



AA Mutual International Insurance Company Limited

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

15 February 2006

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Contact details for queries

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I Summary Information

The Company	AA Mutual International Insurance Company Limited (“AAMI” 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	Nigel Rackham and Dan 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 22 August 2005. Copies of our previous reports sent to creditors may be requested from Caroline Turnbull or Adam Loveday. The report dated 22 August 2005 may also be reviewed on the PwC website at www.pwc.com/uk/aamii.

The following attachments accompany this report:

Appendix A - Administrators' proposals as approved

Appendix B - Receipts and payments account for the period 23 July 2005 to 22 January 2006

Appendix C - FSCS – brief summary

Appendix D - Anticipated Scheme timeline

Creditors' Committee

As you are aware from our previous reports, at the creditors' meeting held by correspondence on 10 September 2004, a Creditors' Committee was established comprising four members. We have reported to the Creditors' Committee on several occasions to update them on strategic matters relating to the Administration. At a meeting in July 2005 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.

We are extremely grateful to the members of the Creditors' Committee for their continued support. We are proposing that the existing members of the Creditors' Committee form the Creditors' Committee in the Scheme of Arrangement. However if any creditor wishes to act on the Creditors' Committee in the Scheme, please advise us accordingly.

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, namely a Scheme of Arrangement. 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 our 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 £47,000 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 because of the commutation activity prior to Administration, little, if any, recoveries were readily available.

We have to date made recoveries totalling £28,520 from brokers, and it is anticipated that a further recovery in the region US\$6,000 will be made shortly.

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. It is not currently possible to determine whether there may 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 we have drawn £8,643.18 plus VAT in accordance with an authorisation previously agreed by the Creditors' Committee for the period 1 April 2005 to 30 June 2005. In addition we have drawn £60,000 plus VAT for the period 1 July 2005 to 30 December 2005 in line with the authorisation previously agreed by the Creditors' Committee whereby the Joint Administrators are allowed to draw up to maximum of £10,000 per month on account of time costs, to be approved by the Creditors' Committee retrospectively. The Administrators have also, as previously advised, 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

Particular features of the proposed Scheme

Creditors will recall in our report dated 22 August 2005 (which, as previously mentioned, may be downloaded from the PwC website at www.pwc.com/uk/aamii) we detailed the features of the proposed Scheme. Since our report it has been decided that the possible weighting of claims discussed in that report will not be pursued. Point 5 below details the proposed estimation methodology.

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

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

1. 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) should be paid in full. Direct policyholders are afforded priority over all other (including reinsurance) creditors, in accordance with 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 (equal dividend) 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 will be entitled to protection from the FSCS under its rules and such claimants are therefore excluded from the Scheme. For further information please see Appendix C.
4. The remaining 50% of the 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:

The Administrators have carefully considered possible estimation methodologies and come to the conclusion that the most appropriate methodology is simply to invite creditors to submit an estimate of their claims (including incurred but not reported claims) and require them to be discounted for the time value of money only (5% in line with the winding up procedures). If a claim cannot be agreed by the Company and a creditor then an Adjudicator will determine its value. Full details will be set out in the Scheme.

III Proposed Scheme of Arrangement

It is proposed that the final claims submission date will be 120 days after the effective date of the Scheme. The Administrators are proposing to issue blank claim forms to creditors and invite creditors to submit their claims. Although there are ledger balances in the books of AAMII most of these are very old and it is understood these have not in general been agreed with creditors and indeed may neither be valid nor appropriate.

IT IS VITAL THAT CREDITORS SUBMIT DETAILS OF THEIR CLAIMS WHETHER OR NOT THEY CONSIDER CERTAIN CLAIMS TO HAVE BEEN SUBMITTED PREVIOUSLY. FAILURE TO SUBMIT CLAIMS BY THE FINAL CLAIMS SUBMISSION DATE WILL PRECLUDE ANY FURTHER SUBMISSION AND NO PAYMENT WILL BE MADE IN RELATION TO CLAIMS SUBMITTED LATE.

In common with many insurance companies in the London Market, AAMII does not maintain comprehensive details of policies underwritten. If creditors wish to obtain details of their policies according to AAMII's records they are invited to contact Adam Loveday or Caroline Turnbull on 020 7804 4761 and 020 7804 8203 respectively, and the Administrators will make reasonable efforts to comply with creditors' requests in this regard.

Implementing the Scheme

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

1. 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. This hearing is due to take place on 28 February 2006. Creditors are invited to contact our office should they require any further details of the hearing.
2. Assuming the High Court grants the Order creditors can expect to receive notice together with a short form explanatory statement. Full copies of the Scheme document and explanatory statement will be made available on the PwC website at www.pwc.com/uk/aamii. An estimated timeline for the Scheme is attached at Appendix D. 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.
3. 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.
4. 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.

If you have any queries or wish to discuss any of the above, please do not hesitate to contact us.

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 transactions 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

AA Mutual International Insurance Company Limited - In administration
Receipts and Payments account for the period 23 July 2005 to 22 January 2006

Receipts	US\$	£	CA\$
Brought forward from previous abstract	2,431,313.72	500,064.77	40,695.31
Reinsurance recoveries	20,255.19	15,608.56	
*USD converted to GBP		659,205.19	
Investment income	25,486.89		
Interest received gross	128.37	6,116.50	109.36
Total receipts	2,477,184.17	1,180,995.02	40,804.67
Payments			
Brought forward from previous abstract	490,101.94	377,200.09	29.09
Joint administrators' fees		68,643.16	
Treasury services		620.81	
Legal & professional fees		2,300.00	
Run-off service provider		6,079.39	
*USD converted to GBP	1,157,432.48		
Bank charges	13.08	21.38	7.10
VAT irrecoverable		12,523.69	
Total payments	1,647,547.50	467,388.52	36.19
Closing balance	829,636.67	713,606.50	40,768.48

Notes

* USD converted into GBP @ 1.7558:1

Appendix C

FSCS – brief summary

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).

Appendix D

Anticipated Scheme Timeline

