

FAI Reinsurances Pty Limited
ACN 004 401 138
(In liquidation and subject to a Scheme of Arrangement)

Scheme Administrators' annual report to
creditors

30 June 2007

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Updated balance sheet for FAI Re as at 30 June 2007

Appendix 2

Summary of the Scheme Administrators' receipts and payments from 30 May 2006 to 30 June 2007

1 Introduction & background

1.1 Introduction

This is the first annual report to the Creditors of FAI Reinsurances Pty Limited - in liquidation and subject to a Scheme of Arrangement ("FAI Re").

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 2007.

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-one 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, detailed in section 3 of this report, 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, as follows:

HIH C&G	5%
FAIG	20%
CIC	25%
WMG	5%

To date no interim Scheme Payments have been made for FAI Re.

More detail on Scheme Payments and the estimated ultimate Scheme Payment Percentage for FAI Re is included in section 4 of this report.

- + Approximately \$1.9 million in Scheme Payments has been received by FAI Re as a creditor of FAI General Insurance Company Limited and CIC Insurance Limited.

3 Development and implementation of Schemes

During 2005 and 2006, the Australian Liquidators and UK Provisional Liquidators formulated schemes of arrangement for the following companies in the HIH group;

HIH Casualty and General Insurance Limited (UK & Australia)
FAI General Insurance Company Limited (UK & Australia)
CIC Insurance Limited (Australia)
World Marine & General Insurances Pty Limited (UK & Australia)
FAI Traders Insurance Company Pty Limited (Australia)
FAI Reinsurances Pty Limited (Australia)
FAI Insurances Limited (UK & Australia)
HIH Underwriting and Insurance (Australia) Pty Limited (Australia)

The Schemes were approved by creditors at meetings held on 29 March 2006. They were subsequently ratified by the Courts in Australia and the UK, and became effective in Australia upon lodgement with ASIC on 30 May 2006, and in the UK upon lodgement with Companies House on 13 June 2006.

The Schemes are now effective and provide a means of agreeing Scheme Creditor Claims, as well as for payments to be made on those claims.

The effect of the Australian Schemes is to introduce a structure to operate in conjunction with, and complementary to, the English Schemes and liquidations of the companies to which the Australian Scheme will apply, covering amongst other things:

- a) the filing and agreement of claims;
- b) priorities to apply to assets, other than those in England, (to enable their release for distribution);
- c) payment of interim distributions to Scheme Creditors;
- d) management of the run-off; and
- e) final closure of the remaining insurance business by an estimation procedure.

The Scheme Administrators consider that the Schemes, in conjunction with the English Schemes, allow more efficient agreement of Scheme Creditor claims, earlier distribution of funds to Scheme Creditors, and earlier final closure of each insolvency.

The Schemes will run for between five and nine years, with any amendment to the current final bar date of May 2013 to be agreed in conjunction with the relevant Creditors' Committees, and subject to a special resolution of creditors. At present, the Scheme Administrators do not consider that there is any reason to amend the cut-off date of May 2013, and Scheme Creditors should continue to lodge their claims in the ordinary way.

4 Current and projected Scheme Payment Percentages

4.1 The current Scheme Payment Percentage

To date no interim Scheme Payment has been made to the creditors of FAI Re. Whilst outstanding and IBNR claims constitute a large part of the estimated final creditor balance, it is hoped that a small interim Scheme Payment can be made within the next twelve months, to those creditors with established Scheme claims.

4.2 Agreement of the current Scheme Payment Percentage

The Scheme Administrators review the Scheme Payment percentages on a regular basis, as major asset recoveries are made and claims estimates are updated. This review is undertaken in consultation with the Creditors' Committees, where they have been appointed. 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.

The Australian Scheme reflects the distribution priorities which apply to liquidators of insurance companies in Australia. This requires certain classes of assets, such as reinsurance recoveries to be distributed in priority to certain classes of creditor claims.

4.3 Scheme Payments for reinsurance creditors

Agreed claims (described as "Acknowledged Creditor Claims" under the scheme) of FAI Re's reinsurance creditors have generally not yet been accepted as Established Scheme Claims by the Scheme Administrators, and so reinsurance creditors have generally not 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, 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 means that the Scheme Administrators are not able to readily identify all transactions with a particular principal.

However in individual cases the Scheme Administrators are now 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. Creditors interested in this should contact the Scheme Administrators.

4.4 Estimated ultimate Scheme Payment Percentage

The Scheme Administrators' current best estimates of the ultimate Payment Percentage for FAI Re is shown below. This estimate is dependant on a wide range of factors including the volatility of claims; levels of set-off; levels of reinsurance recoveries; the class of creditor claim; and litigation outcomes. It is possible that the ultimate Payment Percentage may 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 07
FAI Re	More than 50%	More than 50%

5 Financial position

5.1 Estimated balance sheet at 30 June 2007

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. An updated balance sheet for FAI Re as at 30 June 2007, is included as Appendix 1 to this report

Since the Schemes were implemented, the Scheme Administrators have commissioned a full actuarial review of the insurance liabilities of the eight Scheme companies. This reflects the fact that the insurance liabilities of each company, and the reinsurance recoveries which flow from them, are the largest liabilities and assets respectively of these companies. Any movement in the estimates of these balances is most likely to impact the estimated ultimate Scheme Payment Percentage paid to creditors.

As can be seen from the balance sheet the estimated return to creditors has fallen to below 100 cents in the dollar. Whilst the estimated assets available for creditors have increased due to better than expected inter company returns, the IBNR claims provision has increased following the latest actuarial review. This has caused the estimated Scheme Payment percentage to fall; however, it still remains in excess of 50 cents in the dollar.

5.2 Receipts and payments to 30 June 2007

A summary of the Scheme Administrators' receipts and payments from the commencement of the Scheme on 30 May 2006 to 30 June 2007 is set out in Appendix 2 to this report.

During this period no fees have been paid to the Scheme Administrators in their role as Office Holders.

6 Closure

The scheme for FAI Re 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.

7 Responsibilities

7.1 Scheme Administrators

The Australian Scheme Administrators are Tony McGrath and Chris Honey, partners of McGrathNicol, based in Sydney.

7.2 Run-off Managers

The day to day claims handling and reinsurance recovery activities of FAI Re have been outsourced to Capita CMGL, who are a specialist run-off organisation based in Sydney and London.

7.3 Creditors' Committee

At the meeting of creditors to consider the Scheme on 29 March 2006, the creditors of FAI Re chose not to elect a creditors' committee.

8 Contact Details

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

8.1 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 41, 50 Bridge 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 Reinsurances Pty Limited – in liquidation and subject to a Scheme of Arrangement



Tony McGrath
Scheme Administrator



Chris Honey
Scheme Administrator

Appendix 1

Updated balance sheet for FAI Re as at 30 June 2007

FAI Reinsurances Pty Limited - (In Liquidation and subject to a Scheme of Arrangement)
Balance Sheet
as at 30th June 2007
All values in AUD

	RATA as at 30 June 2007	RATA as at 30 September 2005
	\$'000	\$'000
<i>Assets not specifically charged</i>		
Cash		
Cash at bank	19	55
	<u>19</u>	<u>55</u>
Receivables		
Amounts owing by related bodies corporate	455	2,363
	<u>455</u>	<u>2,363</u>
Investments		
Short term deposits	3,023	829
	<u>3,023</u>	<u>829</u>
Reinsurance recoveries receivable	687	0
Renewal rights	0	0
Other		
Prepayments	0	0
	<u>0</u>	<u>0</u>
<i>Total assets not specifically charged</i>	<u>4,184</u>	<u>3,247</u>
<i>Assets subject to specific charges</i>		
Investments		
Short term deposits	22	0
<i>Total assets subject to specific charges</i>	<u>22</u>	<u>0</u>
TOTAL ASSETS	<u>4,206</u>	<u>3,247</u>
<i>Liabilities secured by specific charge over assets</i>		
Accounts payable		
Amounts payable in relation to letters of credit	(22)	0
<i>Total liabilities secured by specific charge over assets</i>	<u>(22)</u>	<u>0</u>
<i>Unsecured creditors</i>		
Accounts payable		
Trade Creditors	0	0
	<u>0</u>	<u>0</u>
ACC's	(249)	(306)
Claims Reserves	(657)	(666)
IBNR Claims	(4,507)	(477)
Outstanding claims	<u>(5,413)</u>	<u>(1,449)</u>
Unearned premiums	0	0
Other liabilities		
Amounts owing to related bodies corporate	(112)	(104)
	<u>(112)</u>	<u>(104)</u>
<i>Total unsecured creditors</i>	<u>(5,525)</u>	<u>(1,553)</u>
TOTAL LIABILITIES	<u>(5,547)</u>	<u>(1,553)</u>
NET ASSETS/ DEFICIT	<u>(1,341)</u>	<u>1,695</u>

Appendix 2

Summary of the Scheme Administrators' receipts and payments from 30 May 2006 to 30 June 2007

**FAI Reinsurances Pty Limited (In Liquidation and subject to a Scheme of Arrangement)
 Receipts and Payments Account 30 May 2006 to 30 June 2007**

Balance transferred from Liquidation at 30 May 2006		1,045,810.16
Receipts	Movement	
Scheme Payments Received	1,890,770.60	
Interest	144,930.37	
GST Refund from ATO	1,004.02	
Other receipts	11.69	
Total receipts		2,036,716.68
Payments		
Liquidators Fees	(5,849.40)	
Professional Fees	(4,614.59)	
Foreign Exchange Movements	(2,454.87)	
Repayment of Sundry Trading Expenses	(2,357.78)	
Bank Fees	(1,544.60)	
GST	(1,049.04)	
Other Sundry Payments (amounts<\$20,000)	(209.03)	
Total payments		(18,079.31)
Balance at 30 June 2007		3,064,447.53