



**KPMG LLP**  
8 Salisbury Square  
London EC4Y 8BB  
United Kingdom

Tel +44 (0) 20 7694 1864  
Fax +44 (0) 20 7694 3126  
DX 38050 Blackfriars

To all known creditors, potential creditors and  
brokers of HIH Casualty & General Insurance  
Limited

Contact **HIH Helpline**  
+44 (0)20 7743 0900 (UK)  
+61 2 9650 5777 (Australia)

[www.kpmg.co.uk/insurancesolutions](http://www.kpmg.co.uk/insurancesolutions)

23 August 2007

Dear Sir/Madam

**HIH Casualty & General Insurance Limited (In Provisional Liquidation and subject to  
Scheme of Arrangement)  
English Scheme Administrators' Annual Report to Creditors**

**1 Introduction**

This is the first annual report to creditors of HIH Casualty & General Insurance Limited (“HIH C&G”) by the English Scheme Administrators. It will be published on the HIH website as a supplement to the annual report to creditors of the Australian Scheme Administrators, for the year ended 30 June 2007.

The purpose of this report is to provide creditors with information on the progress of the English Scheme to date.

**2 Key points**

- The HIH Group failed on 15 March 2001. HIH C&G was one of the 3 major licensed insurers in the group.
- Summary details of the history of the group; its failure; and other background information are available on the website maintained by the Australian Scheme Administrators at [www.hih.com.au](http://www.hih.com.au).
- Extensive information on the failure including the final report of the HIH Royal Commission established by the Australian Federal Government is available on the website [www.hihroyalcom.gov.au](http://www.hihroyalcom.gov.au)
- On 30 May 2006, Schemes of Arrangement became effective for the eight licensed insurance companies in the HIH Group in Australia. Complementary Schemes of Arrangement became effective for four of those companies in England on 13 June

2006, following approval by creditors and the courts. Copies of the scheme documents are available on the HIH website [www.hih.com.au](http://www.hih.com.au).

- For at least the first five years, the schemes will be “reserving” schemes, under which claims are made in the normal course of business. During this reserving period, interim scheme distributions will be paid to creditors with Established Scheme Claims at the current applicable Scheme Payment Percentage.
- The Australian and English Scheme Administrators co-operate fully. A unified principal to principal ledger system is operated, together with a unified dividend payment system. Creditors need to lodge claims in one location only, which is then effective under both schemes.
- The current Scheme Payment Percentage for HIH C&G under the English Scheme for HIH C&G is 5%. Payment runs are processed quarterly for those creditors with newly Established Scheme Claims.
- The Record Date (the date at which liabilities are measured) for each of the schemes is 27 August 2001.
- There is no bar date for the schemes during the reserving period. The earliest bar date permissible under the terms of the schemes is in June 2011.
- In December 2007 an appeal to the House of Lords will be heard in relation to the distribution priorities which are to apply to the assets held by the English Scheme Administrators. Brief details of this are explained in section 4.2 of this report.

### **3 Scheme Payment Percentages**

#### *3.1 Current Scheme Payment Percentages*

The current Scheme Payment Percentage under the English Scheme for HIH C&G is 5%. The current Scheme Payment Percentage under the Australian Scheme for HIH C&G is also 5%.

To date the Australian Scheme Administrators have only made distributions out of non-reinsurance Assets in Australia, to creditors with Liabilities in Australia. Distributions out of the other classes of assets are expected in the future. The current Scheme Payment Percentages for the various classes of assets for all eight of the Australian schemes are set out on the HIH website, [www.hih.com.au](http://www.hih.com.au).

#### *3.2 How the Scheme Payment Percentages are set*

The Australian schemes reflect the distribution priorities which apply to liquidations of insurance companies in Australia. This requires particular classes of assets to be distributed in priority to particular classes of creditor claims.

The English scheme has only one class of asset, and one distribution rate for all creditors worldwide.

Under the terms of the schemes, the Scheme Administrators review the Scheme Payment Percentage for each relevant class of asset at least annually in consultation with the Creditors' Committees. Factors taken into account include current cash held, expected future asset realisations, expected future claims agreement levels and the remaining potential volatility of the account.

The objective in setting the Scheme Payment Percentages is to make interim distributions to creditors currently holding Established Scheme Claims, whilst ensuring that HIH C&G will be capable of meeting that same percentage on all eligible liabilities reasonably expected to be admitted in the future.

### *3.3 Scheme Payments for reinsurance creditors*

Agreed claims (described as "Acknowledged Creditor Claims" under the scheme) of HIH C&G'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, 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 means that the Scheme Administrators are not able to readily identify all transactions with a particular principal.

In individual cases however, 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 English Scheme Administrators.

### *3.4 Estimated ultimate Scheme Payment Percentages*

The summary estimates of the ultimate Payment Percentages per company given by the Australian Scheme Administrators are shown below. These estimates are dependant on a wide range of factors including the volatility of claims; levels of set-off; litigation outcomes; levels of reinsurance recovery; and the class of creditor claim. It is possible that the ultimate Payment Percentages could vary significantly either above or below those predicted.

In addition the final result for individual creditors will vary according to whether their claims are classed as insurance or non-insurance, and whether their claims are classed as Liabilities in Australia or liabilities not in Australia. As a generalisation, creditors with insurance Liabilities in Australia are expected to receive higher ultimate distributions than creditors with liabilities not in Australia. Most creditors who wrote their business with the UK branch of HIH C&G will not have their claims classed as Liabilities in Australia, and so can expect to receive distribution rates towards the lower end of the range for HIH C&G.

Scheme Company	Estimated Ultimate Scheme Payment Percentage
HIH C&G	15% to 25%
FAIG	25% to 35%
CIC	30% to 40%
FAIT	Less than 5%
FAI Re	More than 50%
FAII	Less than 5%
WMG	30% to 40%
HIH U&I	Less than 5%

## 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 HIH C&G. 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 dividend 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 proportional distribution.

### 4.2 *Distribution Priorities*

The English Scheme is designed to complement the Australian scheme by adopting most of the provisions of the Australian Scheme, with the exception of the distribution priorities that are 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, 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 court directed that the English Assets are not to be remitted to the Australian liquidators for distribution in accordance with the Australian statutory distribution priorities. The English Scheme therefore applies the distribution priorities of the English statutory regime to the English Assets, subject to the comments below in relation to the House of Lords appeal.

### *4.3 Appeal to the House of Lords*

The Australian liquidators and two Australian creditors (the James Hardie Trusts) unsuccessfully appealed the initial court directions obtained by the English provisional liquidators, and have now appealed that decision further to the House of Lords. The appeal is to be heard in December 2007.

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

Based on the Scheme Administrators' modelling, former UK branch creditors of HIH C&G would be disadvantaged by distribution of the English Assets in accordance with Australian distribution priorities.

## **5 Financial position**

### *5.1 Gross Liabilities*

The English Scheme Administrators currently expect the gross undiscounted liabilities of HIH C&G to be approximately £2bn, of which approximately £292m relates to business written through the former UK branch. Approximately £197m of UK branch liabilities have been agreed as Acknowledged Creditor Claims to date. The English Scheme Administrators have not yet published an estimate of the assets ultimately expected to be available for collection.

### *5.2 Receipts and payments to 30 June 2007*

A summary of the English Scheme Administrators' receipts and payments from 13 June 2006 (the commencement of the Scheme of Arrangement) to 30 June 2007 is set out on the following page.

<b>HIH Casualty &amp; General Insurance Limited</b>	
<b>Receipts and payments for the period 13 June 2006 to 30 June 2007</b>	
	<b>£'000</b>
<b>Receipts</b>	
Balance transferred from the English Provisional Liquidators at 13 June 2006	37,493
Insurance and reinsurance recoveries	15,180
Gains and interest on funds invested	2,409
Tax refunds	343
<b>Total receipts</b>	55,425
<b>Payments</b>	
Officeholders' fees and expenses	2,105
Run-off managers' fees	1,283
Legal fees	1,454
Scheme Payments to creditors	819
Other professional and agents' fees	571
VAT	563
IT and market processing costs	411
Other payments	87
<b>Total payments</b>	7,294
Exchange Gain/(Loss) on Currency Conversion at 30 June 2007	(599)
<b>Funds held at 30 June 2007</b>	47,532

## 6 Closure

The scheme for HIH C&G provides for a planned 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. 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.

The schemes provide 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.

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 English Scheme Administrators of HIH C&G are Tom Riddell and John Wardrop, partners of KPMG LLP, based in London. The Australian Scheme Administrators are Tony McGrath and Chris Honey, partners of McGrathNicol+Partners, based in Sydney.

### *7.2 Run-off Managers*

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

### *7.3 Creditors' Committee*

The interests of creditors in the English 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:

<b>Member</b>	<b>Represented by</b>
Financial Services Compensation Scheme	Ms H McMahan
Groupama	Mr E Walker
Markel International Insurance Company Limited	Mr G Appleton
Riverstone Management Limited	Mr J Bator
Syndicate 435, Faraday	Mr J Bond



## **8 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](http://www.hih.com.au).

### *8.1 Creditor enquiries*

Scheme Creditors with claims adjustment queries in relation to UK branch business should call Whittington on +44 (0) 20 7743 0900. Written claims adjustment queries should be directed in the first instance to Whittington at the following address: Whittington Insurance Services Limited, 33 Creechurch Lane, London, EC3A 5EB, Fax +44 (0)20 7743 0979.

Scheme Creditors with enquiries in relation to the Scheme or Scheme Payments should call the Scheme Administrators on +44 (0) 20 7694 3703. Written scheme queries should be directed to the Scheme Administrators at the following address: KPMG LLP, 8 Salisbury Square, London EC4Y 8BB.

Yours faithfully  
*For HIH Casualty & General Insurance Limited*

John Wardrop  
*English Scheme Administrator*

Tom Riddell  
*English Scheme Administrator*