

HIH Casualty and General Insurance Limited
ACN 008 482 291
(In liquidation and subject to Schemes of Arrangement)

Scheme Administrators' annual report to
creditors

30 June 2011

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1 Introduction & background

1.1 Introduction

This is the fifth annual report to the Creditors of HIH Casualty & General Insurance Limited - in liquidation and subject to Schemes of Arrangement (“HIH C&G”).

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 2011.

An annual report has also been prepared by the Scheme Administrators of the UK Scheme of Arrangement for HIH C&G. 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 30 May 2011. However, 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 Scheme Creditor Committee, which now total as follows:

	Creditors with insurance liabilities in Australia	Creditors with insurance liabilities outside of Australia	Creditors with non insurance liabilities in Australia	All other creditors worldwide
HIH C&G	31.00%	26.40%	25.00%	20.00%

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

- + During the year, HIH C&G received various dividend payments from intercompany debtors in Australia. The most significant receipt was a further dividend payment of \$33.97 million from FAIG in respect of the intercompany loan owing by FAIG of \$228.7 million.

In July 2011, FAIG declared and paid a further dividend of 5 cents in the dollar to HIH C&G of \$11.4 million. To date, HIH C&G has collected a total of 50 cents in the dollar from FAIG.

- + The liquidations of 6 HIH Group subsidiary companies have been completed during the year. To date, the liquidations of 19 HIH Group subsidiary companies have been completed and a further 16 companies are close to completion.

The winding up of the additional 16 companies has resulted in the flow of funds to HIH C&G in July 2011 as follows:

- \$4.5 million creditor distribution from Marine & Aviation Management Services;
- \$364k creditor distribution from CIC Workers Compensation (NSW); and
- \$36k creditors' distribution from 422 Collins Street and FAI Overseas Holdings.

In addition to the distributions above, HIH C&G will receive surplus capital distributions from the following wholly owned subsidiaries: Innes Owens (\$13.2 million); Marine & Aviation Management Services (\$235k); and Utilities Insurance Underwriting Agencies (\$220k) prior to the completion of their liquidations in October 2011.

3 Current and projected Scheme Payment Percentages

3.1 The current Scheme Payment Percentage

The current Scheme Payment Percentages for HIH C&G are:

Creditors with insurance liabilities in Australia	31.00%
Creditors with insurance liabilities outside of Australia	26.40%
Creditors with non insurance liabilities in Australia	25.00%
All other creditors worldwide	20.00%

To date, the Scheme Administrators have made distributions out of non-reinsurance assets in Australia, to creditors with liabilities in Australia, totalling 25%. They have also made distributions totalling 20% to all other creditors worldwide.

The Scheme Administrators have made distributions out of reinsurance assets in Australia, to creditors with insurance liabilities in Australia, totalling 8%. They have also made distributions out of reinsurance assets outside of Australia to creditors with insurance liabilities outside of Australia, totalling 8%. As any distribution to creditors with insurance liabilities from assets other than reinsurance recoveries, is made after taking account of any recoveries they may have received from reinsurance assets, the effective total Scheme Payment percentage to date for creditors with Australian insurance liabilities is therefore 31%. The effective total Scheme Payment percentage to date for creditors with insurance liabilities outside of Australia is 26.40%.

A Scheme Payment Percentage of 29.16% for those US domiciled creditors eligible to be paid from the US Trust Fund assets has also been paid.

3.2 Projected further Scheme payments

The Scheme Administrators have made Scheme Payments to date at or in excess of the minimum forecast ranges for each class of creditor. In light of this, and the fact that the Scheme cut-off date of 30 May 2013 is now less than two years away, the Scheme Administrators do not expect to materially increase the Scheme Payment percentages further, prior to this date.

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

3.4 Scheme Payments for reinsurance creditors

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

3.5 Estimated ultimate Scheme Payment Percentage

The Scheme Administrators' current best estimates of the ultimate Payment Percentage for HIH C&G is shown below. This estimate remains 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. 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 11
HIH C&G	15% to 25%	20% to 35%

Part of HIH C&G's realisable assets are future reinsurance recoveries, the size and recoverability of which are dependent upon a number of factors including:

- + future claims development;
- + contract commutations; and
- + the credit risk of certain reinsurers.

The estimated range is a function of two factors:

1. The difficulty in estimating the total final asset recoveries, and the final level of agreed creditor claims, in light of the issues listed above. Estimation of the final level of reinsurance recoveries is particularly difficult; and
2. The fact that due to the application of Australian distribution priorities, certain creditor groups are likely to receive higher final Scheme Payment percentages than others.

The total estimated Scheme Payment range for creditors of 20% to 35%, can be further analysed as:

	Range of estimated Scheme Payment percentage
Creditors with insurance liabilities in Australia	30% - 35%
Creditors eligible to be paid from US Trust Funds	27% - 32%
Creditors with insurance liabilities outside of Australia	27% - 32%
Creditors with non insurance liabilities in Australia	25% - 30%
Creditors with non insurance liabilities outside of Australia	20% - 25%

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 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 now apply to the English Assets.

5 Financial position

5.1 Estimated balance sheet at 30 June 2011

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 C&G as at 30 June 2011, is included as Appendix 1 to this report.

5.2 Receipts and payments to 30 June 2011

A summary of the Scheme Administrators receipts and payments from the commencement of the Scheme on 30 May 2006 to 30 June 2011 is set out in Appendix 2 to this report.

During this period \$2,259,985 has been approved by the HIH C&G Scheme Creditors' Committee, and paid to the Scheme Administrators in their role as Office Holders.

6 Closure

The Scheme for HIH C&G 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. The English Scheme Administrators of HIH C&G are John Wardrop and Tom Riddell, partner and senior adviser respectively of KPMG LLP, based in London.

7.2 Run-off Managers

The day to day claims handling and reinsurance recovery activities of HIH C&G have previously 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, were Capita CMGL. The run-off managers for all business written by the UK branch of HIH C&G are Whittington Insurance Services Limited.

Following an extensive review of the ongoing resources required to manage the run-off process for all business of the company (except business written with the UK branch), HIH C&G terminated Capita CMGL's contract on 30 June 2011, and employed the personnel necessary to manage the run-off process in-house with effect from 1 July 2011.

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 three times a year. The current constitution of the Committee is as follows:

Member	Represented by
ACT Insurance Authority	Mr John Fletcher
ACT Workers Compensation Supplementation Fund	Mr John Fletcher
Law Cover Pty Limited	Mr David Martin
NSW Motor Accidents Authority	Mr Andrew Nicholls
Queensland Motor Accident Insurance Commission	Mr Ashur Merza
HCSL – Australian Government Treasury	Mr Trevor King
United Medical Protection	Mr Scott Pearson
WA Workers Compensation & Rehabilitation Commission	Mr Harry Neesham
HIH Holdings (Asia) Limited	Mr Jan Blauuw
Hong Kong Solicitors Indemnity Fund	Mr David Cowling
Motor Traders Association of NSW	Mr James McCall
Building Insurers Guarantee Corporation NSW	Mr Michael Hanna
Manly Council	Ms Mary Rawlings

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 enquires@hih.com.au.

Yours faithfully

For HIH Casualty & General Insurance Limited – in liquidation and subject to Schemes of Arrangement



Tony McGrath
Scheme Administrator



Chris Honey
Scheme Administrator

Appendix 1

Updated balance sheet for HIH C&G as at 30 June 2011

HIH Casualty & General Insurance Limited - (In Liquidation and subject to Schemes of Arrangement)

Balance Sheet as at 30 June 2011

All values in AUD

	RATA as at 30 June 2011 \$'000	RATA as at 30 June 2010 \$'000
Assets not specifically charged		
Cash at bank and on hand	164,311	294,537
Receivables		
Amounts owing by related bodies corporate (Interco rec)	64,923	133,330
GST Recoverable	1,022	1,080
	<u>65,944</u>	<u>134,410</u>
Investments		
Short term deposits (inc. PEE funds)	24,127	21,468
Managed Investments	333,977	358,152
ADD back: Dividends Paid	697,458	433,750
Shares in controlled entities (Surplus assets)	1,038	52,080
	<u>1,056,600</u>	<u>865,450</u>
Reinsurance recoveries receivable	48,392	45,789
Hannover Commutation	10,109	9,631
	<u>58,501</u>	<u>55,420</u>
Other	1,000	1,000
Sub - Total assets not specifically charged	<u>1,346,356</u>	<u>1,350,817</u>
Provisions	0	0
Total assets not specifically charged	<u>1,346,356</u>	<u>1,350,817</u>
Assets subject to specific charges		
Investments		
LOC related deposits	2,674	4,492
Statutory Reinsurance Cut-Through	3,102	2,879
Total assets subject to specific charges	<u>5,776</u>	<u>7,371</u>
TOTAL ASSETS	<u>1,352,132</u>	<u>1,358,188</u>
Amounts payable in advance of secured creditors		
Provision for redundancy, employee entitlements and employee claims	(1,950)	(1,932)
Total amounts payable in advance of secured creditors	<u>(1,950)</u>	<u>(1,932)</u>
Liabilities secured by specific charge over assets		
Accounts payable		
Statutory Reinsurance Cut-Through	(3,102)	(2,879)
Amounts payable in relation to letters of credit	(2,674)	(4,492)
Total liabilities secured by specific charge over assets	<u>(5,776)</u>	<u>(7,371)</u>
Unsecured creditors		
Accounts payable		
Trade Creditors (A/P and Special Principals)	(87,057)	(80,321)
Sundry creditors - ARS	(27,074)	(27,074)
	<u>(114,131)</u>	<u>(107,395)</u>
ACCs	(1,618,051)	(1,710,231)
Outstanding claims (Reserves)	(422,223)	(459,346)
IBNR Claims	(316,429)	(326,022)
Outstanding claims	<u>(2,356,703)</u>	<u>(2,495,599)</u>
Other liabilities		
Other creditors and accruals (MAIC & Eurobonds)	(580,785)	(652,350)
Amounts owing to related bodies corporate (Interco liabilities)	(461,140)	(502,062)
	<u>(1,041,925)</u>	<u>(1,154,411)</u>
Total unsecured creditors	<u>(3,512,759)</u>	<u>(3,757,405)</u>
TOTAL LIABILITIES	<u>(3,520,485)</u>	<u>(3,766,708)</u>
NET DEFICIT	<u>(2,168,353)</u>	<u>(2,408,520)</u>

Appendix 2

Summary of the Scheme Administrators' receipts and payments from 30 May 2006
to 30 June 2011

HIH Casualty & General Insurance Limited (In Liquidation and subject to Schemes of Arrangement)

Receipts and Payments Account 1 July 2010 to 30 June 2011

	\$	\$
Balance at 1 July 2010		534,927,521.48
Receipts		
Intercompany Settlement	52,498,726.74	
Distribution from solvent subsidiaries	46,009,531.74	
Dividend Payment Funding from UK	40,474,948.86	
Dividends Received from Scheme Companies	37,669,568.68	
Unrealised Gain on Investment Portfolio	16,831,384.06	
Interest on cash and deposits	3,935,370.05	
Reinsurance recoveries	3,926,519.35	
Central expense reimbursement received from other HIH Companies	2,900,451.80	
Claims recoveries (Includes reallocations to other entities)	1,889,366.42	
Pre Liquidation GST Refund	1,670,463.39	
GST Refund from ATO	1,560,998.51	
Dividends Received from Non-Scheme Companies	239,018.58	
Debtors	139,019.46	
Settlement proceeds including reallocations to group companies	102,158.93	
Provision of IT Services to AAA,QBE,NRMA,WGB	23,419.00	
Other receipts (amounts<\$1m)	7,415.09	
GST collected on all receipts	2,522.05	
	<hr/>	
Total receipts		209,880,882.71
Payments		
Scheme Payments to Creditors	(260,651,627.13)	
Unrealised Exchange rate movements on foreign cash accounts	(30,131,229.49)	
Outsourced Claims Management Fees	(5,492,677.59)	
IT Outsource costs	(2,580,243.02)	
Salaries / Annual Leave / LSL	(1,783,892.80)	
Rent and Outgoings	(1,664,373.62)	
Professional Fees	(1,580,584.30)	
GST on payments	(1,450,810.17)	
Scheme Administrators Fees	(1,441,226.00)	
Claims run-off expenses	(1,025,107.66)	
Contractors & Temporary Staff	(539,193.08)	
Computer/Systems Costs	(462,171.11)	
Other Sundry Payments	(285,003.57)	
Other Staff Costs	(144,007.61)	
Superannuation contributions	(143,014.71)	
Liquidators Fees	(55,795.00)	
Communication costs	(40,777.49)	
	<hr/>	
Total payments		(309,471,734.35)
Balance at 30 June 2011		<u><u>435,336,669.84</u></u>