

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

Scheme Administrators' annual report to
creditors

30 June 2013

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1 Introduction & background

1.1 Introduction

This is the seventh annual report to the Creditors of FAI Insurances Limited - in liquidation and subject to Schemes of Arrangement (“FAIL”).

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 2013. It also covers any significant events between that date and completion of the report.

An annual report has also been prepared by the Scheme Administrators of the UK Scheme of Arrangement for FAIL. 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 in the administration of the “Run-off” phase of the Schemes, the estimation date at which all outstanding claims should be valued, was set at 31 May 2013. At this date, the Schemes transitioned from the “Run-off” phase to the “Estimation” phase. Scheme Creditors of the eight licensed insurance companies in the HIH Group whose claims had not been acknowledged or agreed, had until midnight British Summer Time on 2 September 2013 (the bar date) to submit their final claims. No further claims will be accepted after that date.

Under the terms of the Schemes, the Scheme Administrators must determine all claims received within three months of 2 September 2013 (i.e. by 2 December 2013) and notify the relevant Scheme Creditors of their decision.

2 Principal developments to report during the period

The principal developments to report during the period were:

- + No further Scheme Payments were approved for payment to the creditors. The Scheme Payments made to date for FAIL is 5% for all creditors with liabilities in Australia.

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

- + Successfully negotiated a settlement of US\$2.5 million with AFG Insurances Ltd (Subject to a Deed of Company Arrangement) (“AFG”) in respect of FAIL’s participation in an insurance pool, with ME Ruddy Underwriting Agency acting as pool agent, in the 1960s. AFG provided FAIL with a 50% quota share retrocession protection for FAIL’s participation in the Ruddy Pool.

- + On 31 May 2013, the Schemes transitioned from the “Run-off” phase to an “Estimation” phase.

Further information in respect of the “Estimation” phase and determination of the Acknowledged Creditor Claims, is included in section 6 of this report.

- + The bar date for final submission of claims of midnight British Summer Time on 2 September 2013, has now passed. Under the terms of the Schemes no further claims will be accepted by the Scheme Administrators.

- + Since the last annual report dated 30 June 2012, the liquidations of another 4 HIH Group subsidiary companies have been completed.

To date, the liquidations of 49 HIH Group subsidiary companies have been finalised with those of a further 2 companies expected to be completed by October 2013. The winding up of the additional 2 companies has resulted in a flow of funds to FAIL of \$109k of creditor distribution from FAI Overseas Investments in July 2013. Prior to the completion of the liquidation of FAI Overseas Investments, a final dividend of approximately \$361k will be made to FAIL, in the form of cash and the distribution in-specie of outstanding intercompany loans.

There is not expected to be any surplus capital receivable by FAIL from the liquidation of its wholly owned subsidiary, FAI Overseas Investments.

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. The Scheme Administrators do not consider it prudent to make any further interim Scheme Payments until after the Scheme cut-off when the expected final creditor total will be better known.

The Scheme bar date of midnight British Summer Time 2 September 2013 has now passed and no further claims will be accepted by the Scheme Administrators. The Scheme Administrators are currently reviewing the total level of claims received and would hope to be in a position to have completed initial adjudication of all classes of creditors' claims towards the end of this year.

3.3 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.

3.4 Estimated ultimate Scheme Payment Percentage

The Scheme Administrators' current best estimate of the ultimate Scheme Payment Percentages for FAIL as at 30 June 2013 is shown below. As virtually all of the company's forecast reinsurance and other asset recoveries have now been received, the major determinant of any movement in the forecast total Scheme Payment Percentage is the level of final agreed claims.

While the bar date for receipt of final claims has now passed, it is too early at the date of preparation of this report to provide a more accurate update on the final Scheme Payment Percentage estimates.

Scheme Company	Estimated Total Scheme Payment Percentage at Scheme date	Updated Total Scheme Payment Percentage at 30 June 2013
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 30 June 2013
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 2013

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 2013, 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 2013

A summary of the Scheme Administrators' receipts and payments from the commencement of the Scheme on 30 May 2006 to 30 June 2013 is set out in Appendix 2 to this report.

Since the last annual report dated 30 June 2012, \$78,265.00 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 Estimation Date for the FAI Schemes was set as 31 May 2013, at which date the Schemes transitioned from the “Run-off” phase to the “Estimation” phase.

Any creditors’ claims which had not been agreed by the Estimation Date needed to be determined within the Estimation period.

Scheme Creditors of the eight licensed insurance companies in the HIH Group whose claims had not been acknowledged or agreed had until midnight British Summer Time on 2 September 2013 to submit their final claims for estimation. No further claims will be accepted after this date.

6.2 Estimation Period

The Estimation Period commenced on 31 May 2013.

The purpose of the Estimation Period is to enable the Scheme Administrators and Scheme Creditors to agree a final value for any open claims and any IBNR (claims that have been incurred but not reported) in order to determine the final financial position between the Scheme Creditors and the relevant Scheme companies.

Under the terms of the Schemes, 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 an Acknowledged Creditor Claim. Creditors whose existing claims have been agreed by the Scheme Administrators would have received 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 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.

6.3 Determination after Estimation Date

Under the terms of the Schemes, the Scheme Administrators shall determine whether the creditors’ claims are Established Scheme Claims within three months of 2 September 2013.

Following their assessment, the Scheme Administrators shall notify the Scheme Creditors in writing of their decision in respect of the claims received.

If, after a period of a further three months from the Scheme Administrators’ written notice of their determination, the Scheme Administrators have not reached an agreement with the Scheme Creditor as to whether any part of the claim gives rise to an Established Scheme Claim, the Scheme Administrators shall refer the creditor’s claim to a Scheme Adjudicator for determination.

6.4 Scheme Claim Adjudication

Under the terms of the Schemes, the Scheme Administrators shall, with approval of the Creditors’ Committee, appoint one or more Scheme Adjudicators.

The role of the Scheme Adjudicator is principally to determine whether liabilities notified to the Scheme companies by a potential creditor under the estimation process, and referred to the Scheme Adjudicator by the Scheme Administrator, should be accepted as Established Scheme Claims. The Scheme Adjudicator must also determine the value of such claims.

The Scheme Adjudicators appointed to the F&I Schemes are as follows:

Scheme Adjudicator	Representing
Mr Tim Andrews (Finity Solutions)	Australian Scheme Administrators
Mr Gary Wells (Milliman)	English Scheme Administrators

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 Michael Walker and Barry Gale, partner and director respectively of KPMG LLP based in London. Barry Gale replaced John Wardrop as the English Scheme Administrators of FAIL following John Wardrop's resignation on 21 August 2013.

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 Kerry Downey
HIH Casualty & General Insurance (NZ) Ltd (In Liquidation)	Mr Kerry Downey

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 2013

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

Balance Sheet as at 30th June 2013

All values in AUD

	RATA as at 30 June 2013 \$'000	RATA as at 30 June 2012 \$'000
Assets not specifically charged		
Cash		
Cash at bank	14,313	27,384
	<u>14,313</u>	<u>27,384</u>
Receivables		
Amounts owing by related bodies corporate (excluding amounts owing by companies in the cross guarantee group)	5,045	4,719
GST Recoverable	1	4
	<u>5,046</u>	<u>4,723</u>
Investments		
Short term deposits	15,933	2,334
ADD back: Dividends Paid	27,073	23,200
Shares in controlled entities	0	1,058
	<u>43,006</u>	<u>26,592</u>
Reinsurance recoveries receivable	110	0
	<u>110</u>	<u>0</u>
Total company assets not specifically charged	62,475	58,699
Dividends receivable from other companies in the guarantee group	28,166	28,037
Total assets not specifically charged	90,641	86,735
TOTAL ASSETS	90,641	86,735
Unsecured creditors		
Accounts payable		
Trade Creditors	(17,420)	(17,360)
	<u>(17,420)</u>	<u>(17,360)</u>
Borrowings		
Medium term note issues	(80,863)	(73,594)
	<u>(80,863)</u>	<u>(73,594)</u>
Provisions		
Other - Shareholder class action & guarantor for CHF bonds	(19,078)	(18,161)
	<u>(19,078)</u>	<u>(18,161)</u>
ACC's	(11,629)	(12,484)
Claims Reserves - Deferred	(11,494)	(10,668)
IBNR Claims	(863)	(636)
Outstanding claims	(23,985)	(23,788)
Other liabilities		
Other creditors and accruals	(12,484)	(11,125)
Amounts owing to related bodies corporate (excluding amounts owing to companies in the cross guarantee group)	(440,547)	(451,158)
	<u>(453,031)</u>	<u>(462,284)</u>
Total company unsecured creditors	(594,376)	(595,187)
Liabilities from other companies in the cross guarantee group	(139,487)	(140,145)
Total unsecured creditors	(733,863)	(735,332)
TOTAL LIABILITIES	(733,863)	(735,332)
NET DEFICIT	(643,223)	(648,597)

Appendix 2

Summary of the Scheme Administrators' receipts and payments from 30 May 2006
to 30 June 2013

**FAI Insurances Limited (In Liquidation and subject to Schemes of Arrangement)
Receipts and Payments Account 1 July 2012 to 30 June 2013**

	\$	\$
Balance at 1 July 2012		27,945,576.04
Receipts		
AFG Insurances - Litigation Recovery	2,378,857.09	
Foreign exchange movements on foreign currency accounts	990,969.10	
Interest	602,513.80	
Surplus funds received from Lanlex 45	299,708.87	
Scheme Dividends received	28,539.26	
GST refund from ATO	28,462.79	
Other receipts	7,505.57	
Intercompany loan settlement	3,511.60	
Realised gain on investments	239.43	
	<hr/>	
Total Receipts		4,340,307.51
Payments		
Scheme Payments	(3,497,153.18)	
Professional fees	(210,005.26)	
Central expense paid to HIH C&G	(124,141.78)	
Scheme Administrators' fees	(78,265.00)	
GST	(25,454.13)	
Other sundry payments	(6,072.08)	
Liquidators' fees	(464.00)	
	<hr/>	
Total Payments		(3,941,555.43)
Balance at 30 June 2013		28,344,328.12
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