



Highlands Insurance Company (U.K.) Limited (in Administration)

**Joint Administrators' Report in accordance with
Rule 2.47 of the Insolvency Rules 1986
for the period 1 May 2009 to 31 October 2009**

November 2009

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I Summary Information

The Company	Highlands Insurance Company (U.K.) Limited (in Administration) (the "Company" or "Highlands UK")
Registered number	01190948
Registered office and trading address	c/o PRO Insurance Solutions Limited ("PRO") Bruton Court Bruton Way Gloucester GL1 1DA United Kingdom
Activity	Insurance and reinsurance run-off
Court reference	High Court of Justice, Chancery Division, Companies Court, Case No. 7896 of 2007
Administrators	Dan Schwarzmann and Mark Batten of PricewaterhouseCoopers LLP ("PwC")
Date of appointment of the Administrators	1 November 2007
Date of approval of the Administrators' proposals	8 January 2008
Purpose of the Administration	The purpose of the Administration is to achieve one of the following objectives: (a) rescuing the Company as a going concern or, failing that, (b) achieving a better result for the Company's creditors as a whole than would be likely if the Company were wound up (without first being in Administration) or, finally, (c) realising property in order to make a distribution to one or more secured or preferential creditors

II Progress Report

Purpose of this report

This report has been prepared in accordance with Rule 2.47 of the Insolvency Rules 1986. It has been prepared to provide creditors with an update on the progress of the Administration since the last report to creditors dated May 2009. Copies of the previous reports sent to creditors, together with general information and other key documents in relation to the Administration of Highlands UK may be accessed on the Highlands UK website which can be found at www.ukhighlands.com.

The following appendices accompany this report:

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II Progress Report

Overall strategy

The purpose of the Administration is to achieve one of the objectives set out on page one of this report. Accordingly, following my appointment as Administrator, my primary objective has been to oversee the run-off of Highlands UK's business whilst actively assessing the possibilities available to creditors.

Following my last update I am pleased to report that a scheme of arrangement pursuant to part 26 of the Companies Act 2006 for creditors with claims arising from contracts or policies of direct insurance, as opposed to contracts of reinsurance (the "Direct Scheme" or "Scheme"), has been approved by the requisite majority of Scheme Creditors (as defined) and sanctioned by the UK High Court. In addition, a successful application has been made in the US pursuant to Chapter 15 of the US Bankruptcy Code for a permanent injunction recognising and giving effect to the Direct Scheme. Further details are provided below.

The strategy for dealing with the claims of Highlands UK's reinsurance creditors is currently being formulated and it is anticipated that a scheme of arrangement for cedants will be proposed during the first half of 2010.

Creditors' committee

During the period since my last report I have continued to consult with the creditors' committee in relation to major issues and the development of strategy, in particular, with respect to the Direct Scheme. The next formal committee meeting is scheduled for December 2009. I remain very grateful to the members and the observer of the committee for their ongoing support.

II Progress Report

Summary of the Administrators' actions to date

(a) Direct Scheme

In my last report I detailed the progress we had made in formulating the Direct Scheme. The Scheme Meeting which was scheduled for 18 June 2009 took place and I can report that the Scheme was voted on and approved by the requisite majority of Scheme Creditors. The Direct Scheme was subsequently sanctioned by the High Court on 30 July 2009 and permanent injunctive relief under Chapter 15 of the US Bankruptcy Code was granted on 18 August 2009. A copy of the order sanctioning the Direct Scheme was lodged with the Registrar of Companies on 19 August 2009 and the Direct Scheme became effective.

Following this, on 24 August 2009, my team circulated notices to all known potential Scheme Creditors, as well as to all known brokers, agents and intermediaries. This notice requested Scheme Creditors to complete and return a Claim Notification and a Final Claim Form in accordance with the terms of the Direct Scheme by no later than 17 November 2009 and 15 February 2010 respectively. My team also placed copies of this notice in a selection of national and international newspapers and journals and on the Company's website (www.ukhighlands.co.uk).

Further information and copy documents (including a full text of the Direct Scheme) can be obtained at www.ukhighlands.co.uk or on request to the Joint Administrators.

(b) Settlement with Highlands Insurance Company ("HIC")

I previously outlined the details of the settlement that had been reached with HIC. In my last report I advised that, in accordance with the terms of that settlement, the first tranche of the settlement monies payable to Highlands UK of US\$6,625,000 had been paid into an account under the joint control of both Highlands UK and HIC. Since then, interest of US\$10,107.04 has been earned on these funds. As previously reported, payment of the second tranche of settlement monies of US\$6,375,000, together with the release of the first tranche to Highlands UK, is subject to implementation of the Direct Scheme. This should occur within 10 days of the Final Claims Submission Date, that is, towards the end of February 2010.

(c) Financial review

I continue to anticipate that based on advice from my actuarial advisers and with the benefit of the settlement monies due from HIC referred to above, the Company should be able to pay the claims of direct creditors in full.

The dividend to reinsurance creditors remains subject to significant uncertainties, in particular the eventual outcome of the Direct Scheme. Following the Claim Notification deadline in respect of the Direct Scheme, the financial review of the Company's liabilities will be further refined with the support of my actuarial advisers and this work will be shared with the creditors' committee at the meeting scheduled for December 2009.

II Progress Report

(d) Run-off management

Since my last report, PRO has been acquired from Swiss Reinsurance Group by Tawa plc. I am confident that this change of ownership will not impact the current run-off services provided to the Company.

(e) Asset management

PRO, under the continued guidance and direction of my team, has been actively progressing the implementation of our previously agreed reinsurance collection strategy. To date, reinsurance recoveries, including collections from brokers, have amounted to US\$419,410.90 and £19,612.81. I anticipate further progress in this area during the next six months.

As previously reported, my specialist treasury team manages Highlands UK's sterling cash assets in a portfolio of interest bearing investment accounts. Following a review of the investment strategy and consultation with the creditors' committee, the US dollar investments managed by EPIC Asset Managers Limited are gradually being placed under the direct control of my specialist treasury team. Furthermore, to the extent required to prudently hedge the Company's foreign exchange exposures, some of the investments have been, or will be, converted from US dollars to sterling.

My team continue to review the investment strategy on a regular basis to ensure that the risk profile remains acceptable. Interest of £220,602.14 and US\$1,677,508.95 has been earned on the Company's cash and investment assets since the Joint Administrators were appointed.

(f) Creditors and claims processing

As previously reported, prior to our appointment the Directors had imposed an informal moratorium on the agreement of claims effective from August 2006. However, subsequent to our appointment as Joint Administrators PRO were instructed to recommence claims processing and agreement. As referred to previously, creditors with claims arising from contracts or policies of direct insurance are being dealt with under the Direct Scheme. However, any other claims from policyholders, cedants, brokers, intermediaries and agents should continue to be presented to PRO in the normal manner.

We have continued to receive a regular flow of ad-hoc queries from policyholders, cedants, creditors and agents during the period. In particular, my team and PRO have continued to engage actively with direct creditors and, where appropriate, their advisers, in relation to the Direct Scheme.

(g) Statutory reporting

The Insurance Directorate of the FSA (Run-Off Division), which has responsibility for monitoring all insurance entities, continues to be advised of material developments in relation to the Administration.

II Progress Report

(h) Administrators' remuneration

Full details of professional costs incurred by the Joint Administrators and their team in the running the Administration have been reported regularly to the creditors' committee. A detailed analysis of the costs for the period 1 January 2009 to 31 October 2009 will be presented at the next creditors' committee meeting in December 2009. During that meeting, and in accordance with Rule 2.106 of the Insolvency Rules 1986, we will also submit to the creditors' committee for approval a new resolution in relation to the Joint Administrators' budgeted remuneration and expenses for 2010. Further details of fees incurred to date can be found below.

The value of Joint Administrator's remuneration drawn to date comprises £2,446,923.74 of fees and £40,869.19 of expenses, excluding VAT. In accordance with the provisions of Statement of Insolvency Practice, Statement No. 9, as adopted by the Institute of Chartered Accountants in England and Wales, the following information is provided to you.

- (i) Accumulated time costs incurred as at 31 October 2009 are £2,571,280.49 being 9,102 hours at an average hourly rate of £282.50.
- (ii) Of the hours spent, 2,468 hours relate to directing, managing and liaising with PRO and other internal and external parties, day-to-day project management and general administration; 1,880 hours relate to securing assets (including reinsurance) and managing the finances of the Company; 1,047 hours relate to all dealings and negotiations with HIC and the overall strategy of the Administration; 1,043 hours relate to the development and implementation of the Direct Scheme; 924 hours relate to statutory compliance and 1,740 hours relate to dealing with all other matters including actuarial, claims, IT, legal, tax and the creditors' committee.

Appendix A

Joint Administrators' Proposals as approved by Creditors on 8 January 2008

On 20 December 2007 the Administrators circulated to creditors their proposals for achieving the purpose of the Administration. The following proposals were approved by creditors without modification at a meeting held on 8 January 2008.

First resolution

- (i) The Administrators will continue to manage the Company's business, affairs and property in such manner as they consider expedient with a view to either rescuing the Company as a going concern or, failing that, achieving a better result for the Company's creditors as a whole than would be likely if the Company were wound up (without first being in Administration). This may involve the formulation, promotion and, subject to approval, implementation of a scheme or schemes of arrangement under section 425 of the Companies Act 1985.
- (ii) The Administrators may investigate and, if appropriate, pursue any claims that the Company may have under the Companies Act 1985 or Insolvency Act 1986 or otherwise. In addition, the Administrators shall do all such other things and generally exercise all their powers as Administrators as they in their discretion consider desirable in order to achieve the purpose of the Administration or to protect and preserve the assets of the Company or to maximise realisations or for any other purpose incidental to these proposals.
- (iii) A creditors' committee will be established if sufficient creditors are willing to act on it. The Administrators propose to seek the election of a creditors' committee and to consult with it from time to time.
- (iv) The Administrators may use any or a combination of the "exit route" strategies in Paragraphs 76 to 80 and 83 to 84 of Schedule B1 of the Insolvency Act 1986 in order to bring the Administration to an end. If it is possible to rescue the Company as a going concern it is likely that the Administrators will make an application to Court to end the Administration and return management of the Company back to the Directors. However, if it is not possible to rescue the Company as a going concern and instead the objective is to achieve a better result for the Company's creditors as a whole than would be likely if the Company were wound up (without first being in Administration), it is likely that the Administrators will formulate proposals for a scheme or schemes of arrangement under sections 425 of the Companies Act 1985 and, if so ordered by the Court will put them to meetings of the appropriate class(es) of creditors. If a scheme of arrangement is approved and sanctioned by the Court, the Administration will be brought to an end either:
 - (a) when the scheme of arrangement is brought to an end if it is more cost effective to run both procedures in tandem than for the Administration to be discharged, or
 - (b) by notice to the Registrar of Companies on completion of the Administration under Paragraphs 80 or 84 of Schedule B1 of the Insolvency Act 1986.

Appendix A

Joint Administrators' Proposals as approved by Creditors on 8 January 2008

Second resolution

- (v) That if appointed, the creditors' committee will fix the Administrators' fees and Category Two disbursements. It is proposed that the Administrators' fees will be calculated based on time properly spent on the Administration by them and their various grades of staff according to their firm's charge out rates for work of this nature and charged in accordance with their firms' policy. If no creditors' committee is appointed then the Administrators will seek a resolution from creditors that they may be remunerated on a time cost basis at a later meeting of creditors.

Appendix B

Sterling Receipts and Payments Account for the period 1 November 2007 to 31 October 2009

	Notes	Position at 31 October 2009	Position at 30 April 2009	Change since 30 April 2009
		£	£	£
Receipts				
Opening cash at bank balance		185,304.45	185,304.45	0.00
Opening value of investment portfolio	1	979,925.78	979,925.78	0.00
Interest received	2	220,602.14	213,257.74	7,344.40
Reinsurance collections		19,612.81	9,714.86	9,897.95
VAT recoveries		77,614.45	77,614.45	0.00
Transfers from US dollar account	3	13,462,872.79	6,050,228.01	7,412,644.78
Total receipts		14,945,932.42	7,516,045.29	7,429,887.13
Payments				
Administrators' remuneration	4	2,446,923.74	1,920,568.69	526,355.05
Administrators' disbursements	4	40,869.19	38,680.09	2,189.10
Run-off fees		2,293,953.46	1,474,767.39	819,186.07
Other professional costs	5	1,625,525.22	1,219,307.52	406,217.70
Legal fees		929,459.44	740,555.59	188,903.85
Legal settlements		170,000.00	170,000.00	0.00
Statutory costs	6	86,518.25	33,283.78	53,234.47
Bank and investment charges		1,934.90	1,826.73	108.17
Transfer to US dollar account	7	50,000.00	50,000.00	0.00
VAT		826,818.52	657,808.27	169,010.25
Total payments		8,472,002.72	6,306,798.06	2,165,204.66
Closing balance		6,473,929.70	1,209,247.23	5,264,682.47

Notes

- (1) On appointment the investment portfolio comprised a mix of cash, sterling certificates of deposits, Eurosterling bonds and UK gilts
- (2) Includes interest from EPIC, money market deposits, current account and realised gain on investments on closing EPIC account
- (3) Represents transactions undertaken to manage foreign exchange exposures
- (4) PwC charge out rates relate to the Joint Administrators and their staff. These rates are applicable to staff who are employees of PricewaterhouseCoopers Services Ltd and, where appropriate, parties who are otherwise contracted with PwC
- (5) Other professional costs include actuarial and tax services provided by PwC, amounting to £1,537,458.00 and £41,352.70 respectively
- (6) Includes costs relating to advertising, printing, postage and meeting room hire
- (7) To provide immediate post appointment liquidity

Appendix B

US dollar Receipts and Payments Account for the period 1 November 2007 to 31 October 2009

	Notes	Position at 31 October 2009 US\$	Position at 30 April 2009 US\$	Change since 30 April 2009 US\$
Receipts				
Opening value of cash at bank	1	3,003,869.67	3,003,869.67	0.00
Opening value of investment portfolio	2	29,002,839.49	29,002,839.49	0.00
Interest received	3	1,677,508.95	1,414,352.45	263,156.50
Reinsurance collections		419,410.90	46,770.92	372,639.98
Transfer from sterling account	4	97,280.00	97,280.00	0.00
Total receipts		34,200,909.01	33,565,112.53	635,796.48
Payments				
Legal fees		81,988.07	79,192.07	2,796.00
Other professional costs		48,731.64	45,701.58	3,030.06
Letter of Credit draw downs		130,318.09	116,861.65	13,456.44
Bank and investment management charges	5	134,364.79	52,786.02	81,578.77
Transfer to sterling account	6	24,150,000.00	12,000,000.00	12,150,000.00
Total payments		24,545,402.59	12,294,541.32	12,250,861.27
Closing balance		9,655,506.42	21,270,571.21	-11,615,064.79

Notes

- (1) Includes deposits held at Citibank to the value of US\$2,991,939.41 in relation to a trust fund established and letters of credit issued prior to the appointment of Joint Administrators
- (2) On appointment the investment portfolio comprised a mix of cash, Eurodollar commercial paper, US dollar certificates of deposits, and Eurodollar, corporate and US treasury bonds
- (3) Includes interest on bank accounts and investment portfolio with EPIC
- (4) To provide immediate post appointment liquidity
- (5) Includes bank charges from current account, LoC and EPIC charges
- (6) Represents transactions undertaken to manage foreign exchange exposures