



AA Mutual International Insurance Company Limited

**Administrators' report in accordance with
Rule 2.47 of the Insolvency Rules 1986**

22 August 2005

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Contact details for queries

| Function | Contact | Address | Direct line | Email | Fax |
|-----------------|-------------------|---|--------------------------|--|-----------------------|
| General queries | Caroline Turnbull | PricewaterhouseCoopers LLP | + 44 (0) 20 7804 8203 | caroline.j.turnbull@uk.pwc.com | + 44 (0) 20 7804 5203 |
| | Adam Loveday | Plumtree Court London, EC4A 4HT England | + 44 (0) 20 7804 4761 | adam.loveday@uk.pwc.com | + 44 (0) 20 7804 5203 |

I Summary information

| | |
|--|--|
| The Company | AA Mutual International Insurance Company Limited (“AAMII” or “the Company”) |
| Registered number | 01432586 |
| Registered office and trading address | Hampden House, Great Hampden, Great Missenden, Buckinghamshire, HP16 9RD |
| Activity | Insurance Company in run-off since 1987 |
| Court reference | High Court of Justice number 4748/04 |
| Date of the administration order | 23 July 2004 |
| Date of approval of proposals | 10 September 2004 |
| Purpose of the administration order | 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). |
| Joint Administrators | D N Rackham and D Y Schwarzmann Any function required or authorised under any enactment to be exercised or performed by an administrator may be done by all or any one or more of the persons for the time being holding that office. |

II Progress Report

Purpose of 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 this administration since our previous report dated 21 February 2005. Copies of our previous reports sent to creditors may be requested from Caroline Turnbull or Adam Loveday

The following attachments accompany this report:

Appendix A - Administrators' proposals as approved

Appendix B - Receipts and payments account for the period 23 January 2005 to 22 July 2005.

Appendix C - FSCS – brief summary

Creditors' Committee

As you are aware from my previous report, at the creditors' meeting held by correspondence on 10 September 2004, a Creditors' Committee was established comprising four members. I have met with, and reported to, the Creditors' Committee on several occasions since my previous report to update them on strategic matters relating to the Administration. The last meeting with the Committee was held on 21 July 2005. At that meeting the Administrators presented proposals for a Scheme of Arrangement to distribute the assets to creditors who have claims against AAMII in conjunction with proposals which had been received from the FSCS. The Creditors Committee agreed that the Administrators should put these proposals to creditors.

Details of the proposals are set out below at section III, Proposed Scheme of Arrangement.

We are extremely grateful to the members of the Creditors' Committee for their continued support.

Overall strategy

The purpose of the Administration Order was 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 was anticipated that this would be achieved by the sanctioning under section 425 of the Companies Act 1985, of a compromise or arrangement between the Company and its creditors ('a Scheme of Arrangement' or 'Scheme'). Please see section III, Proposed Scheme of Arrangement, below for further details.

II Progress Report

Summary of work done

The focus of work in the last six months is summarised below.

Since our appointment as Joint Administrators, our primary objective has continued to be to investigate the feasibility of a Scheme whilst minimising the ongoing costs and pursuing any asset recoveries.

Asset Management

Since my appointment, our treasury team has managed the Company's cash assets in a portfolio of high interest bearing investment accounts and interest of just over £24,700 has been generated.

As previously advised a review of the outwards reinsurance programme has been carried out with a view to generating reinsurance recoveries where possible. This review suggested that little if any recoveries were readily available.

Since my previous report I have made a final dividend recovery from an insolvent estate of £287.67. I also anticipate making a further recovery in the region of £15,000 from a broker shortly. I am continuing to pursue other recoveries, but it is not anticipated that any significant recoveries will be made.

Claims processing

In view of the minimal impact on the reinsurance programme and in order to keep costs to a minimum the company has ceased to process all inwards claims for all classes of business as at 30 June 2004, pending the formulation of a Scheme.

Tax

Following our review to identify potential tax assets it was ascertained that there were no pre-appointment tax assets to be realised. The only potential recovery available will be in respect of the group relief of the trading losses incurred by AAMII. However early indications are that there are unlikely to be any recoveries in this regard.

The Administrators have complied with their statutory duties of filing tax returns to 31 December 2004 and have obtained the agreement of the tax authorities that no tax is payable for the post appointment period to 31 December 2004.

II Progress Report

Statutory reporting

This report has been filed with the High Court and the Registrar of Companies as required by the Insolvency Rules 1986. The Financial Services Authority, which supervises authorised insurers in the UK, has also been advised of all developments throughout the Administration.

Returns under the Company Directors Disqualification Act 1985 have also been submitted.

Administrators' remuneration

Full details of professional costs have been provided to the Creditors' Committee. Since my previous report the Creditors' Committee authorised the Joint Administrators' remuneration in the sum of £86,415.42 plus VAT for the period from 1 November 2004 to 30 June 2005 and this has been drawn. This brings the total approved and drawn to date to £190,543.16 plus VAT. In addition the committee authorised the joint administrators to draw a maximum of £10,000 per month on account of further time costs to be approved by the Committee retrospectively. It was agreed at the last meeting of the Committee that this is to be reviewed with a view to increasing the limit on account of which fees can be drawn to be approved retrospectively. This is to reflect the increased time costs which will be incurred now that the drafting of the proposals for the anticipated Scheme of Arrangement has commenced. As previously advised the Administrators have also drawn pre Administration fees of £26,784.24 plus VAT which were agreed by the Court on the making of the Administration Order.

Fees have been agreed by reference to the time properly given by the Joint Administrators and their staff in attending to matters arising in this Administration.

III Proposed Scheme of Arrangement

Creditors will recall from my previous report that the Administrators believed that a Scheme would be in the best interests of the creditors as a whole. The proposal for a Scheme was, however, dependent on the resolution of one major issue, namely the extent of possible United Kingdom Employers' Liability ("EL") policies which have been underwritten by the Company. It is not possible to crystallise such claims under the terms of a Scheme as they are policies of compulsory insurance which need, therefore, to be maintained. The Administrators had therefore entered into discussions with the FSCS who deal with such claims in the event of an insurer being unable to pay them, to ascertain whether it would be prepared to come to an agreement to deal with these claims so that a Scheme of Arrangement could be formulated. Without such an agreement with the FSCS an estimation scheme would not be possible. The FSCS have now put forward proposals in this respect and at a meeting of the Creditors' Committee held on 21 July 2004 the committee agreed that a Scheme which took account of these proposals should be put to creditors.

It is anticipated that the Scheme will be by way of a simple crystallisation process. Under the provisions of the Insurers (Reorganisation and Winding Up) Regulations 2004, direct policyholders will be paid in priority to reinsurance creditors. This is a change to the previous legislation which allowed for payment of all claims on a pari-passu basis.

In line with the best practice procedure detailed in the Vice-Chancellor's Practice Direction dated 15 April 2002, I outline below the Company's proposals and provide you with an opportunity to comment on those proposals.

- a. Background
- b. What is a Scheme of Arrangement?
- c. The objectives of the proposed Scheme
- d. Particular features of the proposed Scheme
- e. Why is this Scheme being proposed?
- f. Who will be affected by the proposed Scheme?
- g. Implementing the Scheme
- h. Meeting(s) of creditors to vote on the Scheme
- i. Request for provisional details of claims

III Proposed Scheme of Arrangement

(a) Background to the Company

The Company was incorporated as Saildown Limited on 22 June 1979 and on 19 November 1979 changed its name to AA Mutual International Insurance Company Limited. On 21 November 1979 the Company was authorised under the Insurance Companies Acts to underwrite all classes of non-life business specified in the notice of authorisation of the same date. On 10 July 1980 the company entered into an underwriting agreement with Winchester Fox & Co Limited with authorisation to accept worldwide non proportional reinsurance business of any description. This authority was restricted to accept aviation business only on 31 December 1984. Separately from the Winchester Fox Business, the Company also underwrote general insurance and reinsurance business via brokers.

On 24 June 1986 the Company's major reinsurer AA Mutual Insurance Association Limited was placed in liquidation and in December 1986 the agency agreement with Winchester Fox and Co was terminated. As a result of the liquidation of AA Mutual Insurance Association Limited the company accepted no new business after 1986 and was placed into run off. During 2004 the Directors considered that the claims handling reserve may prove inadequate in view of the costs of defending threatened arbitrations in overseas jurisdictions for which no provision had been made. The Directors therefore considered that it was likely that the company would become unable to pay its debts as and when they fell due. As a result at a board meeting on 29 June 2004, a resolution was passed for steps to be taken for the Company to be placed into administration.

Please note that the proposed Scheme will only be dealing with claims in respect of AA Mutual International Insurance Company Limited and not AA Mutual Insurance Association Limited. Creditors should therefore take care to review their records carefully before submitting any claims.

(b) What is a Scheme of Arrangement?

A Scheme of Arrangement is a compromise or arrangement between a company and its creditors or any class of its creditors which becomes legally binding on all creditors or any class of creditors if the necessary majority of the creditors or class of creditors votes for it and it is subsequently sanctioned by the High Court. Schemes of Arrangement are governed by section 425 of the Companies Act 1985.

(c) Objectives of the proposed Scheme

The Company is insolvent. The objective of the proposed Scheme is to provide a way of estimating creditors' claims and distributing the assets of the Company in the quickest and most economical method thus maximising returns to creditors. Because EL claims cannot be subject to an estimation process for legal reasons it is proposed to leave EL Policyholders out of the Scheme. However in return for a cash payment by AAMII to the FSCS, the FSCS has agreed to meet the claims of EL Policyholders in full as they arise and are agreed in the future.

III Proposed Scheme of Arrangement

(d) Particular features of the proposed Scheme

The proposed Scheme, once it becomes effective, will put in place an agreement and determination procedure for the expeditious estimation of creditors' claims (excluding EL claims) and payment of a dividend in relation to these claims which will be binding on both the Company and the creditors. A bar date will be set for the receipt of these creditors' claims under the Scheme. The Company will have no liability in respect of these claims not received by this deadline.

The following features of the proposed Scheme are drawn to your attention:

1. It is anticipated that there will be two distinct classes of creditors:-
 - (i) Direct insurance claimants (excluding EL)
 - (ii) Others (including reinsurance and trade creditors)
2. After settling the costs of the Administration and the Scheme, direct policyholders (excluding EL) will be paid in full. Direct Policyholders are afforded priority over all other (including reinsurance) creditors, as required under the provisions of the Insurers (Reorganisation and Winding Up) Regulations 2004. This is a change to the previous legislation which required payment of all claims on a pari-passu basis.
3. Of the remaining funds available to creditors it is proposed that a specific reserve of £50,000 representing known or anticipated EL claims is to be paid to the FSCS. In addition a further 50% of the balance, after payment in full of the direct policyholders, will also be paid to the FSCS for possible, unknown future EL claims. Any EL claimant is and will remain entitled to protection from the FSCS under its rules.
4. The other 50% of the remaining balance will be paid to other creditors (including reinsurance and trade creditors) as a dividend to those creditors on a pari passu basis.
5. The estimation process

As discussed above the assets are very limited and this precludes a complex costly estimation process. One solution adopted for certain other insolvent schemes in these circumstances is to place all claims against the company into three categories under the Scheme:

- (i) Paid Loss Claims – claims in the Scheme arising from claims against or the liability of a creditor in respect of losses which are certain in amount and which it has paid (or is due to pay)
- (ii) Notified Outstanding Claims - claims in the Scheme arising from a creditor's liability in respect of losses which have been notified to the creditor but have not yet become Paid Loss Claims and
- (iii) IBNR Claims – claims in the Scheme arising from a creditor's liability in respect of losses which have been incurred but not yet reported to the creditor.

III Proposed Scheme of Arrangement

A weighting is then applied to a creditor's claim (following its determination in the Scheme): 100% of Paid Loss Claims; 75% of Notified Outstanding Claims and 50% of IBNR Claims. Dividends in the Scheme would then be calculated by reference to the weighted value of a creditor's claim.

Consideration is being given to the appropriate mechanism for valuing claims in the case of AAMII. Should a weighting process similar to that described above be adopted, it is not considered that this will alter the composition of the individual classes of creditors being proposed i.e. there would still be two classes as described above.

(e) Why is this Scheme being proposed?

- (i) The Company is insolvent and therefore unable to pay all of its liabilities in full.
- (ii) Under English law it is not possible to crystallise EL liabilities.
- (iii) The alternatives are likely to be a Scheme or a liquidation whereby dividends cannot be paid until all claims can be estimated with a considerable degree of certainty. This is likely to result in considerable delay in the payment of any dividend particularly given the existence of EL policies. It would also be likely to result in substantial costs which in the context of the very limited funds could seriously deplete the assets potentially available for payment to creditors. The Scheme therefore appears to be the best solution for creditors as a whole.

(f) Who will be affected by the proposed Scheme?

The Scheme will bind all the Company's creditors apart from:

- (i) secured creditors, to the extent of their security, and
- (ii) creditors with claims which would have ranked as preferential claims if the Company were being wound up, to the extent of their preferential claim. ("Preferential" has the meaning given in S386 Insolvency Act 1986 with the relevant date under that section being 7 December 1998).
- (iii) EL claimants

The Company is not aware of any creditors who hold security or have preferential status. The EL claims will not be crystallised but as such claims are agreed in the ordinary course they will be paid in full by the FSCS.

III Proposed Scheme of Arrangement

(g) Implementing the Scheme

Before the Scheme will become binding on the Company and the creditors affected:

- The Company has to make an application to the High Court for an order to convene a meeting or meetings of creditors for the purposes of voting on the proposed Scheme.
- The Company has to notify creditors of the proposed Scheme and make available to them copies of the Scheme together with a statement explaining the effect of the Scheme on creditors.
- A meeting or meetings of creditors must be held to vote on the Scheme. For the Scheme to be approved, a majority in number representing not less than 75% in value of claims of those creditors who vote, must vote in favour of the Scheme in person or by proxy at each meeting.
- If the creditors' approval is obtained, the Company will ask the High Court to sanction the Scheme and if sanctioned, will deliver a copy of the order sanctioning the Scheme to the English Registrar of Companies for registration. The Scheme will become effective when a copy of the order is delivered to the Registrar of Companies.

(h) Meeting(s) of creditors and classes of creditors

The first step is for the Company to apply to the High Court for an order to convene one or more meeting(s) of creditors. The High Court will consider whether or not more than one meeting of creditors is required. If there are certain categories of creditors whose rights under a proposed scheme of arrangement are so dissimilar that they cannot consult together with a view to their common interest, it will be necessary to hold separate meetings of these categories of creditors (namely classes of creditors) to consider the Scheme. No date has yet been fixed for the court hearing.

The Administrators consider that there will be two distinct classes of creditors, direct and others, and they therefore intend to convene two separate meetings of creditors to consider and, if the creditors think fit, approve the Scheme. In considering the appropriate classes, the Administrators have reviewed the rights against the Company of certain direct policyholders who may be potentially 'protected' under the FSCS rules. As a general guide private individuals and small businesses may be eligible for protection within certain limits (see appendix C). It is the view of the Administrators that it is extremely unlikely that direct policyholders whether protected or unprotected will not be paid in full under the proposed Scheme. In addition the interpretation of the definition of a 'small business' as regards the eligibility for compensation purposes is potentially fraught with difficulty for both the Company and the policyholders. It is impossible to identify such potentially protected policyholders from the Company's records and indeed it is possible that there are no such policyholders. The costs of dealing with the issue of any further subdivision of this class to both the Company and to creditors are likely to be disproportionate in relation to an estate of this size. The Administrators, having taken legal advice, are of the opinion that both protected and non-protected direct policyholders may be included within the same class as their rights against the Company and proposed treatment under the Scheme are the same.

Creditors are requested to provide any comments they may have on the composition of the classes to the Administrators by 23 September 2005.

III Proposed Scheme of Arrangement

(i) **Request for provisional details of claims**

It would assist the Administrators in formulating the proposed scheme and estimating the likely dividend payable, if creditors could provide provisional details of their potential claims. These details will not constitute formal claims in the proceedings and will be treated for information purposes only. They will not be binding on the creditors or the company. In particular the administrators would appreciate hearing from any creditors who believe they may have direct claims against AAMII which it is proposed will be paid in full under the Scheme.

Your comments on the proposed Scheme and details of your provisional claim would be appreciated in writing addressed to Caroline Turnbull at the above address by **23 September 2005**. Please note that your comments may be placed before the High Court by the Company for consideration at the relevant hearing.

In the meantime if you have any queries please do not hesitate to contact me.

Appendix A

Administrators' proposals as approved

The following proposals were approved by the creditors on 10 September 2004 for achieving the purposes of the administration order dated 23 July 2004.

1. That as Joint Administrators, we continue to manage the business, affairs and property of the Company in such manner as we consider expedient with a view to achieving the purpose for which the Administration Order was made.
2. That we continue to investigate the affairs of the Company with a view to, amongst other matters, determining its financial position in order to formulate and put to meetings of the creditors proposals for a Scheme of Arrangement under Section 425 of the Companies Act 1985, if thought to be in the best interests of the Company and creditors.
3. That we investigate and, if appropriate, pursue any claims that the Company may have under the Companies Act 1985 or The Insolvency Act 1986. The Administrators will investigate transaction in the period leading up to the date the Company entered into Administration typically preferences and transactions at undervalue.
4. That we may apply for the discharge of the Administration Order once meetings of the Company's creditors have been held to consider the proposals for a Scheme of Arrangement.
5. That a formal creditors' committee be established.
6. That the Joint Administrators' fees and disbursements be agreed by the Creditors' Committee or at the meeting of creditors to consider the Scheme.

Appendix B

Receipts and payments account for the period 23 January 2005 to 22 July 2005

| Receipts | US\$ | £ | CA\$ |
|---|---------------------|-------------------|------------------|
| Brought forward from previous abstract | 2,404,591.71 | 498,850.89 | 40,592.68 |
| Commutations | | 6.00 | |
| **USD converted to GBP | | | |
| Book debts | | 287.67 | |
| Investment income | 26,619.93 | | |
| Interest received gross | 102.08 | 917.91 | 102.63 |
| Total receipts | 2,431,313.72 | 500,062.47 | 40,695.31 |
| Payments | | | |
| Brought forward from previous abstract | 490,088.31 | 274,768.75 | 16.99 |
| Joint administrators' fees | | 78,088.66 | |
| Treasury services | | 663.20 | |
| Pre-appointment fee | | | |
| Legal & professional fees | | | |
| *Statutory costs | | | |
| Run-off service provider | | 7,731.49 | |
| **USD converted to GBP | | | |
| Storage costs | | 1,340.00 | |
| Bank charges | 194.14 | 76.10 | 12.10 |
| Interest charged | | | |
| VAT irrecoverable | | 14,585.83 | |
| Total payments | 490,282.45 | 377,254.03 | 29.09 |
| Balance carried forward to next abstract | 1,941,031.27 | 122,808.44 | 40,666.22 |

Notes

*statutory costs relate to statutory advertising as required by Rules 2.34 and 2.27 of the Insolvency Act 1986

** USD converted into GBP @ 1.8842:1

Appendix C

FSCS is the UK's statutory fund of last resort for customers of authorised financial services firms. It protects deposits, insurance and investments. FSCS can provide compensation if an authorised insurance Company is unable or likely to be unable to meet claims against it. The Scheme was mainly set up to assist private individuals and small businesses, although all policyholders are protected for claims under compulsory (eg. UK employers' liability) insurance policies.

Re-insurance, marine, aviation, transport business, and credit insurance are excluded. Also excluded are risks outside the European Economic Area.

There are maximum levels of compensation a policyholder can receive from the FSCS and compensation may not cover all of an insured's loss.

The levels of compensation which may be payable to eligible insurance creditors are as follows:

- Liability subject to compulsory insurance, 100% of the claim.
- In all other cases 100% of the first £2,000 and 90% of the remainder of the claim

For more information on the role of FSCS insurance creditors should refer to the FSCS website (www.fscs.org.uk).