



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 2009 to 30 April 2010**

May 2010

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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 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:

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 2010

II Progress Report

Overall strategy

As mentioned in my previous reports, 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 update I reported 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"), had been approved and had become effective. Further details are provided below.

The strategy for dealing with the claims of the Company's reinsurance creditors is at an advanced stage of development and it is now anticipated that a scheme of arrangement for such cedant creditors (the "Cedant Scheme") will be proposed during the second half of this year. Further details are provided below.

Creditors' committee

Since my last report I have continued to consult with the creditors' committee in relation to major issues and the development of strategy, including progress made in implementing the Direct Scheme, as well as the development of the strategy for dealing with the claims of reinsurance creditors. The last formal meeting of the creditors' committee took place on 29 March 2010 and a further meeting is currently being scheduled for June 2010. 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

The Final Claims Submissions Date under the Direct Scheme was 15 February 2010. Following this, under the direction of my team and where appropriate in consultation with our actuarial advisers, PRO have commenced the claims agreement process in accordance with the terms of the Direct Scheme.

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 am pleased to report that, following the Final Claims Submission Date and in accordance with the terms of the settlement agreement with HIC, the second tranche of settlement monies payable to Highlands UK of US\$6,375,000 was paid, in early March, into an account under the joint control of Highlands UK and HIC. Shortly after, this sum, together with the first tranche of US\$6,625,000 and accrued interest of US\$13,774.45, that is a total of US\$13,013,755.68 (net of bank charges incurred by HIC), was released from the joint account and transferred to Highlands UK.

Following the successful completion of the settlement agreement, my team are continuing to liaise with HIC in order to resolve a number of other residual outstanding issues.

(c) Strategy for reinsurance creditors

Since my last report, I have concluded, in consultation with the creditors' committee, that the Cedant Scheme, pursuant to Part 26 of the Companies Act 2006 for creditors with claims arising from contracts or policies of reinsurance or retrocession, would be in such creditors' best interests.

The Cedant Scheme, which would also deal with a small number of non-insurance creditors ranking pari passu with reinsurance creditors by virtue of the Insurers (Reorganisation and Winding Up) Regulation 2004, is currently in an advanced form of development. I have also had some initial dialogue with the UK Regulator, the Financial Services Authority, in this respect.

It is my current intention to issue the proposed Cedant Scheme during the second half of 2010.

II Progress Report

(d) Financial review

Based on advice from my actuarial advisers and with the benefit of the settlement monies recently received from HIC referred to above, I continue to anticipate that 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 Final Claims Submission Date under the Direct Scheme and the commencement of the claims agreement process, my team will continue, with the support of our actuarial advisers, to review the Company's overall liabilities and the impact on the potential dividend to reinsurance creditors.

(e) Asset management

Since my last report, PRO, under the guidance and direction of my team, has continued to actively progress the implementation of our previously agreed reinsurance collection strategy. To date, reinsurance recoveries, including collections from brokers, have amounted to US\$1,034,084.33 and £33,257.18.

As detailed in my previous report, all US dollar investments managed by EPIC Asset Managers Limited either have been or are in the process of being placed under the direct control of my specialist treasury team. My team continue to manage Highlands UK's sterling and US dollar cash assets in a portfolio of interest bearing investment accounts. The investment strategy is reviewed on a regular basis to ensure that the risk profile remains acceptable. Interest of £229,341.42 and US\$1,924,375.89 has been earned on the Company's cash and investment assets since the Joint Administrators were appointed.

(f) Creditors and claims processing

Creditors with claims arising from contracts or policies of direct insurance are being dealt with under the Direct Scheme. For the time being, any other claims from policyholders, cedants, brokers, intermediaries and agents should continue to be presented to PRO in the normal manner.

We continue to receive a regular flow of ad-hoc queries from policyholders, cedants, creditors and agents. 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. On 20 April 2010, the UK High Court granted an order extending the Administrators' term in office to 30 April 2012.

II Progress Report

(h) Administrators' remuneration

Full details of professional costs incurred by the Joint Administrators and their team in running the Administration have been reported regularly to the creditors' committee. Detailed analyses of the costs for the period 1 January 2009 to 31 December 2009 have been presented to, and approved by, the creditors' committee. In accordance with Rule 2.106 of the Insolvency Rules 1986, we have submitted to the creditors' committee for approval a resolution in relation to the Joint Administrators' remuneration and expenses for the period 1 January 2010 to 31 March 2010. Details of these costs, together with details of budgeted costs for the three month period commencing 1 April 2010, were circulated to the creditors' committee in April 2010. Further details of fees incurred to date can be found below.

The value of Joint Administrator's remuneration drawn to date comprises £2,737,206.44 of fees and £44,236.49 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 2010 are £3,104,336.94 being 11,034 hours at an average hourly rate of £281.34.
- (ii) Of the hours spent, 2,835 hours relate to directing, managing and liaising with PRO and other internal and external parties, day-to-day project management and general administration; 2,366 hours relate to securing assets (including reinsurance) and managing the finances of the Company; 1,303 hours relate to the development and implementation of the Direct Scheme and development of the Cedant Scheme; 1,211 hours relate to all dealings and negotiations with HIC and the overall strategy of the Administration; 1,048 hours relate to statutory compliance and 2,271 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 2010

	Notes	Position at 30 April 2010	Position at 31 October 2009	Change since 31 October 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	229,341.42	220,602.14	8,739.28
Reinsurance collections		33,257.18	19,612.81	13,644.37
VAT recoveries		77,614.45	77,614.45	0.00
Transfers from US dollar account	3	15,909,265.99	13,462,872.79	2,446,393.20
Total receipts		17,414,709.27	14,945,932.42	2,468,776.85
Payments				
Administrators' remuneration	4	2,737,206.44	2,446,923.74	290,282.70
Administrators' disbursements	4	44,236.49	40,869.19	3,367.30
Run-off fees		3,110,595.07	2,293,953.46	816,641.61
Other professional costs	5	1,869,778.92	1,625,525.22	244,253.70
Legal fees		1,076,922.55	929,459.44	147,463.11
Legal settlements		170,000.00	170,000.00	0.00
Statutory costs	6	93,248.15	86,518.25	6,729.90
Bank and investment charges		2,073.78	1,934.90	138.88
Transfer to US dollar account	7	50,000.00	50,000.00	0.00
VAT		927,639.08	826,818.52	100,820.56
Total payments		10,081,700.48	8,472,002.72	1,609,697.76
Closing balance		7,333,008.79	6,473,929.70	859,079.09

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 £1,756,110.00 and £51,974.40 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 2010

	Notes	Position at 30 April 2010 US\$	Position at 31 October 2009 US\$	Change since 31 October 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	1,924,394.66	1,677,508.95	246,885.71
Reinsurance collections		1,034,084.33	419,410.90	614,673.43
Legal settlements	4	12,999,981.23	0.00	12,999,981.23
Transfer from sterling account	5	97,280.00	97,280.00	0.00
Total receipts		48,062,449.38	34,200,909.01	13,861,540.37
Payments				
Legal fees		83,860.07	81,988.07	1,872.00
Other professional costs		48,731.64	48,731.64	0.00
Letter of Credit draw downs		133,599.18	130,318.09	3,281.09
Bank and investment management charges	6	177,387.17	134,364.79	43,022.38
Transfer to sterling account	7	28,038,000.00	24,150,000.00	3,888,000.00
Total payments		28,481,578.06	24,545,402.59	3,936,175.47
Closing balance		19,580,871.32	9,655,506.42	9,925,364.90

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) Relates to the release of the first and second payment tranches of the Settlement Agreement with HIC following the Direct Scheme Final Claims Submission Date on 15 February 2010
- (5) To provide immediate post appointment liquidity
- (6) Includes bank charges from current account, LoC and EPIC charges
- (7) Represents transactions undertaken to manage foreign exchange exposures