



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 2010 to 30 April 2011**

May 2011

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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 2010. 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 2011

II Progress Report

Overall strategy

As previously reported, 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 the claims agreement process, as set out in the scheme of arrangement for creditors with claims arising from contracts or policies of direct insurance, and not contracts of reinsurance, (the "Direct Scheme"), was likely to be completed towards the end of 2010. Further details are provided below.

My last update also reported that it was anticipated that a scheme of arrangement pursuant to Part 26 of the Companies Act 2006 in relation to creditors with claims arising from contracts or policies of reinsurance or retrocession and non-insurance creditors (the "Cedant Scheme") would be issued early in 2011. Further details are provided below.

Creditors' committee

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 claims agreement process and the settlement negotiations with Highlands Insurance Company ("HIC"). The most recent formal meeting of the creditors' committee was held on 23 May 2011.

Following the payment of Direct Scheme claims, further details of which are provided below, CBS Corporation ceased to be a creditor of Highlands UK and was therefore no longer entitled to be member of the creditors' committee. I am pleased to report that following consultation with the remaining members of the creditors' committee, Portman Insurance Limited, formerly an observer to the committee, accepted an invitation to replace CBS Corporation as a member of the creditors' committee. David Strasser, in his personal capacity, has continued as an observer to the creditors' committee. I am very grateful to the members and the observer of the committee for their continued assistance and support.

II Progress Report

Summary of the Administrators' actions to date

(a) Direct Scheme

In my last report I explained that significant progress has been made in agreeing claims submitted in accordance with the terms of the Direct Scheme. I am pleased to report that the claims agreement process has now been completed successfully with all submitted claims being agreed or, where appropriate, rejected or withdrawn. In December 2010, as anticipated, the Company was able to pay, or provide for, in full the claims of all direct creditors.

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

I am pleased to report that since my last report we have been able to resolve a number of residual outstanding issues with HIC. Consequently, a formal settlement agreement has recently been concluded subject to the approval of the Texas Court.

(c) Cedant Scheme

On 6 May 2011, a letter was sent to all known or potential Scheme Creditors to advise them of the proposed Cedant 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 Cedant Scheme. A copy of this letter can be found on the website www.ukhighlands.co.uk. I anticipate that the Cedant Scheme will be issued in the next few months and further details of the proposed scheme will be made available on this website in due course.

(d) Financial review

As mentioned above and as previously anticipated, the Company was able to pay the claims of direct creditors in full. However, the dividend to reinsurance creditors continues to be subject to significant uncertainties.

II Progress Report

(e) Asset management

PRO, under the guidance and direction of my team, has continued to actively progress the implementation of our reinsurance collection strategy. To date, reinsurance recoveries, including collections from brokers, have amounted to US\$1,908,275.91 and £100,238.10.

As previously reported, the Company's US dollar investments are now 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 US\$1,707,715.60 and £247,190.89 has been earned on the Company's cash and investment assets since the Joint Administrators were appointed.

(f) Creditors and claims processing

In advance of the planned issue of the Cedant Scheme, my team and PRO have continued to enter into dialogue with reinsurance creditors and have made significant progress in the process of exchanging and reconciling claims information. This process will continue during the forthcoming period. In the meantime, any claims from cedants, brokers, intermediaries and agents should continue to be presented 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 running the Administration have been reported regularly to the creditors' committee. Since my last report, and in accordance with Rule 2.106 of the Insolvency Rules 1986, the creditors' committee passed a resolution dated 31 January 2011 approving the Joint Administrators' budgeted costs for the three month period commencing 1 January 2011. In addition we have recently submitted to the creditors' committee for approval a resolution in relation to Joint Administrators' budgeted costs for the three month period commencing 1 April 2011. Further details of fees incurred to date can be found below.

The value of Joint Administrator's remuneration drawn to date comprises £3,876,164.76 of fees and £57,497.53 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 2011 are £3,905,749.76 being 13,938 hours at an average hourly rate of £280.22.
- (ii) Of the hours spent, 3,492 hours relate to directing, managing and liaising with PRO and other internal and external parties, day-to-day project management and general administration; 3,184 hours relate to securing assets (including reinsurance) and managing the finances of the Company; 1,691 hours relate to all dealings and negotiations with HIC and the overall strategy of the Administration; 1,511 hours relate to the development and implementation of the Direct Scheme and development of the Cedant Scheme; 1,158 hours relate to statutory compliance and 2,902 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 2011

	Notes	Position at 30 April 2011	Position at 31 October 2010	Change since 31 October 2010
		£	£	£
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	247,190.89	239,791.74	7,399.15
Reinsurance collections		100,238.10	44,674.18	55,563.92
VAT recoveries		236,464.70	236,464.70	0.00
Transfers from US dollar account	3	16,986,715.60	16,986,715.60	0.00
Total receipts		18,735,839.52	18,672,876.45	62,963.07
Payments				
Administrators' remuneration	4	3,876,164.76	3,475,411.19	400,753.57
Administrators' disbursements	4	57,497.53	46,247.81	11,249.72
Run-off fees		4,611,136.73	3,892,549.92	718,586.81
Other professional costs	5	2,930,391.02	2,571,961.92	358,429.10
Legal fees		1,399,952.48	1,338,956.83	60,995.65
Legal settlements		170,000.00	170,000.00	0.00
Statutory and other costs	6	132,806.25	130,423.03	2,383.22
Bank and investment charges		2,101.06	2,097.86	3.20
Transfer to US dollar account	7	50,000.00	50,000.00	0.00
VAT		1,429,318.52	1,281,758.23	147,560.29
Total payments		14,659,368.35	12,959,406.79	1,699,961.56
Closing balance		4,076,471.17	5,713,469.66	-1,636,998.49

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 £2,723,621.00 and £93,998.90 respectively
- (6) Includes costs relating to advertising, printing, postage, meeting room hire and Directors and Officers insurance premiums
- (7) To provide immediate post appointment liquidity

Appendix B

US dollar Receipts and Payments Account for the period 1 November 2007 to 30 April 2011

	Notes	Position at 30 April 2011	Position at 31 October 2010	Change since 31 October 2010
		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	1,707,715.60	1,699,863.34	7,852.26
Reinsurance collections		1,908,275.91	1,439,099.87	469,176.04
Legal settlements	4	12,999,981.23	12,999,981.23	0.00
Transfer from sterling account	5	97,280.00	97,280.00	0.00
Total receipts		48,719,961.90	48,242,933.60	477,028.30
Payments				
Legal fees		84,055.07	84,055.07	0.00
Other professional costs		53,233.61	50,894.19	2,339.42
Letter of Credit draw downs		137,468.89	133,599.18	3,869.71
Bank and investment management charges	6	189,324.03	185,771.80	3,552.23
Payment to Direct Scheme Creditors		6,975,808.81	0.00	6,975,808.81
Transfer to sterling account	7	29,738,000.00	29,738,000.00	0.00
Total payments		37,177,890.41	30,192,320.24	6,985,570.17
Closing balance		11,542,071.49	18,050,613.36	-6,508,541.87

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 (prior period restated to adjust for accrued interest included in opening value of investment portfolio)
- (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