



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 November 2008 to 30 April 2009**

May 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 November 2008. 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:

Appendix A	Joint Administrators' Proposals as approved by Creditors on 8 January 2008
Appendix B	Receipts and Payments Account for the period 1 November 2007 to 30 April 2009

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.

In my last report I indicated that I planned to propose 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"). Significant progress has been made in this respect and further details are provided below.

As previously reported, the strategy for dealing with the claims of Highlands UK's reinsurance creditors is to be addressed and formulated during the period of implementation of the Direct Scheme.

Creditors' committee

During the period since my last report I have continued to consult with the creditors' committee both formally and informally in relation to major issues and the development of strategy, in particular, with respect to the Direct Scheme. Formal committee meetings were held on 5 November 2008 and 19 May 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

Since my last report and following further dialogue with the UK Regulator, the Financial Services Authority ("FSA"), members of the creditors' committee and other interested parties, the detailed terms of the Direct Scheme have been finalised. The FSA have confirmed that it has no objection to the proposed Direct Scheme.

During March a letter was sent to all known or potential Scheme Creditors to advise them of the proposed Direct Scheme and the intention to seek permission from the High Court to convene the Scheme Meeting for the purpose of Scheme Creditors considering and, if thought fit, agreeing to the proposed Direct Scheme. At the same time, the letter was also circulated to all known or potential reinsurance creditors for their information.

On 30 April 2009 the High Court granted the requested permission, following which a letter comprising a short form explanatory statement was circulated to all known or potential Scheme Creditors, as well as to all known brokers, agents and intermediaries, along with accompanying documents including formal notice of the Scheme Meeting to be held on 18 June 2009.

Key dates and provisional timetable

Filing date of voting form by Scheme Creditors	16 June 2009
Scheme Meeting	18 June 2009
Court hearing to sanction the Scheme	30 July 2009*
Hearing of the application for the Chapter 15 Scheme Order	30 July 2009*
Date the Scheme becomes effective	31 July 2009*
Claim Notification Date	29 October 2009*
Final Claims Submission Date	27 January 2010*

* Dates subsequent to the Scheme Meeting are indicative only. The date of the Court hearing to sanction the Scheme can only be confirmed if and when the Scheme has been approved by Scheme Creditors at the Scheme Meeting.

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.

II Progress Report

(b) Settlement with Highlands Insurance Company (“HIC”)

In my last report I outlined the details of the settlement that had been reached with HIC. In accordance with the terms of that settlement, the first tranche of the settlement monies payable to Highlands UK of US\$6,625,000 has been paid into an account under the joint control of both Highlands UK and HIC. Payment of the second tranche of the settlement monies of US\$6,375,000, together with release of the first tranche to Highlands UK, is subject to implementation of the Direct Scheme.

(c) Financial review

Since my last report, the detailed financial review of the Company’s liabilities has been further refined with the continuing support of my actuarial advisers. The results of this work were shared with the creditors’ committee at the last meeting on 19 May 2009. I continue to anticipate that based on the latest 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.

(d) Run-off management

My team are continuing to work closely with PRO in order to resolve a number of complex issues arising from the Company’s participation in various underwriting pools which existed many years ago.

We have also continued to work very closely with PRO in relation to a number of other key strategic and operational matters.

(e) Asset management

PRO under the guidance and direction of my team has initiated the implementation of our previously agreed reinsurance collection strategy and I anticipate that this will be materially progressed during the next six to twelve months.

My specialist treasury team has continued to manage Highlands UK’s sterling cash assets in a portfolio of interest bearing investment accounts and EPIC Asset Managers Limited has continued to manage the US dollar investments. In addition, my team continue to review the investment strategy on a regular basis to ensure that the risk profile remains acceptable. Interest of £213,257.74 and US\$1,414,352.45 has been earned on the Company’s cash and investment assets since the Joint Administrators were appointed.

II Progress Report

(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. Accordingly, policyholders, cedants, brokers, intermediaries and agents should continue to present claims 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 engaged actively with direct creditors and, where appropriate, their advisers, in relation to the proposed 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.

(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 actual costs for the period 1 June 2008 to 31 December 2008 together with a budget for the twelve month period commencing 1 January 2009 were prepared and circulated to the creditors' committee in February 2009. In accordance with Rule 2.106 of the Insolvency Rules 1986 the creditors' committee passed a resolution dated 10 February 2009 approving the Joint Administrators' remuneration and expenses as circulated. In addition, at the creditors' committee meeting on 19 May 2009, the costs for the period 1 January 2009 to 30 April 2009 were presented. Further details of fees incurred to date can be found below and on page nine of this report.

The value of Joint Administrator's remuneration drawn to date comprises £1,920,568.69 of fees and £38,680.09 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 30 April 2009 are £2,080,772.69 being 7,302 hours at an average hourly rate of £284.96.
- (ii) Of the hours spent, 2,093 hours relate to directing, managing and liaising with PRO and other internal and external parties, day-to-day project management and general administration; 1,298 hours relate to securing assets (including reinsurance) and managing the finances of the Company; 934 hours relate to all dealings and negotiations with HIC and the overall strategy of the Administration; 844 hours relate to statutory compliance; 705 hours relate to development and drafting of the Direct Scheme and consultations with direct creditors and 1,428 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 30 April 2009

	Notes	Position at 30 April 2009	Position at 31 October 2008	Change since 31 October 2008
		£	£	£
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	213,257.74	175,378.71	37,879.03
Reinsurance collections		9,714.86	5,821.60	3,893.26
VAT recoveries		77,614.45	0.00	77,614.45
Transfers from US dollar account	3	6,050,228.01	6,050,228.01	0.00
Total receipts		7,516,045.29	7,396,658.55	119,386.74
Payments				
Administrators' remuneration	4	1,920,568.69	968,203.64	952,365.05
Administrators' disbursements	4	38,680.09	32,428.64	6,251.45
Run-off fees		1,474,767.39	601,537.80	873,229.59
Other professional costs	5	1,219,307.52	531,335.52	687,972.00
Legal fees		740,555.59	457,097.50	283,458.09
Legal settlements		170,000.00	170,000.00	0.00
Statutory costs	6	33,283.78	26,965.23	6,318.55
Bank and investment charges		1,826.73	1,749.47	77.26
Transfer to US dollar account	7	50,000.00	50,000.00	0.00
VAT		657,808.27	341,805.71	316,002.56
Total payments		6,306,798.06	3,181,123.51	3,125,674.55
Closing balance		1,209,247.23	4,215,535.04	-3,006,287.81

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 £1,154,814.00 and £32,499.00 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 30 April 2009

	Notes	Position at 30 April 2009	Position at 31 October 2008	Change since 31 October 2008
		US\$	US\$	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	1,414,352.45	912,302.15	502,050.30
Reinsurance collections		46,770.92	38,734.01	8,036.91
Transfer from sterling account	4	97,280.00	97,280.00	0.00
Total receipts		33,565,112.53	33,055,025.32	510,087.21
Payments				
Legal fees		79,192.07	56,401.07	22,791.00
Other professional costs		45,701.58	39,572.39	6,129.19
Letter of Credit draw downs		116,861.65	116,861.65	0.00
Bank and investment management charges	5	52,786.02	39,555.32	13,230.70
Transfer to sterling account	6	12,000,000.00	12,000,000.00	0.00
Total payments		12,294,541.32	12,252,390.43	42,150.89
Closing balance		21,270,571.21	20,802,634.89	467,936.32

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