

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 2008

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1 Introduction & background

1.1 Introduction

This is the second 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 2008.

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, 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 CIC is included in section 3 of this report.

- + 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 4 of this report.

3 Current and projected Scheme Payment Percentages

3.1 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 of which HIH U&I is a member, it is not expected that an interim Scheme Payment will be made within the next twelve months.

3.2 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.

3.3 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 meant that the Scheme Administrators were not able readily to 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.

3.4 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 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	Estimated Total Scheme Payment Percentage at 30 June 08
HIH U&I	Less than 5%	5% - 10%

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. Whilst work has continued to realise assets within the other companies within the Group the Scheme Administrators do not consider that this has had a material impact on HIH U&I estimated total Scheme Payment percentage.

4 Major Litigation

4.1 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

4.2 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.

4.3 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.

Whilst HIH U&I is not a party to this action, another member of the Guarantee Group, HIH Investment Holdings, is. HIH U&I will therefore benefit from any settlement proceeds received by HIH Investment Holdings Ltd.

5 Financial position

5.1 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. An updated balance sheet for HIH U&I as at 30 June 2008, is included as Appendix 1 to this report

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.

Factors that have led to adjustment to the FALL balance sheet over the last year include:

- + Further work on the validity of large inter-company 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.

Work has continued to realise assets and agree the claims of the other members of the cross guarantee group which comprises 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

As previously explained, 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.

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

6 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.

At the date of this report, the Scheme Administrators consider that June 2013 remains the most likely Estimation Date for the Scheme.

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 HIH U&I have been outsourced to specialist run-off organisation Capita CMGL, 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 HIH U&I 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 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 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 2008

HIH Underwriting and Insurance (Australia) Pty Limited
(In Liquidation and subject to a Scheme 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 at bank	130	20
	<u>130</u>	<u>20</u>
Receivables		
Amounts owing by related bodies corporate	119	84
GST Recoverable	7	5
	<u>125</u>	<u>89</u>
Investments		
Short term deposits	0	3,117
Managed Investments	2,977	0
	<u>2,977</u>	<u>3,117</u>
Reinsurance recoveries receivable	6,432	6,582
Renewal rights	0	0
Total company assets not specifically charged	13,714	13,857
Dividends receivable from other companies in the guarantee group	44,309	54,972
Total assets not specifically charged	<u>58,023</u>	<u>68,829</u>
Assets subject to specific charges		
Investments		
Statutory Reinsurance Cut-Through	4,049	4,049
Total assets subject to specific charges	<u>4,049</u>	<u>4,049</u>
TOTAL ASSETS	<u>58,023</u>	<u>68,829</u>
Liabilities secured by specific charge over assets		
Accounts payable		
Statutory Reinsurance Cut-Through	(4,049)	
Amounts payable in relation to letters of credit	0	0
	<u>(4,049)</u>	<u>0</u>
Total liabilities secured by specific charge over assets	<u>(4,049)</u>	<u>0</u>
Unsecured creditors		
Accounts payable		
Trade Creditors	(1)	(1)
	<u>(1)</u>	<u>(1)</u>
Provisions		
Other	0	(100,000)
	<u>0</u>	<u>(100,000)</u>
ACCs	(14,177)	(9,962)
Outstanding claims (Reserves)	(3,991)	(3,943)
IBNR Claims	(66,757)	(71,114)
Outstanding claims	<u>(84,925)</u>	<u>(85,019)</u>
Unearned premiums	0	0
Other liabilities		
Other creditors and accruals	0	0
Contribution to cross guarantee group	0	0
Amounts owing to related bodies corporate (excluding amounts owing to companies in the cross guarantee group)	(1,035)	(1,035)
	<u>(1,035)</u>	<u>(1,035)</u>
Contingent Cross Guarantee Liabilities	<u>0</u>	<u>0</u>
Total company unsecured creditors	<u>(85,961)</u>	<u>(186,055)</u>
Liabilities from other companies in the cross guarantee group	(430,222)	(420,154)
Total unsecured creditors	<u>(516,183)</u>	<u>(606,209)</u>
TOTAL LIABILITIES	<u>(520,232)</u>	<u>(606,209)</u>
NET DEFICIT	<u>(462,209)</u>	<u>(537,380)</u>

Appendix 2

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

**HIH Underwriting & Insurance (Australia) Pty Limited (In Liquidation and subject to a Scheme of Arrangement)
 Receipts and Payments Account 1 July 2007 to 30 June 2008**

	\$
Balance brought forward at 1 July 2007	3,137,676.85
Receipts	
Interest	122,612.93
Scheme Payments Received	62,041.75
Dividend Repatriation from UK	57,953.54
GST Refund from ATO	18,018.01
Unrealised Gain on Investments	16,206.88
Other receipts	10.29
	<hr/>
Total receipts	276,843.40
Payments	
Professional Fees	(126,577.59)
Central Expense paid to HIH C&G	(99,275.47)
Claims Run Off Expenses	(26,912.78)
Outsourced Claims Management Fees	(35,110.06)
GST	(16,416.17)
Other Sundry Payments (amounts<\$20,000)	(3,244.28)
	<hr/>
Total payments	(307,536.35)
	<hr/>
Balance at 30 June 2008	3,106,983.90