

FAI Insurances Limited
ACN 004 304 545
(In liquidation and subject to Schemes of Arrangement)

Scheme Administrators' annual report to
creditors

30 June 2012

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1 Introduction & background

1.1 Introduction

This is the sixth annual report to the Creditors of FAI Insurances Limited - in liquidation and subject to Schemes of Arrangement ("FAI").

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 2012.

An annual report has also been prepared by the Scheme Administrators of the UK Scheme of Arrangement for FAI. 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. In total, 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 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 was 31 May 2011.

In light of the progress made to date on the "run-off" phase of the Scheme, the Scheme Administrators expect the actual bar date to be 31 May 2013.

2 Principal developments to report during the period

The principal developments to report during the period were:

- + The members of the FAIL Creditors' Committee approved a first interim Scheme Payment of 5 cents in the dollar, payable to all creditors in Australia.

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

- + Prior to the Liquidation of FAIL, FAIL and two subsidiaries entered into a Deed of Cross Guarantee whereby each group company within the cross guarantee group guaranteed the debts of each of the other companies within the group. In light of FAIL's obligations under the deed, extensive review was carried out to validate the liabilities of the cross guarantee group prior to the payment of the first interim Scheme Payment.

- + FAIL has received further dividend payments from HIH Group intercompany debtors in Australia. The most significant receipt was a dividend payment of \$7.5 million from United Body Works (QLD).

- + The liquidations of a further 16 HIH Group subsidiary companies have now been completed.

To date, the liquidations of 35 HIH Group subsidiary companies have been completed with those of a further 10 companies expected to be finalised by August 2012. FAIL will not receive any distributions from the closure of these 10 additional companies.

Upon completion of these liquidations, the remaining HIH Group Australian subsidiary liquidations will total 37.

- + In view of the progress made to date in managing the FAIL claims run-off, the Scheme Administrators see no reason to postpone the Scheme Estimation date, which is currently 31 May 2013.

Further information in respect of the Estimation Date and the lodgement of final claims, is included in section 6 of this report.

3 Current and projected Scheme Payment Percentages

3.1 The current Scheme Payment Percentage

The current Scheme Payment Percentage for FAIL is 5% for all creditors with liabilities in Australia. This distribution has been made from non-reinsurance assets in Australia.

3.2 Projected further Scheme Payments

The Scheme Administrators have now made Scheme Payments up to the minimum forecast Scheme Payment percentages for creditors in Australia.

As the Scheme cut-off date of 31 May 2013 is now less than 12 months away, the Scheme Administrators do not consider it prudent to make any further Scheme Payments until after the Scheme cut-off when the expected final creditor total will be better known.

3.3 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, the level of expected future agreed claims, and the remaining potential volatility of the account.

3.4 Scheme Payments for reinsurance creditors

As explained in previous annual reports, the Scheme Administrators are 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.

3.5 Estimated ultimate Scheme Payment Percentage

The Scheme Administrators' current best estimate of the ultimate Scheme Payment Percentages for FAIL 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 Scheme Payment Percentage could vary significantly from that predicted.

Scheme Company	Estimated Total Scheme Payment Percentage at Scheme date	Updated Total Scheme Payment Percentage at 30 June 12
FAIL	Less than 5%	1% - 10%

The estimated Scheme Payment range can be further analysed across the various creditor groups as follows:

	Range of estimated Scheme Payment Percentages
Creditors with insurance liabilities in Australia	5% - 10%
Creditors with insurance liabilities outside of Australia	1%
Creditors with non insurance liabilities in Australia	5% - 10%

FAI is part of a guarantee group comprising three subsidiaries within the HIH Group. Membership of the guarantee group has had the effect of pooling the assets and liabilities of the three HIH companies making up the group. Whilst work has continued during the year to realise assets within the other companies within the HIH Group, the Scheme Administrators do not consider that this has had a material impact on FAI's estimated total Scheme Payment percentage.

The other members of the cross guarantee group are:

- FAI Leasing Finance Pty Limited
- FAI Home Security Holdings Pty Limited.

4 Interaction between Australian and English Scheme

4.1 Claiming under the Australian and English Schemes

All creditors worldwide are entitled to claim in both the Australian and English Schemes for FAIL. 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 has adopted all of the provisions of the Australian Scheme, including the Australian distribution priorities, which will now apply to the English Assets.

5 Financial position

5.1 Estimated balance sheet at 30 June 2012

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 FAIL as at 30 June 2012, is included as Appendix 1 to this report.

FAIL together with 2 subsidiary companies, FAI Leasing Finance and FAI Home Security Holdings are part of a guarantee group. Membership of the guarantee group has the effect of pooling the group companies' assets and liabilities. As such, work has continued to be undertaken during the period to realise the assets and agree the claims of the other members of the cross guarantee group.

5.2 Receipts and payments to 30 June 2012

A summary of the Scheme Administrators' receipts and payments from the commencement of the Scheme on 30 May 2006 to 30 June 2012 is set out in Appendix 2 to this report.

Since the last annual report dated 30 June 2011, \$64,655.50 has been approved by the FAIL Scheme Creditors' Committee, and paid to the Scheme Administrators in their role as Office Holders.

6 Closure

6.1 Estimation Date

The FAIL Schemes provide for an Estimation Date of seven years after the Australian Scheme became effective: that is 31 May 2013.

The Scheme provides that the Estimation Date may be moved up to two years prior to, or two years after the original seven years by special resolution of creditors, on the recommendation of the Scheme Administrators and Creditors' Committees.

The Scheme Administrators now consider that as the majority of the reinsurance asset has been collected and the remaining tail of insurance liabilities is sufficiently small to be managed as part of the cut-off process, that 31 May 2013 should be confirmed as the Estimation Date for the Scheme.

6.2 Notification of Estimation Date

Under the terms of the Scheme, the Scheme Administrators shall, within 180 days of, but not less than 90 days prior to, the Estimation Date of 31 May 2013:

- + send to each known creditors a notice of the Estimation Date and a final claim form for Estimation; and
- + give notice by publication of the Estimation Date.

Based on the Estimation Date of 31 May 2013, the Scheme Administrators expect to provide the written notice to creditors and publication of advertisement in accordance with the terms of the Scheme, in February 2013.

6.3 Estimation

Under the terms of the Scheme, creditors will only be entitled to have their claims determined to be Acknowledged Creditor Claims if:

- + prior to the Estimation Date, the creditors' claims have already been determined to be Acknowledged Creditor Claims. Creditors whose existing claims have been agreed by the Scheme Administrators will receive a notice from the Scheme Administrators in early 2013 confirming their Acknowledged Creditor Claims;
- + a final claim form for Estimation is completed by the creditor detailing each of its claims and returned to the Scheme companies on or before 3 months after the Estimation Date: i.e. by 2 September 2013; or
- + prior to the Estimation Date, the creditor commenced a proceeding in relation to their claim in accordance with the terms of the Scheme which has not been determined by the Estimation Date.

In light of the upcoming Estimation Date, the Scheme Administrators urge all creditors to review any outstanding claims they may have and if necessary, contact the HIH claims run-off team whose details are set out in section 8.1 of this report, as soon as possible.

7 Responsibilities

7.1 Scheme Administrators

The Australian Scheme Administrators are Tony McGrath and Chris Honey, partners of McGrathNicol, based in Sydney. The English Scheme Administrators of FAIL are John Wardrop and Michael Walker, partners of KPMG LLP based in London. Michael Walker replaced Tom Riddell as the English Scheme Administrators of FAIL following Tom Riddell's resignation in January 2012.

7.2 Run-off Managers

The day to day claims handling and reinsurance recovery activities of FAIL in Australia are managed in-house by the HIH run-off team.

The run-off managers for all business written by the UK branch of FAIL are Asta Insurance Services Limited.

7.3 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 as required, usually at least once a year. The current constitution of the Committee is as follows:

Member	Represented by
HSBC	Mr John Dawson
FAI Leasing Finance Pty Ltd (In Liquidation)	Mr Harry Neesham
FAI (NZ) General Insurance Company Ltd (In Liquidation)	Mr Callum Reid
HIH Casualty & General Insurance (NZ) Ltd (In Liquidation)	Mr Callum Reid

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.

8.1 Creditor Enquiries in Australia

Scheme Creditors with claims adjustment queries (excluding those in relation to branch business) should call HIH Help Desk on +61 (0) 2 9650 5777. Written claims adjustment queries should be directed to HIH Group at the following address: HIH Group, GP Box 9814, Sydney NSW 2001, 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 enquiries@hih.com.au.

Yours faithfully

For FAI Insurances Limited – in liquidation and subject to Schemes of Arrangement



Tony McGrath
 Scheme Administrator



Chris Honey
 Scheme Administrator

Appendix 1

Updated balance sheet for FAll as at 30 June 2012

FAI Insurances Limited - (In Liquidation and subject to Schemes of Arrangement)

Balance Sheet as at 30th June 2012

All values in AUD

	RATA as at 30 June 2012	RATA as at 30 June 2011
	\$'000	\$'000
Assets not specifically charged		
Cash		
Cash at bank	27,384	15,933
	<u>27,384</u>	<u>15,933</u>
Receivables		
Amounts owing by related bodies corporate (excluding amounts owing by companies in the cross guarantee group)	4,719	22,777
GST Recoverable	4	5
Other debtors	0	3
	<u>4,723</u>	<u>22,784</u>
Investments		
Short term deposits	2,334	2,206
Managed Investments	(0)	19,355
ADD back: Dividends Paid	23,200	0
Shares in controlled entities	1,058	928
	<u>26,592</u>	<u>22,489</u>
Total company assets not specifically charged	58,699	61,206
Dividends receivable from other companies in the guarantee group	28,037	26,963
Total assets not specifically charged	<u>86,735</u>	<u>88,170</u>
TOTAL ASSETS	<u>86,735</u>	<u>88,170</u>
Unsecured creditors		
Accounts payable		
Trade Creditors	(17,360)	(17,360)
	<u>(17,360)</u>	<u>(17,360)</u>
Borrowings		
Medium term note issues	(73,594)	(69,839)
	<u>(73,594)</u>	<u>(69,839)</u>
Provisions		
Other - Shareholder class action & guarantor for CHF bonds	(18,161)	(18,161)
	<u>(18,161)</u>	<u>(18,161)</u>
ACC's	(12,484)	(22,599)
Claims Reserves - Deferred	(10,668)	(154)
IBNR Claims	(636)	(936)
Outstanding claims	<u>(23,788)</u>	<u>(23,689)</u>
Other liabilities		
Other creditors and accruals	(11,125)	(11,125)
Amounts owing to related bodies corporate (excluding amounts owing to companies in the cross guarantee group)	(451,158)	(500,502)
	<u>(462,284)</u>	<u>(511,627)</u>
Total company unsecured creditors	(595,187)	(640,676)
Liabilities from other companies in the cross guarantee group	(140,145)	(213,384)
Total unsecured creditors	<u>(735,332)</u>	<u>(854,060)</u>
TOTAL LIABILITIES	<u>(735,332)</u>	<u>(854,060)</u>
NET DEFICIT	<u>(648,597)</u>	<u>(765,890)</u>

Appendix 2

Summary of the Scheme Administrators' receipts and payments from 30 May 2006
to 30 June 2012

**FAI Insurances Limited (In Liquidation and subject to Schemes of Arrangement)
Receipts and Payments Account 1 July 2011 to 30 June 2012**

	\$	\$
Balance at 1 July 2011		36,251,062.20
Receipts		
Dividends received	11,254,576.96	
Scheme Dividends received	1,954,550.72	
Interest	1,197,679.97	
Unrealised Gain on Investments	482,969.15	
Foreign Exchange Movements on Foreign Currency Accounts	246,210.35	
Recovery from CGU Insurance	19,286.15	
GST Refund from ATO	15,210.50	
Intercompany Loan Settlement	10,064.24	
Other receipts	18.43	
	<hr/>	
Total receipts		15,180,566.47
Payments		
Scheme Payments	(23,201,517.08)	
Central Expense paid to HIH C&G	(119,511.82)	
Professional Fees	(77,285.32)	
Scheme Administrators' Fees	(64,655.50)	
GST	(14,504.14)	
Outsourced Claims Management Fees	(3,488.65)	
Other Sundry Payments	(2,661.62)	
Liquidators' Fees	(2,428.50)	
	<hr/>	
Total payments		(23,486,052.63)
Balance at 30 June 2012		<u>27,945,576.04</u>