

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 2008

Contents

1	Introduction & background	3
1.1	Introduction.....	3
1.2	Background	3
2	Principal developments to report during the period	4
3	Current and projected Scheme Payment Percentages	5
3.1	The current Scheme Payment Percentage.....	5
3.2	The House of Lords appeal decision	5
3.3	Projected further Scheme payments.....	6
3.4	Agreement of the current Scheme Payment Percentage	6
3.5	Scheme Payments for reinsurance creditors	6
3.6	Estimated ultimate Scheme Payment Percentage.....	7
4	Interaction between Australian and English Schemes	8
4.1	Claiming under the Australian and English Schemes.....	8
4.2	Distribution Priorities	8
5	Major Litigation	9
5.1	Background	9
5.2	The Trading Loss & Dividend claim	9
5.3	FAI Takeover claim	9
6	Financial position	10
6.1	Estimated balance sheet at 30 June 2008.....	10
6.2	Receipts and payments to 30 June 2008.....	10
7	Closure	11
8	Responsibilities	12
8.1	Scheme Administrators	12
8.2	Run-off Managers	12
8.3	Creditors' Committee	12
9	Contact Details	13
9.1	Creditor Enquiries in Australia.....	13
	Appendix 1	14
	Updated balance sheet for FAIG as at 30 June 2008	
	Appendix 2	16
	Summary of the Scheme Administrators receipts and payments from 30 May 2006 to 30 June 2008	

1 Introduction & background

1.1 Introduction

This is the second 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 2008.

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, 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, which now total as follows:

	Creditors with insurance liabilities in Australia	All other creditors worldwide
HIH C&G	12.64%	9.00%
FAIG	30.00%	30.00%
CIC	30.00%	30.00%
WMG	5.00%	5.00%

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

- + The Australian Scheme Administrators were successful in their appeal to the House of Lords. Their Lordships ruled that funds held by the English Scheme Administrators should be remitted to Australia for distribution by the Australian Scheme Administrators under Australian Corporations Act and Insurance Act priorities. This is explained in more detail in section 3.2 of this report.
- + Application was made to the New York Bankruptcy Court for recognition of the FAIG Scheme of Arrangement in the United States in September 2007. This was granted and assets held in the US subject to protection under sec 304, Chapter 11, US Bankruptcy Act have now been returned to Australia for distribution to creditors in accordance with the terms of the Australian Scheme of Arrangement.
- + Following settlement with some of the defendants to the Liquidators' major litigation actions last year, discussions have continued with the defendants to the FAI Takeover claim. Further details of this, and other major litigation matters, are included in section 5 of this report.

3 Current and projected Scheme Payment Percentages

3.1 The current Scheme Payment Percentage

The current Scheme Payment Percentage for FAIG is 30%

To date the Australian Scheme Administrators have only made distributions out of non-reinsurance assets in Australia, to creditors with Liabilities in Australia. The English Scheme Administrators have also made equal distributions to all other creditors worldwide (with the exception of those creditors eligible to be paid from the US Trust Fund Assets). A Scheme Payment Percentage of 30% for those US domiciled creditors eligible to be paid from the US Trust Fund assets has been approved by the FAIG Creditors Committee, under the terms of the Scheme.

The Scheme Administrators have signed a Deed of Release with the Superintendent of Insurance in New York to secure release of the Trust funds to allow 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 include an undertaking to distribute them strictly in accordance with the terms of the Trust Agreement, and are conditional upon recognition by the US Federal Bankruptcy Court of the Australian Scheme of Arrangement. The Scheme Administrators obtained recognition of the Australian Scheme of Arrangement in September 2007. As part of the application, the Scheme Administrators informed the Court that a review of the FAIG creditor base had shown that all creditors, irrespective of their domicile, would qualify as Creditors with liabilities in Australia.

Subsequent to the date of this report, the Scheme Administrators have also obtained recognition from the US Federal Bankruptcy Court of the Australian Scheme of Arrangement for HIH C&G. Application will now be made for NY State Conservation Court ratification of the Deeds of Release for the Trust Funds for both companies. It is hoped that this will be obtained in time to allow payment of the interim 30 cents in the dollar to any US domiciled creditors who have yet to receive a distribution under the Scheme, in the next quarterly Scheme distribution payment run at the end of December 2008.

3.2 The House of Lords appeal decision

Before reviewing the timing and quantum of future dividend payments, it is necessary to consider the implications of the decision of their Lordships following the Australian Scheme Administrators' appeal to the House of Lords.

The English Scheme of Arrangement was originally designed to complement the Australian Scheme by adopting most of the provisions of the Australian Scheme, with the exception of the distribution priorities that were to apply to the English Assets.

As a result of the different statutory distribution priorities that apply to liquidators' distributions in Australia and the UK, and following a formal request to the UK Court by the Australian Court under section 426 UK Insolvency Act, the English Provisional Liquidators sought directions from the English High Court as to whether the assets they controlled should be released to the Australian Liquidators for distribution in accordance with the Australian statutory distribution priorities.

The High Court directed that the English Assets should not to be remitted to the Australian Liquidators for distribution in accordance with the Australian statutory distribution priorities. The English Scheme therefore applied the distribution priorities of the English statutory regime to the English Assets.

The Australian Liquidators and two Australian creditors (the James Hardie Trusts) unsuccessfully appealed the initial court directions obtained by the English Provisional

Liquidators, and subsequently appealed that decision further to the House of Lords. The appeal was heard in December 2007.

In anticipation that the appeal process would otherwise hold up the adoption of the Schemes and the commencement of payments to creditors, the English Scheme contained an inbuilt alternative – if the House of Lords maintains the status quo of the first instance judgment and the Court of Appeal decision, the English Assets would continue to be distributed *pari passu* to all creditors worldwide. If however the House of Lords overturned the Appeal Court decision, the English Assets would be distributed in accordance with the Australian distribution priorities.

In May 2008, judgement was handed down in favour of the Australian Scheme Administrators. The practical effect of the judgement is that assets realised and held by the English Scheme Administrators will now be distributed to creditors in accordance with Australian priorities. The recognition last year by the US Bankruptcy Court of the Australian Scheme of Arrangement means that, with the exception of the US Trust Funds, the same will apply to US assets. From the perspective of distribution of assets, there is now effectively one global Scheme applying Australian distribution priorities worldwide.

3.3 Projected further Scheme payments

The Scheme Administrators are currently reviewing the level of assets realised. Based on this review, 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 2008. This Scheme Payment will be made from non reinsurance assets in Australia, and will bring the total Scheme distribution to creditors to 35%.

3.4 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.

3.5 Scheme Payments for reinsurance creditors

In the last annual report to creditors it was explained that agreed claims (described as "Acknowledged Creditor Claims" under the Scheme) of HIH C&G'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.

The Scheme Administrators have been 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.

3.6 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 08
FAIG	25% to 35%	45% to 55%

The improvement in the estimated total Scheme Payment Percentage since the last annual report is due to factors set out 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; 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, Arthur Andersen and Goldman Sachs, who the Liquidators allege should compensate HIH for losses suffered through the takeover of the FAI Group.

The Liquidators have requested that the Court allow a three month standstill to the Court timetable to allow settlement discussions to be further explored. The matter is before the Court again on 18 December 2008 at which time it will be provided with a further update on the settlement discussions

6 Financial position

6.1 Estimated balance sheet at 30 June 2008

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 2008.

The Scheme Administrators have not commissioned a further full actuarial review of the insurance liabilities of the eight Scheme companies since the last annual report. It is their intention, however, to commission a further such review in the coming months, in order that there is an updated estimate of the final total insurance liabilities for the next annual report.

Other factors that have led to adjustment to the FAIG balance sheet are:

- + Court approval confirming the proposed allocation of the proceeds of a large reinsurance commutation with Swiss Re between the relevant HIH Group companies;
- + Further work to validate large intercompany balances; and
- + Removal of the provision for claims lodged on behalf of the shareholders of HIH Insurance Limited, which were rejected by the Scheme Administrators. This decision has been endorsed by both the Supreme Court and the Court of Appeal.

6.2 Receipts and payments to 30 June 2008

A summary of the Scheme Administrators receipts and payments from the commencement of the Scheme on 30 May 2006 to 30 June 2008 is set out in Appendix 2 to this report.

During this period \$1,844,134 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 Chris Bratchford
WA Workers Compensation & Rehabilitation Commission	Mr Adrian Warner
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	Mr David Bowen

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 2008

FAI General Insurance Company Limited
(In Liquidation and subject to Schemes of Arrangement)
Balance Sheet
as at 30th June 2008
All values in AUD

	RATA as at 30 June 2008	RATA as at 30 June 2007
	\$'000	\$'000
Assets not specifically charged		
Cash		
Cash on hand	0	0
Cash at bank	60,002	36,092
	<u>60,002</u>	<u>36,092</u>
Receivables		
Trade debtors	0	0
Amounts due from reinsurers, other insurers and statutory bodies	5,610	6,363
Amounts owing by related bodies corporate	141,955	155,001
Accrued interest, commission and other income	0	0
GST Recoverable	361	290
Other debtors	0	0
	<u>147,925</u>	<u>161,654</u>
Investments		
Short term deposits	28,844	74,271
Managed Investments	394,608	261,048
ADD back: Dividends Paid	394,267	238,441
Loans secured	56	56
Shares in controlled entities	17,193	10,707
Swiss Re Funds	602	220,573
Other - Overseas equities	131	139
	<u>835,701</u>	<u>805,235</u>
Reinsurance recoveries receivable	63,564	33,706
Renewal rights	0	0
Other		
Other receivables - Allianz & MAMS	1,000	23,500
	<u>1,000</u>	<u>23,500</u>
Total assets not specifically charged	<u>1,108,192</u>	<u>1,060,186</u>
Assets subject to specific charges		
Investments		
LOC related deposits	752	1,089
Statutory Reinsurance Cut-Through	35,530	42,020
Total assets subject to specific charges	<u>36,282</u>	<u>43,109</u>
TOTAL ASSETS	<u>1,144,474</u>	<u>1,103,295</u>
Amounts payable in advance of secured creditors		
Provision for redundancy, employee entitlements and employee claims	0	0
Total amounts payable in advance of secured creditors	<u>0</u>	<u>0</u>
Liabilities secured by specific charge over assets		
Accounts payable		
Statutory Reinsurance Cut-Through	(35,530)	(1,089)
Amounts payable in relation to letters of credit	(752)	(1,089)
	<u>(36,282)</u>	<u>(1,089)</u>
Outstanding claims - Allianz claims reserve trust	0	0
Unearned premiums - Allianz claims reserve trust	0	0
Total liabilities secured by specific charge over assets	<u>(36,282)</u>	<u>(1,089)</u>
Unsecured creditors		
Accounts payable		
Trade Creditors	(29,451)	(28,321)
Sundry creditors	(348)	(55)
	<u>(29,799)</u>	<u>(28,376)</u>
Provisions		
Other - Settlement of FAI Takeover Claim	(100,000)	(100,000)
	<u>(100,000)</u>	<u>(100,000)</u>
ACC's	(1,140,014)	(1,066,237)
Claims Reserves	(152,504)	(190,944)
IBNR Claims	(182,157)	(236,733)
Outstanding claims	<u>(1,474,675)</u>	<u>(1,493,914)</u>
Unearned premiums	0	0
Other liabilities		
Other creditors and accruals	0	0
Amounts owing to related bodies corporate	(419,096)	(419,096)
	<u>(419,096)</u>	<u>(419,096)</u>
Total unsecured creditors	<u>(2,023,570)</u>	<u>(2,041,385)</u>
TOTAL LIABILITIES	<u>(2,059,851)</u>	<u>(1,804,033)</u>
NET DEFICIT	<u>(915,377)</u>	<u>(700,738)</u>

Appendix 2

Summary of the Scheme Administrators receipts and payments from 30 May 2006
to 30 June 2008

**FAI General Insurance Company Limited (In Liquidation and subject to Schemes of Arrangement)
Receipts and Payments Account 1 July 2007 to 30 June 2008**

	\$
Balance brought forward at 1 July 2007	367,005,819.48
Receipts	
Allocation of Swiss Re monies	228,809,382.85
Re-insurance recoveries	9,408,581.15
Interest on cash and deposits	4,306,366.92
Refund of prior paid Legal fees	2,812,587.92
Dividend received from Lake Crackenback	12,583,217.99
Settlement proceeds reallocated from HIH C&G	10,895,095.01
Dividend received from 422 Collins St	2,861,189.63
GST Refund from ATO	782,372.37
Claims recoveries	146,758.44
Bank guarantees recovered	35,795.23
Other receipts	499.79
	<hr/>
Total receipts	272,641,847.30
Payments	
Unrealised Foreign Exchange Movements on Overseas Accounts	(5,917,716.63)
Outsourced Claims Management Fees	(3,413,586.32)
Central Expense reimbursement paid to HIH C&G	(2,849,205.41)
Professional Fees	(941,148.00)
Liquidators Fees	(102,938.50)
GST on payments	(832,201.29)
Scheme Administrator Fees	(1,844,134.00)
Rental property expenses	(180,000.00)
Computer Costs	(177,797.70)
Unrealised Loss on Investment Portfolio	(418,615.45)
Claims run-off expenses	(49,070.71)
Contractors & Temporary Staff	(36,826.64)
Other Staff Costs	(65,351.04)
Other Sundry Payments (amounts <\$20,000)	(339,943.51)
	<hr/>
Sub Total payments	(17,168,535.20)
Scheme Payments to Creditors	(154,652,595.98)
	<hr/>
Total payments	(171,821,131.18)
	<hr/>
Balance at 30 June 2008	467,826,535.60

*It should be noted that any unrealised exchange rate gains or losses on foreign currency holdings are fully offset by corresponding movements in the Australian dollar liability of foreign currency denominated creditors.