



Highlands Insurance Company (UK) Limited (in Administration)

**Joint Administrators' Report in accordance with
Rule 2.47 of the Insolvency Rules 1986
for the period 1 May 2008 to 31 October 2008**

November 2008

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I Summary Information

The Company	Highlands Insurance Company (UK) 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 2008. Copies of the previous report 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.

Having now progressed a number of key strategic matters and recognising the priority pursuant to the Insurers (Reorganisation and Winding-Up) Regulations 2004 of claims arising from contracts or policies of direct insurance, as opposed to contracts of reinsurance, I plan to propose a scheme of arrangement pursuant to part 26 of the Companies Act 1986 for such direct creditors (the "Direct Scheme"). It is my belief that such a scheme of arrangement will be in the best interests of creditors of Highlands UK as a whole. Further details of the proposed Direct Scheme are provided below.

It is anticipated that the strategy for dealing with the claims of Highlands UK's reinsurance creditors will be determined during the period of implementation of the Direct Scheme.

Creditors' committee

Since my last report, the Joint Administrators have met with the creditors' committee on 11 June 2008, 23 July 2008 and 5 November 2008 to discuss significant issues and the strategy relating to the Administration.

Prior to the meeting on 23 July 2008, Ace Property & Casualty Insurance Company indicated that they no longer had an interest in acting as a committee member and therefore formally resigned. Following this, I proposed that CBS Corporation, at that time an observer, become a member of the committee on the basis that this would provide formal representation of the interests of direct creditors. All members of the committee as well as the remaining observer supported this proposal and CBS Corporation therefore became a member of the committee on 23 July 2008. I am very grateful to the members and the observer of the committee for their continued assistance.

II Progress Report

Summary of the Administrators' actions to date

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

In my last report I explained that I was working closely with the Special Deputy Receiver ("SDR") of HIC to finalise outstanding matters between the Company and HIC. Following detailed negotiations and extensive work by all parties, I am pleased to report that a settlement was reached with HIC.

In summary, the settlement provides that in return for the Company agreeing to administer all policies previously transferred from HIC to Highlands UK pursuant to section 51 of the Insurance Companies Act 1982, HIC will pay Highlands UK the sum of US\$13million. The settlement is subject to a number of key conditions, in particular:

- (i) approval of HIC's Rehabilitation Plan by the Texas Court, which was obtained on 9 July 2008;
- (ii) approval of this settlement by the Texas Court, which was obtained on 13 October 2008; and
- (iii) the implementation of a scheme of arrangement between Highlands UK and its direct insurance creditors (the Direct Scheme referred to above).

Following the satisfaction of these conditions, the settlement amount of US\$13million will be payable by HIC to Highlands UK. Based on advice from my actuarial advisers, I anticipate that, with the benefit of this settlement amount, the Company should be able to pay the claims of direct creditors in full.

(b) Preparation for a scheme of arrangement

Since my last report, and in furtherance of the settlement negotiations with HIC referred to above, a Direct Scheme has been drafted and is currently in an advanced form. I have also had some initial dialogue with the UK Regulator, the Financial Services Authority ("FSA"), in this respect and have invited and received comments on the draft Direct Scheme from members of the creditors' committee. In addition, extensive communications with direct insurance creditors have been undertaken and are ongoing.

It is my current intention to issue the proposed Direct Scheme during the first quarter of 2009.

(c) Financial review

In my last report, I explained that a detailed financial review was in progress and was being extended to focus on the Company's liabilities to reinsurance creditors. This has required a substantial amount of work and support from my actuarial advisers and the significant progress made in this respect was shared with the creditors' committee at the last meeting on 5 November 2008.

II Progress Report

(d) Run-off management and participation in underwriting pools

Following completion of the review of the Company's historic participation in certain underwriting pools my team are engaged in ongoing dialogue with the other pool participants with a view to determining the most appropriate strategy going forward.

During the period we have continued to work very closely with PRO to progress a number of key strategic matters and I continue to appreciate their day-to-day support and assistance.

(e) Asset management

Following the progress made in evaluating Highlands UK's liabilities, in particular those arising from inwards reinsurance contracts and their impact on potential outwards reinsurance recoveries, an appropriate reinsurance collection strategy has now been agreed with PRO which will be pursued actively during the coming period.

Since my appointment, colleagues from my specialist treasury team have managed Highlands UK's sterling cash assets in a portfolio of high interest bearing investment accounts. EPIC Asset Managers Limited have continued to manage the US dollar investments. The composition of the sterling and US dollar investments continues to be monitored to match the Company's potential foreign exchange exposure to ultimate liabilities. In addition, we continue to review the investment strategy on a regular basis, to ensure that the risk profile remains acceptable, which is particularly important given recent market conditions. Interest of £175,378.71 and US\$912,302.15 has been earned on the Company's cash and investment assets since my appointment.

(f) Creditors and claims processing

Since my last report, we have continued to work with PRO to improve the Company's policyholder/cedant name and address records. We have also continued to receive a regular flow of ad-hoc queries from policyholders, cedants, creditors and agents during the period.

As highlighted in my last report, 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 and brokers should continue to present claims to PRO in the normal manner.

(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 actual costs for the period 1 February 2008 to 31 May 2008 and a budget for the six months period commencing 1 June 2008 were prepared and presented to the creditors' committee at the meeting held on 11 June 2008. In addition, at the creditors' committee meeting on 5 November 2008, the costs for the period 1 June 2008 to 30 September 2008 were also presented. In accordance with Rule 2.106 of the Insolvency Rules 1986 the creditors' committee passed a resolution at each of these meetings approving the Joint Administrators' remuneration and expenses as 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 £968,203.64 of fees and £32,428.64 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 2008 are £1,554,179.49 being 5385 hours at an average hourly rate of £288.61.
- (ii) Of the hours spent, 1,673 hours relate to directing, managing and liaising with PRO and other internal and external parties, day-to-day project management and general administration; 831 hours relate to all dealings and negotiations with the SDR of HIC and the overall strategy of the Administration; 799 hours relate to securing assets (including reinsurance) and managing the finances of the Company; 666 hours relate to statutory compliance; 322 hours relate to development and drafting of the Direct Scheme and consultations with creditors and 1,094 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 2008

	Notes	Position at 31 October 2008	Position at 30 April 2008	Change since 30 April 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	175,378.71	33,832.18	141,546.53
Reinsurance collections		5,821.60	5,240.85	580.75
Transfers from US dollar account	3	6,050,228.01	6,050,228.01	0.00
Total receipts		7,396,658.55	7,254,531.27	142,127.28
Payments				
Administrators' remuneration	4	968,203.64	482,809.85	485,393.79
Administrators' disbursements	4	32,428.64	12,591.03	19,837.61
Run-off fees		601,537.80	243,908.87	357,628.93
Other professional costs	5	531,335.52	371,819.00	159,516.52
Legal fees		457,097.50	315,380.90	141,716.60
Legal settlements		170,000.00	170,000.00	0.00
Statutory costs	6	26,965.23	21,485.42	5,479.81
Bank and investment charges		1,749.47	1,618.05	131.42
Transfer to US dollar account	7	50,000.00	50,000.00	0.00
VAT		341,805.71	202,879.45	138,926.26
Total payments		3,181,123.51	1,872,492.57	1,308,630.94
Closing balance		4,215,535.04	5,382,038.70	-1,166,503.66

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 fund manager, Money Market Deposits, Current Account and realised gain on investments upon closing EPIC GBP 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 £492,674.00 and £17,167.00 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 31 October 2008

	Notes	Position at 31 October 2008	Position at 30 April 2008	Change since 30 April 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	912,302.15	504,685.28	407,616.87
Reinsurance collections		38,734.01	13,438.85	25,295.16
Transfer from sterling account	4	97,280.00	97,280.00	0.00
Total receipts		33,055,025.32	32,622,113.29	432,912.03
Payments				
Legal fees		56,401.07	37,032.87	19,368.20
Other professional costs		39,572.39	31,941.00	7,631.39
Letter of Credit draw downs		116,861.65	87,118.31	29,743.34
Bank and investment management charges	5	39,555.32	6,339.50	33,215.82
Transfer to sterling account	6	12,000,000.00	12,000,000.00	0.00
Total payments		12,252,390.43	12,162,431.68	89,958.75
Closing balance		20,802,634.89	20,459,681.61	342,953.28

Notes

- (1) Includes deposits held at Citibank to the value of US\$2,991,939.41 in relation to 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