural peril claim costs less allowance	**(78)**	**(1.8)**	80	1.9
Reserve releases in excess of 1% of NEP	**(78)**	**(1.8)**	(113)	(2.7)
Credit spread movements	**(47)**	**(1.1)**	(5)	(0.1)
Underlying insurance margin	**540**	**12.6**	533	12.6

* Reported insurance margin is the insurance profit as a percentage of NEP as disclosed in the Statement of Comprehensive Income.

Tax expense

IAG reported a tax expense of $213 million in the current half year compared to $109 million in the corresponding half year, representing an effective tax rate of 27.2% (31 December 2016: 18.2%).

This outcome was significantly closer to the prevailing Australian corporate rate of 30% and reflects the absence of favourable reinsurance recovery-related effects which were applicable to IAG's captive vehicle in Singapore in the corresponding half year.

Contributory elements reconciling the current half year's effective tax rate to the Australian corporate rate 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 profit of $138 million, a greater than 30% increase on the profit of $105 million in the corresponding half year. This was supported by the strong equity markets, both domestic and offshore. The broader Australian index (S&P ASX200 Accumulation) delivered a return of 8.4% (31 December 2016: 10.6%), while the MSCI World Total Return Index (AUD Hedged) registered a gain of 10.0% (31 December 2016: 10.6%).

At 31 December 2017, the weighting to growth assets (equities and alternatives) within shareholders' funds stood at approximately 53% (31 December 2016: 48%).

A. AUSTRALIA

Australia accounted for 76% of Group GWP and continued to deliver a strong, but slightly lower, underlying margin of 11.4% (31 December 2016: 12.2%) and an improved reported insurance margin of 18.8% (31 December 2016: 16.5%).

I. Premiums

Australia reported marginally lower GWP of $4,453 million in the first half of the current year (31 December 2016: $4,483 million), however like-for-like growth was nearly 3% after allowance for impacts from discontinued business, ESL collection changes and the influence of NSW CTP reform. This outcome includes:

- solid rate-driven growth of 4.9% in short-tail motor, largely in response to claims inflation pressures;
- ongoing average rate momentum of approximately 5% in commercial lines, as targeted increases were applied in most classes;
- a $23 million reduction in GWP from exiting motor vehicle and motorcycle dealership activities;
- significantly lower NSW CTP GWP, with the combination of rate reductions and premium refunds accounting for nearly $80 million, in response to scheme reform; and
- lower ESL-related GWP of nearly $50 million following its reintroduction in NSW.

Consumer division

IAG is the largest personal lines insurer in Australia, offering short-tail motor and home products across the country under a range of brands, supplemented by long-tail CTP offerings in NSW, ACT and South Australia. The Australian Consumer division accounted for 52% of Group GWP and produced a strong, but slightly lower, underlying margin of 13.9% (31 December 2016: 14.1%).

Consumer GWP in the current half year amounted to $3,052 million (31 December 2016: $3,060 million) which was flat compared to the corresponding half year. Excluding the effects of ESL and NSW CTP related changes, like-for-like Consumer GWP growth was over 3%.

Short-tail personal lines GWP represented over 86% of Consumer GWP, with nearly 97% of this derived from motor and home classes. Compared to the corresponding half year, overall short-tail GWP growth of 2.3% was predominantly rate-driven, and included an approximately $30 million impact from lower ESL-related GWP.

Long-tail (CTP) GWP decreased by over 14%, compared to the corresponding half year, largely owing to rate reductions and refunds associated with NSW scheme reform. Broader reforms to the NSW scheme took effect from 1 December 2017. Changes in scheme design, including defined benefits for low severity injuries and access to common law for the most seriously injured, are expected to reduce future claim costs. In response, IAG reduced its average NSW CTP premiums by an additional 22% from 1 December 2017.

Business division

IAG sells a range of commercial insurance products across Australia. The Australian Business division accounted for 24% of Group GWP and produced a lower underlying margin of 6.5% (31 December 2016: 8.8%).

GWP declined slightly in the current half year to $1,401 million (31 December 2016: $1,423 million) compared to the corresponding half year. Like-for-like Business GWP growth was of the order of 1.4%, after allowance for discontinued Swann Insurance activities and an adverse ESL-related effect. The outcome comprised:

- a continuation of targeted rate increases across most business classes, and notably in commercial motor and packaged product portfolios;
- underwriting agency-derived growth, primarily from NTI;
- retention levels slightly lower than the same period last year, however higher than expected;
- slightly lower new business volumes;
- an approximately $23 million reduction from Swann Insurance; and
- an $18 million reduction in ESL-related GWP, following its reintroduction in the current half year.

II. Insurance profit

Australia reported an insurance profit of $625 million, compared to $542 million in the corresponding half year. This equates to a higher reported insurance margin of 18.8% (31 December 2016: 16.5%) compared to the corresponding half year and includes the net effect of:

- higher prior period reserve releases;
- lower net natural peril claim costs; and
- a higher favourable credit spread impact.

III. Underlying margin
Australia's underlying performance was sound, with an underlying margin of 11.4% representing an improvement on the second half of the prior year (10.8%), and a slightly lower outcome against the corresponding half year (12.2%). Contributory factors to the improvement seen relative to the second half of the prior year were:
- reduced pressure on motor profitability from higher claim costs, as increased premium rates earned through;
- increased flow-through impact of average rate increases across commercial portfolios;
- a more normal large loss experience in commercial property classes, down from the elevated level seen in the prior year;
- maintenance of the improved current year profitability in NSW CTP seen in the second half of the prior financial year, reflecting lower small claim frequency; and
- some offset from increased expenses.

IV. Fee-based business
The principal source of fee income for the Business division is its role as agent under both the NSW and Victorian workers' compensation schemes, which are underwritten by the respective state governments. In March 2017, IAG decided to withdraw from the NSW scheme by 31 December 2017 after assessment of associated risks and returns. As part of the withdrawal, anticipated redundancy costs associated with the exit were fully provided for in the prior year ended 30 June 2017.

In the current half year, net income from fee-based operations was $5 million, compared to $2 million in the corresponding half year. The current half year result contained $10 million of prior period fee income for the Victorian scheme, which was $5 million higher than the corresponding half year. This related to a new incentive fee, and the scheme is on track for improved performance. This is the second year of a five-year contract in the Victorian scheme. A secondary source of fee income is Business division's interest in authorised representative brokers.

B. NEW ZEALAND
New Zealand accounted for 21% of Group GWP and continued to deliver a strong underlying performance, with a higher underlying margin of 17.4% (31 December 2016: 15.3%) and a higher reported margin of 14.2% (31 December 2016: 4.3%).

I. Premiums
New Zealand's reported current half year GWP rose by 5.5% to $1,190 million, compared to the corresponding half year GWP of $1,128 million. This increase comprises an adverse foreign exchange translation effect, with local currency GWP increasing by 9.5%, to NZ$1,299 million (31 December 2016: NZ$1,186 million). This outcome was the result of:
- strong GWP growth in the Business division, as rate increases were achieved, particularly in commercial lines, with some offset from lower new business volumes as IAG adhered to its strong underwriting disciplines; and
- ongoing GWP growth in the Consumer division, led by the private motor vehicle portfolio which achieved volume growth and higher rates.

II. Insurance profit
The New Zealand business produced a substantially higher insurance profit of $119 million in the current half year, compared to $36 million in the corresponding half year, translating to a reported insurance margin of 14.2% (31 December 2016: 4.3%) which reflects the net effect of:
- a positive movement in gross earned premium, reflecting sound growth in the Consumer division (led by the AMI private motor portfolio) and rate-driven benefits in the Business division;
- subdued net natural peril claim costs and the absence of any earthquake events in the current half year;
- working claims in line with expectations as initiatives to remediate claims performance begin to deliver;
- continued focus on disciplined expense management; and
- some offset from prior period reserve strengthening.

Net prior period reserve strengthening of $53 million was recognised in the current half year. This primarily relates to:
- potential claims under architect/engineer professional indemnity policies relating to residual risk (e.g. negligence) from post-earthquake building damage and rebuild activity; and
- adverse development in prior year storm events.

III. Canterbury rebuild
The settlement of claims associated with the financial year 2011 Canterbury earthquake events continues to make sound progress. At 31 December 2017:
- over NZ$6.5 billion of claim settlements had been completed;
- 98% of all claims by number had been fully settled;
- over 98% of commercial claims had been fully settled; and
- over 97% of residential claims had been settled, with the balance either in construction or negotiation for cash settlement.

During the current half year, IAG continued to receive new claims from the Earthquake Commission (EQC) as they tipped over the EQC cap of NZ$100,000 plus Goods and Services Tax (GST). At 31 December 2017, IAG's reserving position allows for further claims exceeding the EQC's cap.

IAG has increased its gross reserved position on the three major earthquakes in financial year 2011. This falls to the account of IAG's reinsurers, with no earnings impact to IAG. Following this increase in earthquake reserves, IAG has utilised approximately 10% of the NZ$600 million adverse development cover in excess of NZ$4.4 billion on the February 2011 event.

C. ASIA

IAG has a presence in five Asian markets: consolidated businesses in Thailand, Vietnam and Indonesia and investment in associates in Malaysia and India.

I. Divisional result

The division contributed a total profit of $15 million, including shares of associates and allocated costs compared to the corresponding half year profit of $2 million. The improved result reflects the combination of:

- the absence of large commercial losses in Thailand following reduced exposure to selected segments of this book;
- the favourable impact of effective portfolio management in Malaysia, along with higher prior period reserve releases;
- improved profits in India owing to better risk selection following portfolio remediation, a favourable one-off reinsurance effect and the influence of a relatively benign monsoon season; and
- lower regional support and development costs.

As part of its overall Asia strategy, IAG has expressed a strong interest in growth via market consolidation and increased ownership. IAG's current assessment is that such opportunities are limited, resulting in the decision to conduct a strategic review of the options available for its Asian businesses (refer to Note 2.9). This review is expected to be concluded by the end of calendar 2018.

II. Controlled entities

GWP from the Group's controlled entities was $185 million, which was an increase of 2% on the corresponding half year GWP of $182 million, within this:

- the Thai business (Safety Insurance) reported a GWP increase of 2.3% to $177 million in the current half year compared to $173 million in the corresponding half year. The increase was mainly driven by a strong recovery in motor, as price competition subsided and market conditions improved, resulting in local currency GWP growth of over 6%, and lower commercial volumes following a planned reduction in exposure to selected segments;
- AAA Assurance in Vietnam recorded GWP equivalent to $7 million (31 December 2016: $8 million); and
- Parolamas in Indonesia, recorded GWP of less than $1 million (31 December 2016: $1 million).

During the current half year, the controlled entities reported an insurance profit of $1 million (31 December 2016: loss of $2 million) excluding allocated regional development costs. Within this:

- the Thai business reported an improved insurance profit of $5 million compared to breakeven result at the insurance profit line in the corresponding half year, derived from a relative absence of large losses and prior period reserve strengthening following remediation actions undertaken in the commercial book, partially offset by higher flood claims from a prolonged rainy season and a further regulatory-led increase in compulsory motor claim limits, with no commensurate premium increase;
- AAA Assurance reported an insurance loss of $1 million compared to a breakeven result at the insurance profit line in the corresponding half year; and
- Parolamas in Indonesia contributed an insurance loss of $3 million compared to a loss of $2 million in the corresponding half year.

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

The Group's share of net profit of associates was a profit of $24 million (31 December 2016: $16 million), excluding allocated regional development costs and before amortisation. This result includes AmGeneral Holdings Berhad (AmGeneral) in Malaysia and SBI General Insurance Company Limited (SBI General) in India.

IAG's share of AmGeneral's profit for the current half year increased to $13 million (31 December 2016: $10 million). The positive outcome comprised the net effect of:

- effective pricing actions and portfolio management, supplemented by higher prior period reserve releases; partially offset by
- reduced net earned premium on the back of a reduction in average premiums for motor insurance and lower growth; and
- additional marketing spend on detariffication-related initiatives.

IAG's share of SBI General's profit for the half year increased to $11 million (31 December 2016: $6 million). This positive outcome comprised the net effect of:

- an improved loss ratio arising from motor portfolio remediation;
- a relatively benign monsoon season in the current half year;
- lower investment income due to an unfavourable mark-to-market movement in the technical reserves fund; and
- a positive one-off effect from the finalisation of a reinsurance treaty for the long-term home portfolio.

D. CORPORATE AND OTHER

A pre-tax profit of $16 million was reported, which compares to a profit of $18 million in the corresponding half year. Further details on the operating segments are set out in Note 1.3 within the financial statements.

REVIEW OF FINANCIAL CONDITION

A. FINANCIAL POSITION

The total assets of the Group as at 31 December 2017 were $29,456 million compared to $29,597 million as at 30 June 2017. Movements within the overall decrease of $141 million include:

- a decrease in investments of $556 million from the funds outflow associated with the payments of the 2017 final dividend of $473 million, net settlements on the Berkshire Hathaway (BH) quota share partially offset by sound operating earnings for the half year;
- a decrease in trade and other receivables of $308 million, predominantly driven by a $136 million reduction in premium receivables driven by the NSW CTP regime changes and $212 million due to lower unsettled investment transactions outstanding at 31 December 2017; and
- an increase in deferred insurance expenses of $827 million, predominantly related to recognition of the new whole-of-account quota share reinsurance agreements covering an additional 12.5% of IAG's consolidated business.

The total liabilities of the Group as at 31 December 2017 were $22,631 million compared with $22,805 million at 30 June 2017. The decrease in liabilities of $174 million is mainly attributable to the net effect of:

- a decrease in the outstanding claims liability of $423 million primarily due to the prior year releases from Australian long-tail classes, settlement of prior year natural peril claims and New Zealand earthquake claims partially offset by reserves for the Melbourne storm event;
- a decrease in the unearned premium liability of $179 million, largely due to the effect of lower GWP growth in the period which embraced the impacts from NSW CTP reform measures, ESL collection changes, discontinued business and lower seasonal renewals; and
- an increase in trade and other payables of $411 million largely reflecting the increase in the net reinsurance payable associated with the new quota share reinsurance agreements.

IAG shareholders' equity (excluding non-controlling interests) increased from $6,562 million to $6,598 million as at 31 December 2017, reflecting the combined effect of:

- a strong earnings performance in the current half year, resulting in a net profit attributable to shareholders of $551 million;
- payment of the final dividend of $473 million declared in respect of the 2017 financial year; and
- a decrease in the reserves of $43 million predominantly due to the foreign exchange movements between the New Zealand and Australian dollars in the first half of the 2018 financial year.

B. CASH FROM OPERATIONS

The net cash inflows from operating activities for the half year ended 31 December 2017 were $23 million compared with $469 million for the corresponding half year. The movement is mainly attributable to the net effect of:

- a $206 million decrease in reinsurance and other recoveries due to the period-on-period reduction in collection of recoveries pertaining to the 2010 and 2011 Canterbury earthquakes, partially offset by higher recoveries on BH and Group catastrophe reinsurance covers;
- a $204 million increase in taxes paid due to timing and quantum of the final tax payment for the year ended 30 June 2017; and
- a $46 million increase in claim costs due to increased claims paid for the Kaikoura earthquake event and short-tail claims offset by decreased payments associated with the 2010 and 2011 Canterbury earthquakes.

C. INVESTMENTS

The Group's investments totalled $11.6 billion as at 31 December 2017, excluding investments held in joint ventures and associates, with 65% represented by the technical reserves portfolio. Total investments at 30 June 2017 were $12.1 billion. The decrease in total investments since 30 June 2017 reflects the combined effect of:

- a $0.6 billion reduction in technical reserves, in response to further quota share and prior period reserve release effects; and
- a $0.1 billion increase in shareholders' funds, where operating earnings during the period exceeded dividend payments.

As at 31 December 2017, the Group's overall investment allocation remains conservatively positioned, with 81% of total investments in fixed interest and cash. Technical reserves were 100% invested in fixed interest and cash, while the equivalent figure for shareholders' funds was 47%.

D. INTEREST-BEARING LIABILITIES

The Group's interest-bearing liabilities stood at $1,608 million at 31 December 2017, compared to $1,624 million at 30 June 2017. The small net decrease reflects the foreign exchange movement on a NZ$-denominated debt instrument.

E. CAPITAL MIX

The Group 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. It remains IAG's intention to have a capital mix in the following ranges over the longer term:

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

At 31 December 2017, the Group's capital mix stood at the lower end of its targeted range, with debt and hybrids representing 31.1% (30 June 2017: 31.9%) of total tangible capitalisation.

F. CAPITAL MANAGEMENT

The Group remains strongly capitalised under APRA's Prudential Standards, with regulatory capital of $4,722 million at 31 December 2017 (30 June 2017: $4,526 million). The Group 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 2017, the Group had a PCA multiple of 1.81 (30 June 2017: 1.70) and a CET1 multiple of 1.19 (30 June 2017: 1.09).

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 across Australia, New Zealand or Asia, 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.

The IAG strategy is to optimise our 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) 1.5x weighted average cost of capital (WACC);
- a dividend payout of 60-80% of 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 our customers and automate processes enabling us 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 that anticipate customers' needs.
- Use data to power decision making, allowing us to better understand our 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.
- 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 our strategy and helping our people transition to the future of work.
- Be recognised as a purpose led organisation that shapes our internal and external environment.

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 industry and stakeholder expectations. This means that IAG needs to manage its baseline compliance obligations and beyond that, take risk in a manner that is aligned with customer, shareholder, industry, regulatory and other key stakeholder expectations.

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) is reviewed annually, or as required by the Risk Committee (RC), before being recommended for approval by the Board. IAG's Chief Risk Office function provides regular reports to the RC on the operation of and any changes to IAG's risk management framework, the status of key risks, risk and compliance incidents, risk trends and IAG's risk profile. IAG's Internal Audit function provides reports to the Audit Committee (AC) on significant audit findings and other audit related matters.

Roles and responsibilities of the Board and its standing committees, the AC, the RC, the People and Remuneration Committee (PARC) and the Nominations Committee, are set out in the Corporate Governance section of the IAG website.

The Group is exposed to multiple risks relating to the conduct of its general insurance business. The risks noted below are not meant to represent an exhaustive list, but outline those risks faced by the Group that have been identified in IAG's Risk Management Strategy:
- strategic risk – the risk of not achieving corporate or strategic goals due to poor decisions regarding future business plans and strategies and/or a lack of responsiveness to changes in the business environment;
- insurance risk – the risk that the Group is exposed to financial loss as a result of inadequate or inappropriate underwriting, inadequate or inappropriate product design and pricing, unforeseen, unknown or unintended liabilities that may eventuate, inadequate or inappropriate claims management including reserving or insurance concentration risk (i.e. by locality, segment or distribution);
- reinsurance risk – the risk of insufficient or inappropriate reinsurance coverage, inadequate underwriting and/or pricing of reinsurance exposures retained by IAG's reinsurance captives, inadequate or inappropriate reinsurance recovery management, reinsurance arrangements that are not legally binding, reinsurance concentration risk and credit counterparty concentration risk to reinsurers;
- financial risk – the risk of inadequate liquidity, adverse movements in market prices (foreign exchange, equities, credit spreads, interest rates, etc) within the investment funds and a counterparty failing to meet its obligations (credit risk);
- operational risk – the risk of loss resulting from inadequate or failed internal processes, 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.

Detail of the Group's overall risk management framework, which is outlined in the RMS, is set out in Note 3.1 in the 30 June 2017 Annual Report and in the Corporate Governance Statement, which is available at www.iag.com.au/about-us/corporate-governance.

OUTLOOK

IAG expects to report further improvement in its underlying performance in the second half of the current financial year.

IAG's GWP guidance for the current financial year of 'low single digit growth' remains unchanged. In December 2017, the Group increased its reported margin guidance for the year ended 30 June 2018 from 12.5-14.5% to 13.75-15.75%, to reflect six months' impact of the combined 12.5% quota share agreements which commenced on 1 January 2018. Following finalisation of its current half year results, IAG has further upgraded its financial year 2018 reported margin guidance to 15.5-17.5%. This incorporates an increased prior period reserve release expectation and inclusion of the favourable credit spread impact reported in the current half year. Underlying assumptions behind the updated financial year 2018 margin guidance are:

- net losses from natural perils in line with an allowance of $627 million (2017: $680 million);
- prior period reserve releases of around 3% of NEP (previously at least 2%);
- no material movement in foreign exchange rates or investment markets in the second half of the current financial year; and
- a neutral impact from optimisation program initiatives, as benefits are broadly matched by related implementation costs.

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 2.5 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 IAG shareholders;
- plus amortisation and impairment of acquired identifiable intangibles; and
- excluding any unusual items (non-recurring in nature).

CASH EARNINGS	**31 December 2017 $m**	31 December 2016 $m
Net profit after tax	**551**	446
Acquired intangible amortisation and impairment	**79**	29
	630	475
Non-recurring items:		
Corporate expenses	**-**	4
Tax effect on corporate expenses	**-**	-
Cash earnings*	**630**	479
Interim dividend	**331**	308
Cash payout ratio*	**52.5%**	64.3%

* 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% (31 December 2016: 60-80%) of reported full year cash earnings in respect of any given financial year.

The Board has determined to pay a fully franked interim dividend of 14.0 cents per ordinary share (cps) (31 December 2016: 13.0 cps). The interim dividend is payable on 29 March 2018 to shareholders registered as at 5pm on 21 February 2018.

The Company's Dividend Reinvestment Plan (DRP) will operate for the interim dividend by acquiring shares on market with no discount applied. The DRP Issue Price will be based on a volume-weighted average share price as defined in the DRP terms. The last date for receipt of an election notice for participation in the Company's DRP is 22 February 2018. Information about IAG's DRP is available at www.iag.com.au/shareholder centre/dividends/reinvestment.

SIGNIFICANT CHANGES IN STATE OF AFFAIRS

During the half year, the following changes became effective:

- Effective 19 July 2017, IAG announced the creation of a single Australian division to be led by Mark Milliner as CEO Australia. The Australian division simplifies IAG's operating model by bringing together the former Australian Consumer, Australian Business, Operations and Satellite divisions. There has been no change to the reportable segments in the current reporting period as financial information was prepared and reviewed by the chief operating decision maker based on the pre-existing segment structure for Australia.
- On 1 August 2017, IAG consolidated its nine Australian Insurance licences into two licences following Federal Court approval received in July 2017. The consolidation transferred the insurance assets and liabilities of seven entities into a related entity, Insurance Australia Limited, with no impact to the Group's consolidated financial performance or position. Following the transfer, IAG retains two authorised insurers in Australia being Insurance Australia Limited and Insurance Manufacturers of Australia Pty Limited. The transfer is part of IAG's focus on becoming a simpler, more efficient and agile business.
- On 8 December 2017, IAG announced it had entered into three agreements to quota share a combined 12.5% of its consolidated business from 1 January 2018. The agreements, with Munich Re, Swiss Re and Hannover Re, are on a whole-of-account basis, covering IAG's consolidated business in Australia, New Zealand and Thailand and have an initial average period of more than five years. Expected benefits include reduced earnings volatility, reduced reliance on catastrophe reinsurance cover and exposure to future volatility in reinsurance rates, and reduced regulatory capital requirements.

EVENTS SUBSEQUENT TO REPORTING DATE

Detail of matters subsequent to the end of the half year are set out below and in Note 2.9 within the financial statements. These include announcements made on 14 February 2018 that:

- The Board determined to pay an interim dividend of 14.0 cents per share, 100% franked. The dividend will be paid on 29 March 2018. The dividend reinvestment plan will operate by acquiring shares on market for participants with no discount applied.
- The Group will conduct a strategic review of the options available for its Asian businesses. This review is expected to be concluded by the end of calendar 2018.

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 2017.

Signed at Sydney this 14th day of February 2018 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 2017 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

Andrew Yates
Partner

Sydney
14 February 2018

CONSOLIDATED FINANCIAL STATEMENTS

CONTENTS		PAGE

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

FOR THE HALF YEAR ENDED 31 DECEMBER 2017

	31 December 2017 $m	31 December 2016 $m
Gross earned premium	**5,966**	5,868
Outwards reinsurance premium expense	**(1,663)**	(1,624)
Net earned premium (i)	**4,303**	4,244
Claims expense	**(4,143)**	(4,313)
Reinsurance and other recoveries revenue	**1,552**	1,688
Net claims expense (ii)	**(2,591)**	(2,625)
Commission expense	**(534)**	(526)
Underwriting expense	**(920)**	(912)
Reinsurance commission revenue	**358**	353
Net underwriting expense (iii)	**(1,096)**	(1,085)
Underwriting profit (i) + (ii) + (iii)	**616**	534
Investment income on assets backing insurance liabilities	**137**	46
Investment expenses on assets backing insurance liabilities	**(10)**	(9)
Insurance profit	**743**	571
Investment income on shareholders' funds	**146**	109
Fee and other income	**95**	107
Share of net profit of associates	**18**	8
Finance costs	**(39)**	(51)
Fee-based, corporate and other expenses	**(180)**	(141)
Net loss attributable to non-controlling interests in unitholders' funds	**(1)**	(3)
Profit before income tax	**782**	600
Income tax expense	**(213)**	(109)
Profit for the period	**569**	491
OTHER COMPREHENSIVE INCOME/(EXPENSE)		
Items that may be reclassified subsequently to profit or loss:		
Net movement in foreign currency translation reserve, net of tax	**(29)**	2
Items that will not be reclassified to profit or loss:		
Remeasurements of defined benefit plans, net of tax	**(2)**	21
Other comprehensive income, net of tax	**(31)**	23
Total comprehensive income for the period, net of tax	**538**	514
PROFIT FOR THE PERIOD ATTRIBUTABLE TO		
Shareholders of the Parent	**551**	446
Non-controlling interests	**18**	45
Profit for the period	**569**	491
TOTAL COMPREHENSIVE INCOME FOR THE PERIOD ATTRIBUTABLE TO		
Shareholders of the Parent	**520**	469
Non-controlling interests	**18**	45
Total comprehensive income for the period, net of tax	**538**	514

	NOTE	**31 December 2017 cents**	31 December 2016 cents
EARNINGS PER SHARE			
Basic earnings per ordinary share	2.4	**23.32**	18.61
Diluted earnings per ordinary share	2.4	**22.60**	17.92

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

CONSOLIDATED BALANCE SHEET

AS AT 31 DECEMBER 2017

	NOTE	**31 December 2017 $m**	30 June 2017 $m
ASSETS			
Cash held for operational purposes		**436**	424
Investments	2.1	**11,580**	12,136
Trade and other receivables		**3,845**	4,153
Current tax assets		**102**	66
Reinsurance and other recoveries on outstanding claims		**5,235**	5,258
Deferred insurance expenses		**3,597**	2,770
Deferred levies and charges		**95**	105
Deferred tax assets		**509**	545
Property and equipment		**177**	182
Other assets		**107**	121
Investment in joint venture and associates	2.7	**510**	505
Goodwill and intangible assets		**3,263**	3,332
Total assets		**29,456**	29,597
LIABILITIES			
Trade and other payables		**2,845**	2,434
Current tax liabilities		**84**	169
Unearned premium liability		**6,152**	6,331
Outstanding claims liability		**10,948**	11,371
Non-controlling interests in unitholders' funds		**229**	219
Provisions		**292**	329
Other liabilities		**473**	328
Interest-bearing liabilities	2.2	**1,608**	1,624
Total liabilities		**22,631**	22,805
Net assets		**6,825**	6,792
EQUITY			
Share capital	2.3	**7,082**	7,082
Treasury shares held in trust		**(30)**	(38)
Reserves		**(26)**	17
Retained earnings		**(428)**	(499)
Parent interest		**6,598**	6,562
Non-controlling interests		**227**	230
Total equity		**6,825**	6,792

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 2017

	SHARE CAPITAL	TREASURY SHARES HELD IN TRUST	FOREIGN CURRENCY TRANSLATION RESERVE	SHARE-BASED REMUN-ERATION RESERVE	RETAINED EARNINGS	NON-CONTROLLING INTERESTS	TOTAL EQUITY
	$m	$m	$m	$m	$m	$m	$m
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 income/(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	**7,082**	**(30)**	**(48)**	**22**	**(428)**	**227**	**6,825**
31 December 2016							
Balance at the beginning of the financial period	7,275	(43)	(3)	35	(701)	222	6,785
Profit for the period	-	-	-	-	446	45	491
Other comprehensive income	-	-	2	-	21	-	23
Total comprehensive income for the period	-	-	2	-	467	45	514
Transactions with owners in their capacity as owners							
Off-market share buy-back, including transaction costs	(193)	-	-	-	(123)	-	(316)
Share-based remuneration	-	4	-	(9)	(4)	-	(9)
Purchase of non-controlling interests	-	-	-	-	(3)	-	(3)
Dividends determined and paid	-	-	-	-	(316)	(44)	(360)
Balance at the end of the financial period	7,082	(39)	(1)	26	(680)	223	6,611

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 2017

	31 December 2017 $m	31 December 2016 $m
CASH FLOWS FROM OPERATING ACTIVITIES		
Premium received	**5,971**	5,981
Reinsurance and other recoveries received	**1,590**	1,796
Claim costs paid	**(4,560)**	(4,514)
Outwards reinsurance premium expense paid	**(1,627)**	(1,672)
Dividends, interest and trust distributions received	**230**	238
Finance costs paid	**(46)**	(56)
Income taxes paid	**(291)**	(87)
Other operating receipts	**794**	747
Other operating payments	**(2,038)**	(1,964)
Net cash flows from operating activities	**23**	469
CASH FLOWS FROM INVESTING ACTIVITIES		
Net cash flows on disposal/(acquisition) of subsidiaries and associates	**2**	37
Net cash flows from sale/(purchase) of investments and plant and equipment	**174**	570
Net cash flows from investing activities	**176**	607
CASH FLOWS FROM FINANCING ACTIVITIES		
Outlays for repurchase of shares, including transaction costs	**-**	(316)
Proceeds from borrowings, net of transaction costs	**-**	394
Repayment of borrowings	**(2)**	(574)
Net cash flow from issue and redemption of trust units	**9**	(42)
Dividends paid to IAG shareholders	**(473)**	(316)
Dividends paid to non-controlling interests	**(21)**	(44)
Net cash flows from financing activities	**(487)**	(898)
Net movement in cash held	**(288)**	178
Effects of exchange rate changes on balances of cash held in foreign currencies	**(3)**	2
Cash and cash equivalents at the beginning of the financial period	**1,480**	1,104
Cash and cash equivalents at the end of the financial period*	**1,189**	1,284

* Includes $436 million (31 December 2016: $378 million) of cash held for operational purposes, $753 million (31 December 2016: $906 million) of cash and short-term money held for investments.

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 the Group.

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. 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 (IAG, Parent or Company), the ultimate parent entity in the Consolidated entity, 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 26, 388 George Street, Sydney, NSW 2000, Australia. This financial report covers the consolidated financial statements for the Company and its subsidiaries (Group or Consolidated entity) for the half year ended 31 December 2017.

This report is also to be read in conjunction with the annual report for the year ended 30 June 2017 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 the Group'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 14 February 2018 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 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, however this standard will not come into effect until 1 January 2021. Until this standard takes effect, the financial reports of insurers in different countries that comply with IFRS may not be comparable in terms of the recognition and measurement of insurance contracts.

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 the Group 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 the Consolidated entity. 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 2017.

I. Changes in accounting policies

There were no new Australian Accounting Standards and Interpretations issued and effective for the current reporting period, which had a material financial impact on the Company.

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 2017.

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

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

A. REPORTABLE SEGMENTS

The Consolidated entity has general insurance operations in Australia, New Zealand and Asia, with the reportable segments comprising the following business divisions:

I. Australia

The Australian division is comprised of two segments:

Consumer

This segment provides general insurance products to individuals and families throughout Australia, primarily under the NRMA Insurance, SGIO, SGIC and CGU brands, under the RACV brand in Victoria (via a distribution and underwriting relationship with RACV) and the Coles Insurance brand nationally (via a distribution agreement with Coles).

Business

This segment provides commercial insurance to businesses throughout Australia, predominantly under the CGU and WFI brands 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. Asia

This segment provides direct and intermediated insurance business underwritten through subsidiaries in Thailand, Vietnam and Indonesia and shares in the operating result from its investment in associates in Malaysia and India. The businesses offer personal and commercial insurance products through local brands.

IV. Corporate and other

This segment comprises other activities, including corporate services, capital management activity, shareholders' funds investment activities and inward reinsurance from associates. The Group'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. The Group 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			NEW ZEALAND	ASIA	CORPORATE AND OTHER	TOTAL
	Consumer	Business	Total				
	$m	$m	$m	$m	$m	$m	$m
31 December 2017							
I. Financial performance							
Total external revenue(1)	**4,205**	**2,060**	**6,265**	**1,604**	**240**	**163**	**8,272**
Underwriting profit/(loss)	**432**	**73**	**505**	**118**	**(6)**	**(1)**	**616**
Net investment income on technical reserves	**77**	**43**	**120**	**1**	**4**	**2**	**127**
Insurance profit/(loss)	**509**	**116**	**625**	**119**	**(2)**	**1**	**743**
Net investment income on shareholders' funds	**-**	**-**	**-**	**-**	**-**	**138**	**138**
Share of net profit/(loss) of associates	**-**	**2**	**2**	**-**	**17**	**(1)**	**18**
Finance costs	**-**	**-**	**-**	**-**	**-**	**(39)**	**(39)**
Other net operating result	**-**	**5**	**5**	**-**	**-**	**(83)**	**(78)**
Total segment result	**509**	**123**	**632**	**119**	**15**	**16**	**782**
Income tax expense							**(213)**
Profit for the period							**569**
II. Other segment information							
Capital expenditure(2)	**-**	**-**	**-**	**-**	**-**	**77**	**77**
Depreciation and amortisation expense	**27**	**28**	**55**	**26**	**2**	**14**	**97**
31 December 2016							
I. Financial performance							
Total external revenue(1)	3,983	1,954	5,937	1,837	278	127	8,179
Underwriting profit/(loss)	447	76	523	23	(12)	-	534
Net investment income on technical reserves	14	5	19	13	5	-	37
Insurance profit/(loss)	461	81	542	36	(7)	-	571
Net investment income on shareholders' funds	-	-	-	-	-	105	105
Share of net profit/(loss) of associates	-	-	-	-	9	(1)	8
Finance costs	-	-	-	-	-	(51)	(51)
Other net operating result	-	2	2	-	-	(35)	(33)
Total segment result	461	83	544	36	2	18	600
Income tax expense							(109)
Profit for the period							491
II. Other segment information							
Capital expenditure(2)	-	-	-	-	-	46	46
Depreciation and amortisation expense	28	28	56	25	2	-	83

(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.

(2) Capital expenditure includes acquisitions of property and equipment, intangibles and other non-current segment assets.

2. 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 the Group's financial position and performance since the end of the last annual reporting period.

NOTE 2.1 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 2017				
Interest-bearing investments	**2,058**	**7,528**	**1**	**9,587**
Equity investments	**1,164**	**357**	**254**	**1,775**
Other investments	**-**	**217**	**1**	**218**
	3,222	**8,102**	**256**	**11,580**
30 June 2017				
Interest-bearing investments	2,085	8,282	1	10,368
Equity investments	1,076	340	162	1,578
Other investments	4	185	1	190
	3,165	8,807	164	12,136

NOTE 2.2 INTEREST-BEARING LIABILITIES

	31 December 2017		30 June 2017	
	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	**550**	**572**	550	569
Capital notes	**404**	**435**	404	431
b. TIER 2 REGULATORY CAPITAL				
AUD subordinated convertible term notes	**350**	**357**	350	356
NZD subordinated convertible term notes(2)	**318**	**328**	334	337
II. Operational nature				
Other interest-bearing liabilities	**-**	**-**	2	2
Less: capitalised transaction costs	**(14)**		(16)	
	1,608		1,624	

(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 2017: $1 million) which is presented within trade and other payables.

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 2.3 NOTES TO THE STATEMENT OF CHANGES IN EQUITY

	31 December 2017	30 June 2017	**31 December 2017**	30 June 2017
	Number of shares in millions	Number of shares in millions	**$m**	$m
SHARE CAPITAL				
Ordinary shares				
Balance at the beginning of the financial period	**2,367**	2,431	**7,082**	7,275
Off-market share buy-back, including transaction costs	**-**	(64)	**-**	(193)
Balance at the end of the financial period	**2,367**	2,367	**7,082**	7,082

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.

NOTE 2.4 EARNINGS PER SHARE

	31 December 2017	31 December 2016
	cents	cents
A. REPORTING PERIOD VALUES		
Basic earnings per ordinary share(1)	**23.32**	18.61
Diluted earnings per ordinary share(2)	**22.60**	17.92

(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.

	31 December 2017	31 December 2016
	$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	**551**	446
Finance costs of convertible securities, net of tax	**18**	18
Profit attributable to shareholders of the Parent which is used in calculating diluted earnings per share	**569**	464

	31 December 2017	31 December 2016
	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	**2,363**	2,397
Weighted average number of dilutive potential ordinary shares relating to:		
Convertible securities	**150**	187
Unvested share-based remuneration rights supported by treasury shares held in trust	**5**	5
	2,518	2,589

NOTE 2.5 DIVIDENDS

	31 December 2017		31 December 2016	
	Cents per share	**$m**	Cents per share	$m
A. ORDINARY SHARES				
31 December 2016: dividend component of off-market share buy-back fully franked at 30%	**-**	**-**	192.0	123
2017 final dividend paid on 9 October 2017 (31 December 2016: 2016 final dividend) fully franked at 30%[1]	**20.0**	**473**	13.0	316
		473		439

(1) Of the total 2017 final dividend declared of $474 million, right and entitlement of $1 million (2016 final dividend: nil) to dividends on unallocated treasury shares was waived during the year by the trustee of the IAG Share and Rights Plans Trust.

	31 December 2017		31 December 2016	
	Cents per share	**$m**	Cents per share	$m
B. DIVIDEND NOT RECOGNISED AT REPORTING DATE				
2018 interim dividend (31 December 2016: 2017 interim dividend) fully franked at 30% to be paid on 29 March 2018[2]	**14.0**	**331**	13.0	308

(2) Of the total 2017 interim dividend declared of $308 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) operates which allows eligible shareholders with ordinary shares to elect to receive their dividend entitlement in the form of IAG shares. 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 2017 final dividend paid on 9 October 2017 was settled with the on-market purchase of 11.9 million shares priced at $6.34 per share (based on a daily VWAP for 13 trading days from 11 September 2017 to 27 September 2017 inclusive, with no discount applied).

NOTE 2.6 DERIVATIVES

	31 December 2017			30 June 2017		
	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	**942**	**11**	**(7)**	922	14	(3)
II. Investment-related derivatives (derivatives without hedge accounting applied)						
Bond futures	**2,764**	**-**	**-**	2,913	-	-
Share price index futures	**95**	**-**	**-**	(44)	-	-
Forward foreign exchange contracts	**2,522**	**51**	**-**	2,827	29	-
Options	**-**	**-**	**-**	(48)	3	(1)
III. Treasury-related derivatives (derivatives without hedge accounting applied)						
Forward foreign exchange contracts	**572**	**3**	**(5)**	1,160	11	(4)
Interest rate swaps	**318**	**-**	**(1)**	334	-	(5)

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 2.7 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 2017	30 June 2017	**31 December 2017**	30 June 2017
			$m	$m	**%**	%
AmGeneral Holdings Berhad (AmGeneral)	Malaysia	Insurance underwriting	**350**	353	**49.00**	49.00
SBI General Insurance Company Limited (SBI General)	India	Insurance underwriting	**142**	138	**26.00**	26.00
Other			**18**	14		
			510	505		

The Group has undertaken an assessment of the recoverable amount of its Asian assets. In aggregate, this has given rise to a write-down totalling $50 million during the reporting period. The write-down reflects updated assumptions and forecasts in relation to the current operating landscape affecting both the investment in associates and select identifiable intangibles. The related expense has been presented within 'Fee-based, corporate and other expenses' in the statement of comprehensive income. Where applicable, in addition to the impact of the write-down, the movement in carrying values shown above also includes the net impact of current period earnings and changes in exchange rates. The post-tax discount rates applied for valuation purposes have remained unchanged since 30 June 2017.

NOTE 2.8 CONTINGENCIES

There have been no material changes in the Group's contingent liabilities or contingent assets since 30 June 2017.

NOTE 2.9 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 2017. These include announcements made on 14 February 2018 that:

- The Board determined to pay an interim dividend of 14.0 cents per share, 100% franked. The dividend will be paid on 29 March 2017. The dividend reinvestment plan will operate by acquiring shares on market for participants with no discount applied.
- The Group will conduct a strategic review of the options available for its Asian businesses. This review is expected to be concluded by the end of calendar 2018.

NOTE 2.10 NET TANGIBLE ASSETS

	31 December 2017	30 June 2017
	$	$
Net tangible assets per ordinary share	**1.41**	1.36

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 2.10 are in accordance with the *Corporations Act 2001* including:
  - giving a true and fair view of the financial position of the Consolidated entity as at 31 December 2017 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 14th day of February 2018 in accordance with a resolution of the Directors.

Peter Harmer
Director

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 2017 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 2017;
- 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 2.10 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 2017 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

KPMG

Andrew Yates
Partner
Sydney
14 February 2018

Ian Moyser
Partner