



**SOVEREIGN MARINE & GENERAL
INSURANCE COMPANY LIMITED**

**ANNUAL REPORT TO
CREDITORS**

2 December 2005

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To all known creditors, potential creditors and
brokers of Sovereign Marine & General
Insurance Company Limited

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2 December 2005

Dear Sir / Madam

**Sovereign Marine & General Insurance Company Limited (“Sovereign”)
The Scheme Administrators’ Annual Report to Creditors**

1 Introduction

Further to our previous annual report to the creditors of Sovereign on 12 August 2004, we are writing to update you on Sovereign’s financial position and the progress made to date by the Scheme Administrators with regard to asset realisations and payments to creditors. This report also provides important information regarding the Scheme Administrators’ plans to close the estate and make final, or near final, payments to creditors.

2 Summary

- Following consultation with the Creditors’ Committee, the Scheme Administrators have maintained the Scheme Payment Percentage at 40%.
- Sovereign’s insurance liabilities as at 31 December 2004 are estimated at \$382 million (2003: \$399 million).
- Sovereign’s total assets as at 31 December 2004 are estimated at \$295 million (2003: \$316 million).
- As at 30 September 2005, Established Scheme Liabilities total \$96.4 million (30 June 2004: \$46.5 million). Scheme payments totalling \$38.1 million (30 June 2004: \$16.4 million) have been made to creditors in respect of these liabilities.
- The Scheme Administrators believe that Sovereign has reached a point with respect to reinsurance collections and asset realisations where it is in the interests of creditors to propose a plan to close the Sovereign estate (further details at section 6).

3 Scheme Payment Percentage

In consultation with the Sovereign Creditors' Committee, the Scheme Payment Percentage is reviewed on an annual basis by the Scheme Administrators. Factors such as current cash held, expected future asset realisations, expected future claims agreement levels, and the remaining potential volatility of the account are all considered. The objective when setting the Payment Percentage is to ensure that Sovereign will be capable of meeting the same percentage on all liabilities reasonably expected to be established in the future.

The Scheme Payment Percentage has increased since the commencement of the Scheme as follows:

March 2001	30%
May 2003	35%
July 2004	40%

The Scheme Administrators' review of the Scheme Payment Percentage was completed in April 2005 and concluded that the Scheme Payment Percentage remain at 40%.

Since that date, significant progress has been made in collecting Sovereign's reinsurance assets, principally through commutations. The key remaining uncertainty in dealing with Sovereign's estate is how claims will develop in the future. Crystallising all of Sovereign's claims under the proposed cut-off Scheme (see section 6) will allow the Scheme Administrators to calculate a final or near final dividend to creditors.

4 Scheme Payments

Under the existing Scheme, Scheme Payments are made to creditors with Established Scheme Liabilities i.e. claims which have been agreed by the Scheme Administrators after taking account of any set-off, letter of credit recoveries or counter-claims. Payments are not made on the basis of case reserves or IBNR claims unless a binding commutation or other final settlement of liabilities has been entered into by Sovereign and the policyholder or cedant.

At any time a number of Scheme Payments are withheld from payment by PRO Insurance Solutions Limited ("PRO"), Sovereign's run off agents, as a result of incorrect creditor details. If you believe Scheme Payments to you may not have been made as a result of inaccurate contact details please contact David Phipps at PRO Insurance Solutions Limited, Bruton Court, Bruton Way, Gloucester, GL1 1DA (Tel: +44 (0) 1452 782 500; email: david_phipps@pro-ltd.co.uk) with your up to date details.

As at 30 September 2005, \$96.4 million (30 June 2004: \$46.5 million) had become Established Scheme Liabilities, resulting in Scheme Payments to creditors of \$38.1 million (30 June 2004: \$16.4 million).

5 Financial position

5.1 Actuarial review

Current actuarial projections show that, as at 31 December 2004, Sovereign's ultimate gross insurance liabilities are as follows:

	Total \$ million	Asbestos \$ million
Agreed Claims	77	44
Reserves		
- Outstanding Claims	123	63
- IBNR	<u>182</u>	<u>115</u>
Ultimate Gross Liabilities	382	222

There remains significant uncertainty in Sovereign's book, in particular in relation to the ultimate level of asbestos claims. Out of the reserves of \$382 million shown in the above table, \$222 million relates to asbestos type risks. Any further increases in the Payment Percentage will, to a large extent, be dependent upon the development of these liabilities, and the ultimate claims agreed and crystallised when Sovereign enters a cut-off Scheme (see section 6).

5.2 Summary Balance Sheet as at 31 December 2004

The latest audited financial position of Sovereign is summarised below.

Sovereign Marine and General Insurance Company Limited		
Summary audited Balance Sheet as at 31 December 2004		
	2004 US\$m	2003 US\$m
Assets		
Cash and investments	94	90
Subsidiaries	36	34
Reinsurers' share of:		
- agreed claims	33	38
- outstanding reserves	70	84
- IBNR reserves	56	66
Other assets	6	4
	<hr/>	<hr/>
Total assets	295	316
	<hr/> <hr/>	<hr/> <hr/>
Liabilities		
Due to policyholders		
- agreed claims	77	92
- outstanding reserves	123	124
- IBNR reserves	182	183
Provision for run-off costs	39	48
Deposits received from insurers	3	9
Other creditors	1	-
	<hr/>	<hr/>
Shareholders' deficit	425 (130)	456 (140)
	<hr/>	<hr/>
Total liabilities	295	316
	<hr/> <hr/>	<hr/> <hr/>
Notes to summary balance sheet		
1.	The figures shown in the 2003 comparative balance sheet are different to those reported in the 12 August 2004 Annual Report to Creditors as the prior year summarised the unaudited Balance Sheet as at 31 December 2003 which was then subject to audit adjustment.	
2.	No allowance has been made for set-off. This will have a significant effect on the value of reinsurance recoveries.	
3.	The balance sheet above is not intended to represent any actual forecast of the outcome of the Scheme. Extreme caution must therefore be exercised when considering this balance sheet.	

Copies of Sovereign's accounts for the year ended 31 December 2004 are available from Mick Summersgill, KPMG LLP, 8 Salisbury Square, London EC4Y 8BB or can be obtained from Companies House.

5.3 Receipts and payments to 30 September 2005

The table set out below is a summary of the Scheme Administrators' receipts and payments since our appointment as Provisional Liquidators on 11 July 1997 to 30 September 2005.

SOVEREIGN MARINE & GENERAL INSURANCE COMPANY LIMITED	
Receipts and payments for the period 11 July 1997 to 30 September 2005	
RECEIPTS	\$m
Reinsurance recoveries	114.4
Recoveries from bank accounts and fund managers	43.9
Tax refunds	3.6
Investment income	18.8
Other receipts	<u>10.2</u>
Total receipts	<u>190.9</u>
PAYMENTS	
KPMG Scheme Administrators' fees	23.0
KPMG actuarial fees	1.5
Run-off managers' fees	31.6
Legal fees	5.8
Other professional and agents fees	4.8
VAT	5.9
Other payments	<u>0.7</u>
	73.3
Scheme Payments to creditors	38.1
Total payments	111.4
Exchange rate gains	5.0
	<hr/>
Funds held at 30 September 2005	<u>84.5</u>

The Scheme Administrators and PRO collected \$27.0 million of reinsurance recoveries in the fifteen months since the last reported position in the previous Annual Report to Creditors. Since that date significant progress has been made towards crystallising the remaining reinsurance assets with key commutation targets.

6 Closure Strategy

As creditors will be aware, following its insolvency in 1997, Sovereign's existing Scheme of Arrangement became effective in January 2000 which allowed it to continue to agree claims in the normal course and make Scheme Payments on a pro-rata basis to creditors with Established Scheme Liabilities. The Scheme Payment Percentage is discussed in section 3.

The Scheme Administrators believe that Sovereign has reached a point with respect to its reinsurance collections and asset realisations such that it is appropriate to propose a "closing" or "cut-off" Scheme of Arrangement. This Scheme will replace the existing Scheme and is considered more appropriate than using the special resolution procedure referred to in our earlier report.

The new Scheme will, inter-alia, incorporate an estimation methodology which will have the effect of estimating and crystallising all of Sovereign's remaining contingent liabilities. The value of these claims would then be applied to the reinsurance programme. This would enable valuation statements to be prepared on a net basis for policyholders who are also reinsurers. Once these amounts are known, final or near final dividends can then be calculated and paid and Sovereign formally wound up.

Approximately 95% of Sovereign's liabilities emanate from business underwritten and/or administered by Willis Faber (Underwriting Management) Limited ("WFUM"), Devonport Underwriting Agency Limited and Willis Faber & Dumas Limited, known as the "WFUM pools". A number of other insurance companies also participated in the WFUM pools. The WFUM pools stopped accepting new insurance and reinsurance risks in 1991, since which time they have been in run-off.

Sovereign and its subsidiaries account for approximately 50% of the WFUM pools' liabilities. If Sovereign were to effect its closure plans in isolation, the effect would be to create a fragmented pool administration, with the remaining pool participants continuing in run-off, receiving claims notifications and collecting reinsurance balances as they arise. This may require policyholders to separate the presentation of their claims for collection between the pool participants. It would therefore be more problematic and costly for both Sovereign and its policyholders if Sovereign were to close without the solvent WFUM participant companies also closing their involvement in the WFUM pools at the same time.

The other pool participants intend to propose a collective Scheme of Arrangement ("Pool Scheme") alongside Sovereign. This would result in all of the liabilities of the WFUM pools and their remaining reinsurance being valued in a consistent way. The mechanism for the valuation of policyholders' claims will mirror that proposed by Sovereign.

The Scheme Administrators believe that the efficiencies of this unified closure strategy will result in a higher ultimate payment percentage for Sovereign's creditors than would otherwise be achieved if Sovereign closed separately.

The enclosed letter from PRO outlines this proposal and explains the action you may need to take. Please read this letter carefully and consider its contents. PRO are the WFUM pool's run-off manager and the proposed Scheme Manager for the proposed unified Pool Scheme.

A dedicated website for the WFUM pools administration is available at www.wfumpools.com where contact details and news of developments of the proposed Scheme will be posted.

7 Responsibilities and contact details

7.1 Scheme Administrators

The Scheme Administrators of Sovereign are Tony McMahon and John Wardrop, partners in KPMG LLP (UK). The Scheme Administrators control the affairs of the company in accordance with the existing Scheme's provisions, consulting, where appropriate, with the Creditors' Committee.

7.2 Creditors' Committee

The interests of creditors are represented by a Creditors' Committee of 7 members. Among other things, the Committee comments on significant transactions, such as commutations in excess of \$500,000, is consulted in the setting of the Scheme Payment Percentage, and approves the Scheme Administrators' fees. We report to the Creditors' Committee on a quarterly basis and hold a Creditors' Committee meeting approximately every 4 months. The current constitution of the Creditors' Committee is as follows:

Member	Represented by
Anderson Kill & Olick	Mr M Keenan
Equitas Ltd	Mr R Williams
Financial Services Compensation Scheme	Mr N Hamilton
Gilbert Heintz & Randolph	Ms J Brennan
Grant Thornton, representing Gan Insurance Company	Mr E Walker
KWELM Management Services Ltd	Mr I Sleave
ReSolutions Group	Mr F DeMaria

In October 2005, the Combined Coordinating Council ("CCC") resigned as a member of the Creditors' Committee as it considered that its exposure was not sufficiently material to warrant its future representation. The Scheme Administrators would like to thank the CCC for its contribution and support.

7.3 *Run-off agent*

The day to day management of Sovereign's run-off, including maintenance of the records and handling of creditor enquiries in relation to claims adjustment, is the responsibility of PRO. PRO is the run-off manager of the WFUM pools.

7.4 *Creditor enquiries*

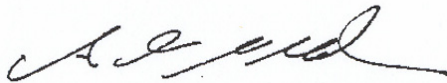
Scheme Creditors with claims adjustment queries should contact PRO by calling the Sovereign helpline: +44 (0)1452 413 982. Written claims adjustment queries should be directed in the first instance to PRO at the following address: PRO Insurance Solutions Limited, Bruton Court, Bruton Way, Gloucester GL1 1DA, for the attention of Mr David Phipps.

Enquiries in relation to the Sovereign's Scheme, Scheme Payments or the proposed closure plans should be directed to the Scheme Administrators at the following address: KPMG LLP, 8 Salisbury Square, London EC4Y 8BB or the WFUM Pool Scheme helpline on +44 (0)1452 523 426.

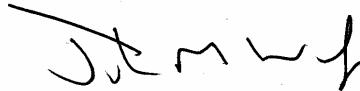
Further copies of this letter are available at <http://www.kpmg.co.uk/insurancesolutions>.

Yours faithfully

For Sovereign Marine & General Insurance Company Limited



AJ McMahon
Joint Scheme Administrator



JM Wardrop
Joint Scheme Administrator

