ERNST & YOUNG

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To: **POLICYHOLDERS AND SCHEME CREDITORS OF THE BERMUDA FIRE & MARINE INSURANCE COMPANY LIMITED**

27 August 1999

Dear Sirs

THE BERMUDA FIRE & MARINE INSURANCE COMPANY LIMITED (IN LIQUIDATION) ('BFMIC')

1. Introduction

We are writing to provide you with an update on the position of the Scheme of Arrangement for BFMIC ('the Scheme'), which was approved by the creditors in November 1996 and became effective on 15 January 1997.

This report is being sent to all known creditors, policyholders and insurance brokers who have placed business with BFMIC for whom contract details are available. Brokers, agents and intermediaries are encouraged to bring this report to the attention of their clients.

2. Estimated Financial Position

At 31 December,1998 BFMIC held liquid assets of $99 million. In addition, the Joint Liquidators estimate that reinsurance proceeds in excess of $180 million will be realised over the course of the Scheme, subject to actual claims development. Estimated liabilities (excluding a margin for adverse development) are $705 million.

Attached to this report at Appendix One is a summary of the receipts and disbursements of the estate since the date of appointment of provisional liquidators, an estimate of the assets and liabilities of the estate as at 31 December 1998, and an illustrative projection of the possible payments to creditors over time.

3. Payments to Creditors

Under the Scheme, the first payments to creditors with established liabilities were made in July 1997, using the initial payment percentage which was set at 1.5% . The payment percentage was increased to 2.5% in July 1998. The Joint Liquidators are pleased to announce that with effect from 1 July 1999 they have set an increased payment percentage of 5% to the creditors of BFMIC. In total, more than $62 million has now been allocated to creditors.

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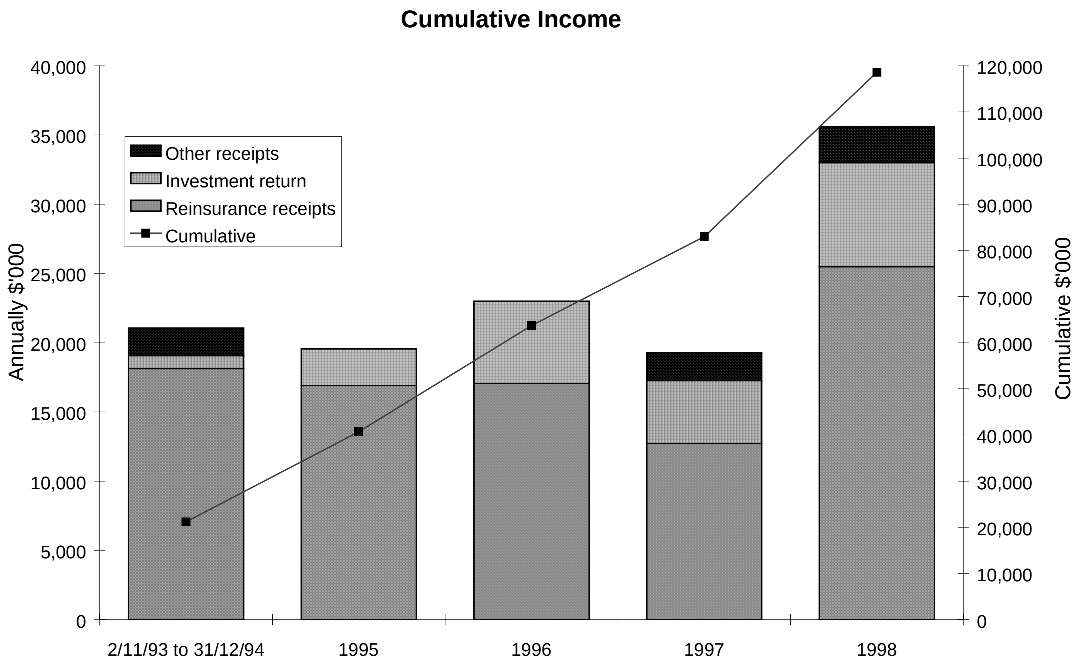
4. Income

There are two principal sources of income: reinsurance and investment return. The levels of both will fluctuate from year to year, as shown in the graph below:-



In total, at 31 December 1998, assets amounting to $118.5 million have been realised since the appointment of Provisional Liquidators on 2 November 1993.

5. Reinsurance

The collection of reinsurance recoveries due both now and in the future represents BFMIC's largest realisable asset. The Joint Liquidators, in association with BFMIC's run-off agents, KWELM Management Services Limited ('KMS'), continue to pursue reinsurers owing money to recover valid contractual debts. BFMIC has a large reinsurance programme consisting of over 500 reinsurers, and over 200 of these have made payments to BFMIC since the appointment of provisional liquidators. Many reinsurers continue to try to find ways of delaying or avoiding their liabilities. The Joint Liquidators' policy is to pursue the timely collection of reinsurance balances due. Where disputes or delays arise, the Joint Liquidators will consider commercial settlement by commutation, mediation or other forms of Alternative Dispute Resolution, but will also arbitrate or litigate where necessary in association with other members on the relevant Stamp, with the aim of maximising the net recovery from the reinsurance programme.

6. Investment Return

Under the Scheme substantial funds are set aside to meet the distribution to creditors whose claims will not arise for many years. The principal objectives of the management of cash and investment assets of BFMIC are the security of principal and the maintenance of liquidity, to support anticipated distributions. Within the constraints on security and liquidity, the Joint Liquidators wish to achieve the maximum real rate of return on the estate's assets. As at 31 December 1998, the investment manager held funds of $76.7 million on behalf of BFMIC, and its performance is closely scrutinised on a regular basis against pre-determined criteria.

7. Claims Development

BFMIC's Scheme claims arise primarily from acceptances on behalf of BFMIC by H.S. Weavers (Underwriting) Agencies Limited ('Weavers') and C.R. Driver & Co Limited ('Driver'), underwriting agents in the UK, from 1969 to 1983, and Bermuda London Underwriting Agency Limited ('BLUA'), underwriting agent in Bermuda from 1978 to 1985.

The principal business underwritten through Weavers was North American insurance and reinsurance. The continuing claim activity comprises many classes of casualty business including environmental pollution, asbestos liability, other toxic tort and medical indemnity. The principal business underwritten through BLUA was similar to that underwritten though Weavers, but also included significant London Market excess of loss retrocessions.

Case estimates are maintained on behalf of BFMIC by KMS, and are subject to continual assessment and re-assessment during the course of the year. The Joint Liquidators establish a reserve for IBNR claims from an independent annual actuarial review, in consultation with a reserving sub-committee of the Committee of Inspection.

8. Scheme Claims

Under the Scheme, payment is being made on claims as they are established, not on estimates of outstanding claims or on incurred but not reported claims, and therefore proofs of debt are not being requested. The management of the run-off of all business underwritten by BFMIC is being conducted by KMS (the run-off of the BLUA and sundry books having been transferred from Ernst & Young in Bermuda from 1 October 1997). Claims should therefore be presented to KMS for agreement as they arise, at the address given at the end of this report.

Claims agreed by BFMIC are subject to extensive verification procedures, which must be completed before the transactions can be treated as Established claims and cleared for payment. At 31 December 1998, claims agreed amounted to $129.8 million, gross of Scheme Dividends and amounts available for set-off. From June 1997 to 31 December 1998 cumulative payments amounting to $1.82 million (including payment by set-off of $0.33 million) have been made to creditors on claims of $73.0 million which have become Established.

Approximately $30.6 million of the total agreed claims were undergoing reconciliation and verification processing by KMS at 31 December 1998, and approximately a further $26.2 million has been reconciled and verified, but dividends withheld pending resolution of factors such as the impact of set-off for reinsurance balances due, and drawings on Letters of Credit. These factors require reconciliation and agreement before a dividend can be paid on the relevant creditor's net balance.

There is no time bar date for the filing of claims under the scheme. Established claims are paid at the current scheme payment percentage of the Established balance. However, no cheques are raised below the de minimis level of $1,000 or equivalent currency, unless a creditor specifically requests payment.

9. The 1991 Transaction / Litigation

Proceedings have been brought by the Joint Liquidators and certain of BFMIC's creditors against BF&M Limited and a number of its subsidiaries, five of BFMIC's former directors, BFMIC's former attorneys, Conyers Dill & Pearman ('CDP'), BFMIC's former auditors, Cooper & Lines, and a large number of BFMIC's present and former shareholders, in order to recover assets transferred out of BFMIC prior to the company entering into formal insolvency proceedings.

The hearing commenced in Bermuda in May 1999, and is scheduled to last up to twelve months. The progress of the litigation is being extensively reported in the Bermudian press, and the Joint Liquidators do not consider it appropriate to make any further comment in this report.

10. The Committee of Inspection

The Scheme allows for there to be between three and eight Scheme Creditors on the Committee of Inspection, which at present meets formally four times a year as a full committee, supported by three sub-committees covering the areas of reinsurance, finance and reserving.

The Joint Liquidators value the input of committee members, who provide their time at no cost to the estate, and who collectively have a current and detailed knowledge of the nature of BFMIC's run-off and the issues affecting the industry. For your information, the current list of members is produced below.

Organisations acting as designated representatives and/or as creditors	**Representative**	**Alternate**
Anderson Kill & Olick P.C.	Mark Keenan	-
Federation of Jewish Philanthropies	Joel Glass	-
The Hartford Financial Services Group Inc.	David Robb	Richard Grant
International Insurance Company	Dennis Gibbs	Frank De Maria Clive Becker-Jones
The International Policyholders Association	W.D. Hilton, Jr	-
The Policyholders Protection Board	Deryck Wright	-

Transit Casualty Company (in receivership) Burleigh Arnold Thomas Crone

Attached to this report at Appendix Two is a letter from the Chairman of the Committee of Inspection, Mr Dennis Gibbs.

11. Further Correspondence

All further correspondence in relation to the run-off of BFMIC should be directed as follows:-

Correspondence in connection with insurance claims relating to the run-off of all books of business underwritten for or by BFMIC.	KWELM Management Services Limited John Stow House 18 Bevis Marks London EC3A 7JB Telephone: +44 171 645 4700 Fax: +44 171 645 4777
For the attention of:-	Keith Garwood *(Head of Claims)* Mark Adams *(Treaty and PI Claims Manager)* Fred Bunyan *(UK Technical Claims Manager)* Paul Corver *(Claims Support Manager)* George Sandow *(Casualty Claims Manager)*
Correspondence in connection with the payment of Scheme Dividends and other issues relating to the run-off of BFMIC's liabilities.	Mr James Bolton The Bermuda Fire & Marine Insurance Company Limited (In Liquidation) c/o KWELM Management Services Limited John Stow House 18 Bevis Marks London EC3A 7JB Telephone: +44 171 645 4700 Fax: +44 171 645 4777
Correspondence relating to all other matters should be addressed to the Joint Liquidators in Bermuda or London.	Ernst & Young P O Box HM 463 Hamilton HM BX Bermuda Ernst & Young Rolls House 7 Rolls Buildings Fetter Lane London EC4A 1NH

Yours sincerely
for The Bermuda Fire & Marine Insurance Company Limited

Gareth H Hughes, L Anthony Joaquin and John C McKenna
Joint Liquidators

APPENDIX ONE
ESTIMATED FINANCIAL POSITION

A) Summary of Receipts and Disbursements

Set out below is a table summarising the cumulative receipts and disbursements from the date of appointment of provisional liquidators in 1993 until 31 December 1998.

	Cumulative Total from 2/11/93 $'000
Receipts	
Reinsurance & run-off receipts	90,299
Income from managed Investments	11,666
Income from other investments	9,901
Other recoveries	6,616
	118,482
Disbursements	
Legal fees & disbursements	15,879
Liquidator fees & disbursements	8,263
Run-off agent fees	6,132
Other expenses	2,414
	32,688
Receipts over Disbursements before Scheme Dividends	85,794
Scheme payments	1,487
Receipts over Disbursements after Scheme Dividends	84,307
Cash at appointment	2,081
Cash at bank and managed funds at 31 December 1998	86,388

B) Estimated Assets and Liabilities as at 31 December 1998 (Unaudited)

	Note	31 December 1998 $'000	$'000
Estimated Assets			
Cash and short term deposits	1		9,723
Managed investments	2		76,665
Unpledged investments	3		8,732
Pledged investments	4		4,079
			99,199
Current reinsurance receivables, less provision	5		16,035
Future reinsurance receivables, less provision	6		173,631
			288,865
Expenses			
Provision for run-off costs	7		(37,506)
Net Assets			251,359
Estimated Liabilities			
Current claims payable (net of Scheme Dividends)	8	(123,428)	
Gross provision for future claims	9	(581,215)	
			(704,643)
Shortfall carried forward at 31 December 1998			(453,284)

Notes:

1 Cash & short term deposits represents amounts held as at 31 December 1998

2 Managed investments represents the market value of funds held with the investment manager.

3 Unpledged investments represent 9% cumulative preference shares in BF&M Limited at market value.

4 Pledged investments represent the portfolio of fixed interest investments held at Citibank in the UK as security of LOC's issued to US cedants.

5 Current reinsurance receivables, less provisions, represent the Joint Liquidators' estimate, incorporating estimates of potential set-off and uncollectible amounts and based upon currently available information, of total amounts recoverable from reinsurers in respect of agreed claims.

6 Future reinsurance receivables, less provisions, represent a figure derived from the estimate of the gross provision for claims (see 9 below), after application of a provisioning methodology consistent with that adopted for the estimate of current reinsurance receivables (see 5 above).

7 Provision for future run-off expenses is a projection of the likely legal, professional and run-off fees payable assuming a run-off period approximating 16 years.

8 Current claims payable, net of scheme Dividends, represents the level of known agreed claims, based upon currently available information, less an estimate of the potential set-off amounts due to BFMIC, and less payments of Scheme Dividends made to creditors.

9 Gross provision for future claims represents an estimate of BFMIC's outstanding claims and IBNR, adjusted for likely set-off and security held. Included within this figure are outstanding claim reserves of $173,431,000 and IBNR of $407,784,000. Included in the corresponding future reinsurance receivable figure of $173,631,000, is an amount relating to outstanding claims of $68,969,000, and an amount relating to IBNR of $104,662,000.

C) Estimated Future Realisations and Illustrative Theoretical Payment Percentage Projection

Under the Scheme the Joint Liquidators intend to review the Payment Percentage annually, in consultation with the Committee of Inspection. In setting the Payment Percentages, it is necessary that the Joint Liquidators make adequate provision for the possibility that the number and severity of known outstanding and IBNR claims may increase, in order to protect the interests of long tail Scheme Creditors who may be prejudiced if the Payment Percentage level has to be subsequently reduced.

Over time the uncertainty of claims deteriorating further will decrease, so that, as claims become agreed and Established, the levels of IBNR and Special Margin will fall.

For illustrative purposes, using the estimates of assets and liabilities presented above and based on further assumptions, it is possible to set up a model of future realisations to approximate potential ranges of Payment Percentages and at what point these may be set. On the basis of this model, an illustrative theoretical Payment Projection may look like this:

	Illustrative Theoretical Payment Projection at the end of:			
	1998 $'000	**2001 $'000**	**2005 $'000**	**2015 $'000**
Assets available for distribution	95,120	104,093	159,042	79,007
Assets distributed in prior years	1,487	13,465	61,836	195,835
Less: reserve for three years of run-off expenses	(32,402)	(10,699)	(4,800)	(3,855)
	64,205	106,859	216,078	270,987
Gross liabilities (including amounts potentially subject to future set-off)	706,130	701,960	696,459	662,771
Special margin	535,915	513,751	358,428	64,956
	1,242,045	1,215,711	1,054,887	727,727
Possible range of Payment Percentages	5%	7%-10%	18%-23%	30%-40%

N.B. Gross liabilities will decrease over time due to the reconciliation and agreement of set-off balances.