

HIH Underwriting and Insurance (Australia) Pty Ltd
ACN 004 906 110
(In liquidation and subject to a Scheme of Arrangement)

Scheme Administrators' annual report to
creditors

30 June 2007

Contents

1	Introduction & background	3
1.1	Introduction.....	3
1.2	Background	3
2	Principal developments to report during the period	4
3	Development and implementation of Schemes	5
4	Current and projected Scheme Payment Percentages	6
4.1	The current Scheme Payment Percentage.....	6
4.2	Agreement of the current Scheme Payment Percentage	6
4.3	Scheme Payments for reinsurance creditors	6
4.4	Estimated ultimate Scheme Payment Percentage.....	6
5	Major Litigation	7
5.1	Background	7
5.2	The Trading Loss & Dividend claim	7
5.3	FAI Takeover claim	7
6	Financial position	8
6.1	Estimated balance sheet at 30 June 2007	8
6.2	Receipts and payments to 30 June 2007.....	8
7	Closure	9
8	Responsibilities	10
8.1	Scheme Administrators	10
8.2	Run-off Managers	10
8.3	Creditors' Committee	10
9	Contact Details	11
9.1	Creditor Enquiries in Australia.....	11

Appendix 1

Updated balance sheet for HIH U&I 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 HIH Underwriting & Insurance (Australia) Ltd - in liquidation and subject to a Scheme of Arrangement (“HIH U&I”).

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 HIH U&I.

More detail on Scheme Payments and the estimated ultimate Scheme Payment Percentage for HIH U&I is included in section 4 of this report.

- + Settlement has been reached with some of the defendants to the Liquidators' major litigation actions. Further details of this, and other major litigation matters, are included in section 5 of this report. It should be noted that whilst HIH U&I itself was not a beneficiary of the settlement, it is a member of a guarantee group containing HIH Underwriting and Agency Services Limited – In Liquidation and HIH Investment Holdings Ltd - in Liquidation, both of which were. Details of the impact of the cross guarantee group on the ultimate Scheme Payment percentage for HIH U&I are included in section 6 of this report.

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 HIH U&I. In view of the small estimated final Scheme Payment to creditors, the large balance of outstanding and IBNR claims, and the complexity of the guarantee group, it is not expected that an interim Scheme Payment will be made within the next twelve months.

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. 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 HIH U&I'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 HIH U&I 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 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 07
HIH U&I	Less than 5%	5% - 10%

Further work on the HIH Group's financial affairs has revealed that HIH U&I is part of a guarantee comprising eleven of the HIH Group's subsidiaries. Membership of the guarantee group has had the effect of pooling the assets and liabilities of the eleven HIH companies making up the group. This has helped improve the estimated final position of HIH U&I creditors. More detail is provided in section 6 of this report

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; and
- + The FAI Takeover claim

5.2 The Trading Loss & Dividend claim

The Trading Loss and Dividend claims were brought by the Liquidators against a number of defendants including HIH and FAI directors, the Groups' auditors, the Groups' actuaries, reinsurers and a broker.

In June 2007, after filing but before serving the claims, the Liquidators settled with certain of the defendants. One of the consequences of those settlements is that the Liquidators have discontinued all of the Trading Loss and dividend claims.

5.3 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 and Goldman Sachs, who the Liquidators allege should compensate HIH for losses suffered through the takeover of the FAI Group. The quantum of the claim, plus accrued interest thereon, is in excess of \$500 million.

Proceedings have been commenced and are being pursued against the defendants in the Supreme Court of New South Wales.

6 Financial position

6.1 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 HIH U&I 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.

The other main factor that has led to the large adjustments to the HIH U&I balance sheet has been determination of its membership of a cross guarantee group including the following other HIH Group companies:

- HIH Underwriting and Agency Services Limited
- HIH Underwriting Holdings Pty Limited
- FAI (CTP) Pty Limited
- MW Payne (Assessors) Pty Ltd
- HIH Legal Services Pty Limited
- HIH Travel (Australia) Pty Ltd
- Ready Plan Group Limited
- Ready Plan Asia Pacific Pty Ltd
- Industrial Rehabilitation Services Pty Limited
- HIH Investment Holdings Limited

Membership of the guarantee group has had the effect of pooling the assets and liabilities of the eleven HIH companies making up the group. This has helped improve the estimated final position of HIH U&I creditors.

This improvement has been offset to some extent by the inclusion of a provision for shareholder claims arising from claims by shareholders of HIH Insurance Ltd – In liquidation to prove as creditors of its major insurance subsidiaries. The Liquidators and Scheme Administrators do not consider such claims to be valid and have rejected them; however, as the rejection is currently subject to appeal in the Supreme Court, it is felt prudent to include a suitable provision at this stage.

6.2 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 Scheme Administrators fees have been paid to the Scheme Administrators in their role as Office Holders.

7 Closure

The Scheme for HIH U&I 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.

8 Responsibilities

8.1 Scheme Administrators

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

8.2 Run-off Managers

The day to day claims handling and reinsurance recovery activities of HIH U&I have been outsourced to specialist run-off organisation Capita CMGL, based in Sydney and London.

8.3 Creditors' Committee

At the meeting of creditors to consider the Scheme on 29 March 2006, the creditors of HIH U&I chose not to elect a creditors' committee.

9 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.

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 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 HIH Underwriting and Insurance (Australia) 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 HIH U&I as at 30 June 2007

**HIH Underwriting and Insurance (Australia) 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
	S'000	S'000
Assets not specifically charged		
Cash		
Cash at bank	20	8
	<u>20</u>	<u>8</u>
Receivables		
Amounts owing by related bodies corporate	84	358
GST Recoverable	5	5
Other debtors	0	0
	<u>89</u>	<u>364</u>
Investments		
Short term deposits	3,117	4,614
Other	0	0
	<u>3,117</u>	<u>4,614</u>
Reinsurance recoveries receivable	6,582	1,775
Renewal rights	0	0
Total company assets not specifically charged	13,857	
Dividends receivable from other companies in the guarantee group	54,972	
Total assets not specifically charged	<u><u>68,829</u></u>	<u><u>6,761</u></u>
Assets subject to specific charges		
Investments		
Statutory Reinsurance Cut-Through	4,049	0
Total assets subject to specific charges	<u><u>4,049</u></u>	<u><u>0</u></u>
TOTAL ASSETS	<u><u>68,829</u></u>	<u><u>6,761</u></u>
Liabilities secured by specific charge over assets		
Statutory insurance cut-through	(4,049)	0
Total liabilities secured by specific charge over assets	<u><u>(4,049)</u></u>	<u><u>0</u></u>
Unsecured creditors		
Accounts payable		
Trade Creditors	(1)	0
	<u>(1)</u>	<u>0</u>
Provisions		
Other	(100,000)	0
	<u>(100,000)</u>	<u>0</u>
ACCs	(5,913)	(4,998)
Outstanding claims (Reserves)	(3,943)	(30,487)
IBNR Claims	(71,114)	(29,818)
Outstanding claims	<u>(80,970)</u>	<u>(65,303)</u>
Unearned premiums	0	0
Other liabilities		
Amounts owing to related bodies corporate (excluding cross guarantee group)	(1,035)	(1,510)
	<u>(1,035)</u>	<u>(1,510)</u>
Contingent Cross Guarantee Liabilities		
HIH Underwriting and Agency Services Limited - In Liquidation	0	(207,994)
FAI (CTP) Pty Limited	0	(13,461)
MW Payne (Assessors) Pty Limited	0	(7,406)
HIH Legal Services Pty Limited	0	(7,096)
HIH Travel (Australia) Pty Limited	0	(12,446)
A.C.N 006 584 103 Pty Limited (formerly Ready Plan Group Limited) - In Liq	0	(358)
A.C.N 005 312 345 Pty Limited (formerly Ready Plan Asia Pacific Pty Ltd) - In Liq	0	(103)
HIH Investment Holdings Limited - In Liquidation	0	(141,778)
	<u>0</u>	<u>(390,642)</u>
Liabilities from other companies in the cross guarantee group	(420,154)	
Total unsecured creditors	<u><u>(602,160)</u></u>	<u><u>(457,454)</u></u>
TOTAL LIABILITIES	<u><u>(606,209)</u></u>	<u><u>(457,454)</u></u>
NET DEFICIT	<u><u>(537,380)</u></u>	<u><u>(450,693)</u></u>

Appendix 2

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

**HIH Underwriting & Insurance (Australia) Pty Limited (In Liquidation and subject to a Scheme of Arrangement)
Receipts and Payments Account 30 May 2006 to June 2007**

Balance transferred from Liquidation at 30 May 2006		3,034,023.68
Receipts	Movement	
Scheme Payments Received	258,495.50	
Interest	209,859.57	
GST Refund from ATO	23,475.44	
Reimbursement of Sundry Trading Expenses	17,909.92	
Other receipts	30.79	
Total receipts		509,771.22
Payments		
Professional Fees	(114,048.06)	
Central Expense paid to HIH C&G	(110,851.74)	
Claims Run Off Expenses	(99,006.56)	
Outsourced Claims Management Fees	(58,410.63)	
GST	(16,788.60)	
Liquidators Fees	(4,916.80)	
Other Sundry Payments (amounts<\$20,000)	(2,095.66)	
Total payments		(406,118.05)
Balance at 30 June 2007		3,137,676.85