SOVEREIGN MARINE & GENERAL INSURANCE COMPANY LIMITED

ANNUAL REPORT TO CREDITORS

2 December 2005

www.kpmg.co.uk/insurancesolutions

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 and 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.