

FAI General Insurance Company Limited
ACN 000 327 855
(In liquidation and subject to Schemes of Arrangement)

Scheme Administrators' annual report to
creditors

30 June 2009

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1 Introduction & background

1.1 Introduction

This is the third annual report to the Creditors of FAI General Insurance Company Limited - in liquidation and subject to Schemes of Arrangement (“FAIG”).

The report has been prepared in accordance with clause 43.2 of the Scheme of Arrangement, which became operative in Australia on 30 May 2006. Under the terms of the clause: “Within three months after each anniversary of the date, being either 31 December or 30 June, at the discretion of the Scheme Administrators, after The Australian Scheme becomes effective, the Scheme Administrators shall report to the Scheme Creditors on the progress of The Australian Scheme, including details of remuneration paid to the Office Holders, since the date of the last such report”. Accordingly this report has been prepared for the period to 30 June 2009.

An annual report has also been prepared by the Scheme Administrators of the UK Scheme of Arrangement for FAIG. This will be published on the HIH website as a supplement to the Australian annual report for this company.

1.2 Background

HIH Insurance Limited and certain of its major subsidiaries were placed into Provisional Liquidation on 15 March 2001, and subsequently into liquidation on 27 August 2001. To date, eighty-two HIH Group companies in Australia have been placed into liquidation.

Summary details of the history of the group; its failure; and background information are available on the HIH website at www.hih.com.au. Extensive information on the failure of the group, including the final report of the HIH Royal Commission established by the Australian Federal Government, is available on the website www.hihroyalcom.gov.au.

Schemes of Arrangement for the eight licensed insurance companies in the HIH Group in Australia became effective on 30 May 2006, following approval by Creditors and the Court. Schemes of Arrangement for the UK branches of the four of these companies became effective in the UK on 13 June 2006. Each of the Schemes has a Record Date (the date at which liabilities are measured) of 27 August 2001. The earliest bar date permissible under the terms of the Schemes is 30 May 2011. At this stage the Scheme Administrators expect the actual bar dates to be 30 May 2013.

2 Principal developments to report during the period

The principal developments to report during the period were:

- + Agreement of Scheme Payment Percentages by the members of the requisite Scheme Creditor Committees, which now total as follows:

	Creditors with insurance liabilities in Australia	Creditors with insurance liabilities not in Australia	Creditors with non insurance liabilities in Australia	All other creditors worldwide
HIH C&G	16.28%	16.28%	9.00%	9.00%
FAIG	31.40%	n/a	30.00%	n/a
CIC	35.00%	n/a	35.00%	n/a
WMG	5.00%	nil	5.00%	nil

More detail on Scheme Payments and the estimated ultimate Scheme Payment Percentage for FAIG is included in section 3 of this report.

- + The Liquidators are close to finalising settlement with the defendants to the FAI Takeover claim. Further details of this are included in section 4 of this report.
- + The Scheme Administrators have been successful in their application to the New York State Conservation Court, seeking release of the small balance of Trust funds held to protect US domiciled holders of policies written by FAIG in the US. This has allowed the Scheme Administrators to make a Scheme Payment to these policy holders of 31.4%, which is in line with all other FAIG insurance creditors.

3 Current and projected Scheme Payment Percentages

3.1 The current Scheme Payment Percentage

The current Scheme Payment Percentage for FAIG is 31.40% for creditors with insurance liabilities in Australia (in the case of FAIG this encompasses all insurance creditors) and 30.00 for all non insurance creditors.

During the year a successful application was made to the NY State Conservation Court, which ratified the Deed of Release for the small balance of US Trust Fund monies held in respect of FAIG. This has allowed payment of the interim 31.40 cents in the dollar to any US domiciled creditors who had yet to receive a distribution under the Scheme, thus bringing them in line with all other insurance creditors.

The Superintendent of Insurance in New York has released the Trust funds, which has allowed payment to those creditors eligible to participate in any distribution from the Trust. The Trust Agreement defines such policyholders as: “the holders of an American Policy resident or doing business in the United States, and any other persons or associations who are assignees, pledgees, or mortgagees named therein”.

The terms of the Release of the Trust funds included an undertaking to distribute them strictly in accordance with the terms of the Trust Agreement.

3.2 Projected further Scheme payments

The Scheme Administrators are currently reviewing the level of assets realised. Unfortunately delays in the finalisation of the liquidation of other companies within the HIH Group, who owe large intercompany balances to FAIG, meant that the Scheme Administrators were unable to make the further Scheme payment of 5 cents in the dollar that was forecast in the last report to creditors. As these liquidations are now close to completion, the Scheme Administrators hope to make a fourth interim Scheme Payment of 5 cents in the dollar to all creditors by the end of December 2009. This Scheme Payment will be made from non reinsurance assets in Australia, and will bring the total Scheme distribution to insurance creditors to 36.3% and to all non insurance creditors to 35%.

3.3 Agreement of the current Scheme Payment Percentage

The Scheme Administrators review the Scheme Payment percentages on a regular basis, as they make major asset recoveries and update claims estimates. This review is undertaken in consultation with the Creditors' Committees. Factors taken into account when estimating these percentages include current cash held, expected future agreed claims levels and the remaining potential volatility of the account.

3.4 Scheme Payments for reinsurance creditors

In the previous annual reports to creditors it has been explained that agreed claims (described as “Acknowledged Creditor Claims” under the Scheme) of FAIG’s reinsurance creditors had generally not yet been accepted as Established Scheme Claims by the Scheme Administrators, and so reinsurance creditors would not generally have yet been paid any Scheme distributions.

The reason for this is the difficulty in identifying all potential future set-off. The HIH companies wrote both inwards reinsurance business and outwards reinsurance business, in more than one location, and significant set-off is expected. In common with many solvent insurers, prior to insolvency the HIH Group did not maintain their insurance records on a principal to principal basis, which meant that the Scheme Administrators were not able readily to identify all transactions with a particular principal. Considerable improvements to information management have now been made through the introduction of a P to P system.

The Scheme Administrators remain willing to consider making Scheme Payments to reinsurance creditors with Acknowledged Creditor Claims before all potential set off has been finalised, provided the creditor is willing to give an undertaking to refund any amounts which

subsequently prove to have been overpaid. Payment has been made to a number of such creditors over the last year and creditors interested in this should continue to contact the Scheme Administrators.

3.5 Estimated ultimate Scheme Payment Percentage

The Scheme Administrators' current best estimates of the ultimate Payment Percentage for FAIG is shown below. This estimate is dependent on a wide range of factors including the volatility of claims; levels of set-off; levels of reinsurance recovery; the class of creditor claim; and litigation outcomes. It is possible that the ultimate Payment Percentage could vary significantly either above or below that predicted.

Scheme Company	Estimated Total Scheme Payment Percentage at Scheme date	Updated Total Scheme Payment Percentage at 30 June 09
FAIG	25% to 35%	45% to 55%

The total Scheme Payment Percentage has remained in line with that set out in the last annual report. This is explained in more detail in section 6.1 of this report.

4 Interaction between Australian and English Schemes

4.1 Claiming under the Australian and English Schemes

All creditors worldwide are entitled to claim in both the Australian and English Schemes for FAIG. The Australian and English Scheme Administrators co-operate fully. Creditors do not need to lodge separate claims in each jurisdiction. Creditors need to lodge claims in one location only, which is then effective under both schemes.

The Australian and English Scheme Administrators, and the respective run-off managers, operate a unified principal to principal ledger system and a unified distribution payment system.

The entitlements of individual creditors under both schemes are automatically calculated, and when a scheme payment is made, the creditor receives a statement showing how their liability has been classed, and from which classes of assets their distribution has been paid.

Both the Australian and English Schemes contain a “hotchpot” clause. The effect of the hotchpot clause is to prevent a creditor who has already been paid a distribution under one of the schemes, from receiving further payments under the other scheme until such time as all other creditors with similarly ranked claims have received an equal proportionate distribution.

4.2 Distribution Priorities

The English Scheme is designed to complement the Australian Scheme. Following receipt of the House of Lords judgement the English Scheme will adopt all of the provisions of the Australian Scheme, including the Australian distribution priorities, which will now apply to the English Assets.

5 Major Litigation

5.1 Background

Following the collapse of the HIH Group in 2001, the Australian Government established the HIH Royal Commission to inquire into the reasons for the failure of the Group. The Hon Justice Neville Owen was appointed as Royal Commissioner and began his enquiry in September 2001. He presented his findings on the outcome of the enquiry in April 2003.

Considerable work was undertaken by the Commissioner and his team in investigating the circumstances behind the HIH collapse. This provided an extremely useful background against which the Liquidators could assess which of those HIH Directors, auditors and former advisors may be liable under any successful recovery action.

Having reviewed the potential courses of action open to them, the Liquidators decided to focus on two major recovery actions:

- + The Trading Loss & Dividend claim which was settled in 2007; and
- + The FAI Takeover claim

5.2 FAI Takeover claim

This claim arises from the takeover by the HIH Group of the FAI Group in 1998/99. The defendants to the claim include General Cologne Re, Guy Carpenter, Arthur Andersen and Goldman Sachs, who the Liquidators allege should compensate HIH for losses suffered through the takeover of the FAI Group.

The Liquidators are close to finalising a settlement with the defendants to this claim.

6 Financial position

6.1 Estimated balance sheet at 30 June 2009

Included as Appendix 3 to the Australian Explanatory Statement section of the Scheme of Arrangement documentation, which was sent to creditors prior to the creditors' meeting on 29 March 2006, were balance sheets for each of the Scheme companies at 25 September 2005. Included as Appendix 1 to this report is an updated balance sheet for FAIG, as at 30 June 2009.

Since the last annual report, the Scheme Administrators have commissioned a further full actuarial review of the insurance liabilities of the eight Scheme companies. This review has provided the Scheme Administrators with a more accurate estimate of the expected final insurance creditor claims, based on eight years of claims development since the start of the HIH Group liquidation. It has also provided an update on the forecast reinsurance asset that is remaining to be collected.

The actuarial review has not revealed the need for any major adjustments to the level of forecast total insurance creditors, such that the forecast Scheme Payment percentage needs to be amended from the current range of 45% to 55%.

6.2 Receipts and payments to 30 June 2009

A summary of the Scheme Administrators receipts and payments from the commencement of the Scheme on 30 May 2006 to 30 June 2009 is set out in Appendix 2 to this report.

During this period \$1,357,231.50 has been approved by the Scheme Creditors' Committee of FAIG and paid to the Scheme Administrators in their role as Office Holders.

7 Closure

The Scheme for FAIG provides for an Estimation Date of seven years after the Australian Scheme became effective, which means that the Estimation Date is expected to be in June 2013. By that time the Scheme Administrators expect that the majority of the reinsurance asset will have been collected or commuted, and the remaining tail of insurance liabilities will be sufficiently small to justify closure of the insolvency on cost benefit grounds.

The Scheme provides that the Estimation Date may be moved two years either way from the expected seven years (to be as early as five years or as late as nine years after the Effective Date) by special resolution of creditors, on the recommendation of the Scheme Administrators and Creditors' Committees. Under the terms of the Scheme all creditors will be given notice of the actual Estimation Date between six and three months prior to the time.

Following the Estimation Date all remaining outstanding and IBNR creditor claims will be crystallised by estimation, to allow for the closure of the insolvency.

At the date of this report, the Scheme Administrators consider that June 2013 remains the most likely Estimation Date for the Scheme.

8 Responsibilities

8.1 Scheme Administrators

The Australian Scheme Administrators are Tony McGrath and Chris Honey, partners of McGrathNicol, based in Sydney. The English Scheme Administrators of FAIG are John Wardrop and Tom Riddell, partner and senior advisor respectively of KPMG LLP, based in London.

8.2 Run-off Managers

The day to day claims handling and reinsurance recovery activities of FAIG have been outsourced to specialist run-off organisations in Sydney and London, who work in close co-operation. The run-off managers for all business of the company, except business written with the UK branch, are Capita CMGL. The run-off managers for all business written by the UK branch of FAIG are Whittington Insurance Services Limited.

8.3 Creditors' Committee

The interests of creditors in the Australian Scheme are represented by a Creditors' Committee. The Committee sanctions significant transactions (such as commutations), is involved in the setting of the Scheme Payment Percentage, and approves the Scheme Administrators' fees. It is reported to, and meets on a quarterly basis. The current constitution of the Committee is as follows:

Member	Represented by
ACT Workers Compensation Supplementation Fund	Mr Peter Mathews
Department of Treasury & Finance Victoria	Mr Peter Coatman
Law Cover Pty Limited	Mr David Martin
Queensland Motor Accident Insurance Commission	Mr Ashur Merza
HCSL – Australian Government Treasury	Mr Trevor King
Australasian Medical Insurance	Mr Scott Pearson
WA Workers Compensation & Rehabilitation Commission	Mr Harry Neesham
Hong Kong Solicitors Indemnity Fund	Mr David Cowling
Motor Traders Association of NSW	Mr James McCall
Building Insurers Guarantee Corporation NSW	Mr Michael Hanna
Motor Accidents Authority NSW	Ms Carmel Donnelly

9 Contact Details

Contact details for the Australian Scheme Administrators, the English Scheme Administrators, and the Australian and English Run-Off Managers are set out on the HIH website, www.hih.com.au.

9.1 Creditor Enquiries in Australia

Scheme Creditors with claims adjustment queries (excluding those in relation to branch business) should call Capita CMGL on +61 (0) 2 9650 5777. Written claims adjustment queries should be directed in the first instance to Capita CMGL at the following address: Capita CMGL Level 2, 117 Clarence Street, Sydney, NSW, 2000, Fax +61 (0) 2 9650 5710.

Scheme Creditors with enquiries in relation to the Scheme or Scheme Payments should call the HIH Help Desk on +61 (0) 2 9650 5777. Written scheme queries should be directed to the Scheme Administrators at the following address: McGrathNicol, GPO Box 9986, Sydney, NSW, 2001 or to the HIH Help Desk at enquires@hih.com.au.

Yours faithfully

For FAI General Insurance Company Limited – in liquidation and subject to Schemes of Arrangement



Tony McGrath
Scheme Administrator



Chris Honey
Scheme Administrator

Appendix 1

Updated balance sheet for FAIG as at 30 June 2009

FAI General Insurance Company Limited - (In Liquidation and subject to Schemes of Arrangement)
Balance Sheet as at 30 June 2009
All values in AUD

	RATA as at 30 June 2009 \$'000	RATA as at 30 June 2008 \$'000
Assets not specifically charged		
Cash		
Cash at bank	66,923	60,002
	<u>66,923</u>	<u>60,002</u>
Receivables		
Amounts due from reinsurers, other insurers and statutory bodies	6,655	5,610
Amounts owing by related bodies corporate	152,171	141,955
GST Recoverable	0	361
	<u>158,826</u>	<u>147,925</u>
Investments		
Short term deposits	25,126	28,844
Managed Investments	395,301	394,608
ADD back: Dividends Paid	424,326	394,267
Loans secured	56	56
Shares in controlled entities	19,233	17,193
Sundry	4	733
	<u>864,047</u>	<u>835,701</u>
Reinsurance recoveries receivable	9,649	63,564
Other	1,000	1,000
Total assets not specifically charged	<u>1,100,444</u>	<u>1,108,192</u>
Assets subject to specific charges		
LOC related deposits	875	752
Statutory Reinsurance Cut-Through	14,347	35,530
Total assets subject to specific charges	<u>15,222</u>	<u>36,282</u>
TOTAL ASSETS	<u>1,115,667</u>	<u>1,144,474</u>
Liabilities secured by specific charge over assets		
Statutory Reinsurance Cut-Through	(14,347)	(35,530)
Amounts payable in relation to letters of credit	(875)	(752)
Total liabilities secured by specific charge over assets	<u>(15,222)</u>	<u>(36,282)</u>
Unsecured creditors		
Accounts payable		
Trade Creditors	(31,164)	(29,451)
Sundry creditors	(469)	(348)
	<u>(31,633)</u>	<u>(29,799)</u>
Provisions		
Settlement of FAI Takeover Claim	(100,000)	(100,000)
	<u>(100,000)</u>	<u>(100,000)</u>
ACC's	(1,124,418)	(1,140,014)
Claims Reserves	(159,845)	(152,504)
IBNR Claims	(155,333)	(182,157)
Outstanding claims	<u>(1,439,596)</u>	<u>(1,474,675)</u>
Other liabilities		
Amounts owing to related bodies corporate	(416,590)	(419,096)
Total unsecured creditors	<u>(1,987,819)</u>	<u>(2,023,570)</u>
TOTAL LIABILITIES	<u>(2,003,041)</u>	<u>(2,059,851)</u>
NET DEFICIT	<u>(887,375)</u>	<u>(915,377)</u>

Appendix 2

Summary of the Scheme Administrators receipts and payments from 30 May 2006
to 30 June 2009

FAI General Insurance Company Limited (In Liquidation and subject to Schemes of Arrangement)

Receipts and Payments Account 1 July 2008 to 30 June 2009

Balance at 1 July 2008		467,826,535.60
Receipts		
Re-insurance recoveries	40,525,257.92	
Unrealised Foreign Exchange Movements on Overseas Accounts	9,579,158.02	
Interest on cash and deposits	4,415,097.78	
GST Refund from ATO	1,230,362.15	
Claims recoveries	371,114.50	
Income Tax Refund received	295,245.38	
Sale of US Equities	99,470.42	
Other receipts	<u>10,437.42</u>	
Total receipts		56,526,143.59
Payments		
Scheme Payments to Creditors	(26,919,103.88)	
Unrealised Loss on Investment Portfolio	(13,293,610.90)	
Outsourced Claims Management Fees	(3,432,532.63)	
Professional Fees	(2,532,888.28)	
Central Expense reimbursement paid to HIH C&G	(2,377,631.71)	
Scheme Administrator Fees	(1,357,231.50)	
GST on payments	(748,880.12)	
Claims run-off expenses	(248,947.95)	
Computer Costs	(170,944.28)	
Property expenses	(155,043.64)	
Other Sundry Payments (amounts <\$20,000)	(57,728.03)	
Other Staff Costs	(33,318.40)	
Liquidators Fees	<u>(1,077.50)</u>	
Total payments		(51,328,938.82)
Balance at 30 June 2009		473,023,740.37