

Statement from the provisional liquidator of HIH Tony McGrath- Early Estimates to the Federal Government Task Force on HIH

Friday 25 May 2001

The provisional liquidator of HIH Insurance Tony McGrath has advised the Federal Government today that early estimates for the total deficiency of the HIH Group of companies will be between \$2.7 billion and \$4 billion.

These estimates were provided as part of a report requested by, and provided today to the Federal Government Task Force on HIH.

“Most importantly for the relief of those hardest hit by the HIH collapse, I have provided the Task Force with early estimates of liabilities for some classes of insurance. These estimates will help the Task Force determine the amount of funding needed to help policyholders who are in greatest financial distress from the loss of their insurance provider. These estimates are consistent with projections that have earlier been provided to the Federal Government Task Force.”

“The Federal Government’s offer to pay 90 or 100 cents in the dollar for hardship claims will ensure that those in most need can receive funding as soon as possible, without distorting the claims of other unsecured creditors, including those in other countries.”

“As the Federal government’s Funding vehicle will effectively replace many retail policyholders, the Task Force has also been given an outline of its subrogated rights to participate in future creditor distributions.”

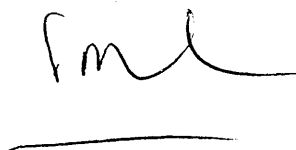
“As provisional liquidator my main responsibility is to the court and to all the various creditors. It is my intention to form consultative committees for each of the three main licence holding companies. I intend to invite representatives of key Australian and overseas creditor groups to a meeting on Tuesday 5th June, to appraise them of the progress of the provisional liquidations to date and my intended courses of action over the next few months.”

The provisional liquidators will be reporting to the Court on 18 June 2001.

Please find attached a 3 page summary of early estimates of the financial position of the HIH group.

For further information please contact Suzanne Mercer on 9552 4499 or Verity Webb on 9335 7360.

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Early estimates of ultimate deficiency

We have undertaken an initial assessment of the financial position of the HIH Group, including a first stage actuarial review of the calculation of the reserves. Based upon this initial assessment, we provide the following range of estimates for the total deficiency for the HIH group:

- Best Estimate of ultimate deficiency: \$2.7 billion

This includes estimation of insurance liabilities after allowing for reinsurance recoveries, based on a 50% confidence level.

- Pessimistic Estimate of ultimate deficiency: \$4.0 billion

This includes estimation of insurance liabilities after allowing for reinsurance recoveries, based on a 75% confidence level. The 75% confidence level is where the actuaries consider that there is a 75% probability that the claims will be equal to or lower than this amount.

The effect is to allow a prudential margin in case the actual claims experience is worse than the best estimate.

We stress that this is an early view of the estimated deficiency. There are a number of reasons why the ultimate deficiency may turn out to be worse than this initial estimate of \$2.7 billion.

The HIH Group accounts as at 30 June 2000 showed net assets of approximately \$940 million. In very broad terms, the \$2.7 billion deficiency now estimated reflects a worsening of \$3.6 billion. The movement is caused by write off of intangible assets; reduction in other asset values; subsequent trading losses; increases in net claims reserves and a shift to undiscounted claims reserves.

Estimates of deficiency for individual companies

At this stage we are not yet ready to provide a breakdown of the estimated deficiency on a company-by-company basis.

However we are able to confirm that our preliminary views formed on the basis of investigations to date are:

- Each of the major insurance licence holding companies within the HIH Group are clearly insolvent – that is, they will clearly not be able to pay their debts in full.
- The financial position of each of the three main licence holding companies is worse than the stated balance sheet position by a very significant margin in each case.
- The deficiencies reflect previous optimistic valuation of assets and extensive underestimation of liabilities.
- The very substantial losses are not restricted to the last nine months of operation.

Dividend estimates for individual companies

The estimated ultimate deficiency on a group basis cannot be used to predict dividend rates for creditors. The main reason for this is that creditors have rights to claim against individual

companies, and the dividend rates for individual companies may vary widely because some HIIH companies will be in a better position than others.

It will be some significant time before we are able to provide realistic estimates of the expected ultimate returns for different groups of creditors. This is due to a number of factors, including:

- The fact that policyholder liabilities (reserves) are estimates only. The estimates will need to be reviewed and updated on a regular basis (typically annually) for actual events as the claims experience unfolds.
- Some of the assets of the companies are in the form of future claims that will ultimately need to be recovered through commencing a legal process. These claims include but would not be limited to actions against auditors, directors and officers and recovery of potential insolvent transactions. Whilst ultimately a significant return might come from this source, it is currently impossible to put a fair estimation on that position.
- Within the group there are significant intercompany debts, and some cross guarantees. The outcome of these on individual company positions has not yet been determined.
- The impact of security over some companies' assets, and potential variation in the realisable value of many investments will have a significant effect.
- The ultimate realisation of reinsurance recoveries is presently difficult to estimate with accuracy.

Impact on creditors

The impact on individual creditors will depend upon which HIIH entity they have a claim against, and the nature of their claim. The impact on creditors will not be uniform. Some policyholders who by virtue of special arrangements applicable to them will obtain a good return. These policyholders include:

- Policyholders transferred to Allianz, QBE or NRMA (as outlined in the press release dated 23 March 2001).
- Those policyholders benefiting from special arrangements put in place by State and Federal Governments to provide a safety net to certain classes of policyholders.

In addition, certain classes of policyholders will ultimately be the recipients of reinsurance proceeds that may become available pursuant to the operations of Section 562A of the Corporations Law.

The effect of Section 562A is that reinsurance recoveries collected by a liquidator are allocated in priority to the claims of creditors or groups of creditors whose claims lead to the particular reinsurance recovery. Although the intention of the section is very clear, its application in practice is not straightforward, particularly for complex reinsurance covering a number of companies. It is likely that ultimately allocation of reinsurance recoveries between different groups of creditors will need Court direction. As Provisional Liquidators, we will preserve the position until the companies are in liquidation or are subject to Schemes of Arrangement approved by the Courts and creditors.

Other creditors will achieve an enhanced outcome as a result of holding security such as letters of credit.

The overall conclusion in relation to dividend rates for creditors not benefiting from government assistance schemes is that:

- Some creditors will receive better than average returns and others worse than average returns, because of the position of the particular company their claim is against.
- Some creditors will receive better than average returns, because they hold security or because they benefit from Section 562A priorities.
- Those creditors without any special arrangements are likely to receive a very poor return. It is too early to predict rates, but for these creditors without any special arrangements or priority, the ultimate return is likely to be well less than 50 cents in the dollar.

Delays in payment to creditors

For those creditors not covered by special arrangements, there will be extensive delays before any dividend payments.

The primary reason for extensive delays is the length of time over which long tail claims can be made and resolved and any applicable reinsurance recovered. In the case of each of the main HIH companies, we expect that reliable estimates of creditor payment outcomes will not be possible for at least one year. It is also likely that there will be a delay of at least two years before the first general dividend payment, and a delay of up to 10 years before the final payment to creditors.

Tony McGrath
Provisional Liquidator

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