

August 19, 1996

Dear Sirs:

**Re: The Bermuda Fire & Marine Insurance Company Limited
(in liquidation) ("BFMIC")**

✓ 1. **Introduction**

- 1.1 We refer to the proposed Scheme of Arrangement (the "Scheme") between BFMIC and its creditors pursuant to section 99 of the Companies Act 1981 of Bermuda and section 425 of the Companies Act 1985 of Great Britain. The Scheme will be substantially in the form of the document (draft dated August 2, 1996) which has recently been sent to you in order to obtain your consent to issue.
- 1.2 We are the Liquidators of BFMIC. In accordance with the terms of the Scheme and the Companies Act 1981 of Bermuda, as the Liquidators, we will be acting as agents of BFMIC.
- 1.3 You are the initial members of the Committee of Inspection.
- 1.4 We are writing to set out the understanding we have discussed with you as to how certain aspects of the Scheme involving the Liquidators and concerning the Committee of Inspection will initially operate in practice. Once the Scheme has become effective, this letter will be taken to have been written pursuant to clause 6.4.6 of the Scheme.
- 1.5 Words and expressions defined in the Scheme shall, unless the context otherwise requires, have the same meanings in this letter. In the event of any conflict or inconsistency between the terms of this letter and the Scheme, the terms of the Scheme shall prevail.

✓ 2. **Committee of Inspection Meetings**

The reports referred to in the following paragraphs will be presented to meetings of the Committee of Inspection. We have had discussions with you as to the regularity of meetings of the Committee of Inspection. We are satisfied that, at least in the initial years of the Scheme, there shall be meetings at least every three months (unless agreed otherwise). If we or the Committee of Inspection consider that there should be more frequent meetings, we shall arrange for such additional meetings to be convened.

3. **Setting the Payment Percentages**

- ✓ 3.1 We shall review the amount of the free cash assets and of the estimated ultimate liabilities of BFMIC as soon as practicable after the Effective Date of the Scheme and as soon as practicable after 31 December of each year thereafter. If, following any such review we consider that we would be able to set a Payment Percentage whilst complying with the provisions of Part 3 of the Scheme, we shall set such a Payment Percentage and make cash payments to Scheme Creditors in accordance with clause 3.3 of the Scheme.
- ✓ 3.2 We shall keep the members of the Committee of Inspection informed at all appropriate stages whilst we are reviewing BFMIC's assets and liabilities and considering whether to set, or make any changes to, any Payment Percentage. We will not set a Payment Percentage or increase or decrease a Payment Percentage unless at least a majority of all the members of the Committee of Inspection have agreed to the basis on which such percentage or revised percentages is to be set.
- 3.3 We shall consult with the Committee of Inspection as to the financial and/or actuarial information and advice that should be obtained pursuant to clause 3.2.8 of the Scheme for the purpose of setting a Payment Percentage. We would normally expect to obtain an actuarial report before setting or revising a Payment Percentage.
- 3.4 Under clause 3.2.5 of the Scheme the Liquidators are entitled to take into account reinsurance recoveries and future investment income in reserving for the costs of the Scheme. However, in order to protect the interests of "long tail" creditors, we will not set a Payment Percentage, at least in the initial years of the Scheme, without providing in full in cash for the costs of the Scheme for the following three years. We will keep our reserving policy under review and discuss it with the members of the Committee of Inspection as appropriate. We will not amend the policy set out in this paragraph without the consent of at least a majority of all the members of the Committee of Inspection.

4. **Settlement, Commutations and Other Discharges**

- 4.1 We shall not enter into any settlement or commutation agreement with any Scheme Creditor unless we are satisfied that the agreement will reduce the net estimated ultimate liabilities of BFMIC and will not put the relevant Scheme Creditor in a better position than it would have been in without such arrangement (disregarding any advantage such Scheme Creditor may thereby obtain by receiving payment earlier than it would otherwise). We will obtain such actuarial advice as is appropriate in the circumstances.
- 4.2 We will not enter into any agreement providing for the discharge of any reinsurer's or retrocessionaire's liability to BFMIC unless we are satisfied that, where under such arrangement the reinsurer or retrocessionaire is paying less than it would be otherwise, such arrangement is beneficial to BFMIC by reason of it receiving payment earlier than it would otherwise. We will obtain such actuarial advice as is appropriate in the circumstances.

- 4.3 In normal circumstances we will not enter into any such agreement if it is likely to affect adversely or prejudice the rights of BFMIC under any other reinsurance contract.
- 4.4 We will not enter any such agreement if it would be likely to affect adversely the amount of the free cash assets and/or of the liabilities of BFMIC and as a result that the Payment Percentage would be liable to be decreased at the next review or, if it has not then been set, be set at a lower level or not at all, without the agreement of at least a majority of all the members of the Committee of Inspection.
- 4.5 We envisage further consultation with the Committee of Inspection concerning guidelines as to the commutation agreements (both “inwards” and “outwards”) that they will wish to review, and the nature of that review. Notwithstanding such guidelines, it should be recognized that it may not be possible in all circumstances for each individual agreement to be reviewed and discussed with the Committee of Inspection in advance of settlement.

5. **Defence Liabilities**

We do not envisage settling, in whole or in part, defence liabilities owed to creditors other than by way of payment of the Payment Percentage in the normal way under the Scheme. In exceptional circumstances, we may need to do otherwise and in such circumstances, if material, we will not do so without the consent of at least a majority of all the members of the Committee of Inspection.

6. **Run-Off**

We shall keep the members of the Committee of Inspection informed of the arrangements agreed with any third party for the run-off of BFMIC’s existing insurance businesses and of any substantial changes thereto. We will not enter into any run-off agreements or make any changes thereto which are not agreed to by at least a majority of all the members of the Committee of Inspection.

7. **Investment**

7.1 We shall inform the members of the Committee of Inspection of our policy regarding the investment of BFMIC’s assets from time to time. Our investment policy will take into account the currencies in which BFMIC’s assets and liabilities are denominated from time to time.

7.2 The overriding objectives of our investment policy will be as follows:-

- a minimal exposure to risk of default by counterparties;
- a maturity structure which enables BFMIC to make payments to Scheme Creditors as claims are agreed; and
- a balanced mixed portfolio as respects investment terms and counterparty profile.

7.3 Our investment policy will be subject to the following criteria in order of importance:-

- security of investment;
- adequate maturity (liquidity); and
- competitive based profitability (yield).

7.4 Our investment policy will not be altered (save in immaterial respects not adverse to the overriding objectives set out in paragraph 7.2 above or to the criteria set out in paragraph 7.3 above) unless at least a majority of all the members of the Committee of Inspection agree to the proposed alteration.

8. Long Term Stay Provisions

8.1 We will operate the long term stay provisions as set out in clause 2.2 of the Scheme and the Explanatory Statement, following, in the vast majority of cases, settlements entered into by, and judgments against, Co-Insurers. We confirm that only in exceptional circumstances will we require Scheme Creditors to re-litigate a claim after it has been settled by any other Co-Insurers. Where such re-litigation is considered appropriate, we shall inform the members of the Committee of Inspection, excluding from the meeting any member of the Committee of Inspection who may have a direct interest in such litigation.

8.2 In relation to the use of alternative dispute resolution mechanisms, we are convinced in general terms of the merits of alternative dispute resolution and we will keep the need for an alternative dispute resolution mechanism in relation to the Scheme under review. We may, at an appropriate stage, introduce proposals for the resolution of disputes, other than through litigation, provided that such proposals for the resolution of disputes shall be formulated (either generally or with specific reference to a dispute or disputes) if the Committee of Inspection so require by a resolution passed by a two-thirds majority of those present and voting (such majority to include the Policyholders Protection Board where proposals are made in connection with disputes concerning or relating to Protected Policyholders) and shall be implemented only if agreed upon by both the Committee of Inspection and the Liquidators.]

9. Litigation, Arbitration and Other Proceedings

9.1 We shall inform the members of the Committee of Inspection of any litigation, arbitration or other proceedings involving, or which may involve BFMIC, and which will or may involve BFMIC and which will or may have a material effect on the Scheme or on the assets or liabilities of BFMIC so as to affect the Payment Percentage.

9.2 We shall inform the members of the Committee of Inspection of any actions, claims, proceedings or demands brought or made, or threatened to be brought or made, against us which may lead to us or any of our Employees or Delegates seeking indemnity from BFMIC under the Scheme.

9.3 Each member of the Committee of Inspection shall inform us, and we shall inform the other members of the Committee of Inspection accordingly, of any actions, claims, proceedings or demands brought or made, or threatened to be brought or made, against it (or its Nominated Representative, representative or alternate) which may lead to it seeking indemnity from BFMIC under the Scheme.

9.4 Members of the Committee of Inspection should be aware that the Liquidators as agents of BFMIC may be required to take action against them in their capacity as Scheme Creditors. Committee of Inspection members will be excluded from parts of meetings during which such action against them, or in which they have a direct interest, is discussed.

10. Financial Reporting

10.1 We shall inform the members of the Committee of Inspection at the regular quarterly meetings of the financial position of BFMIC up to the date of the last quarter and will provide the following information:-

- A statement of cash receipts and payments cumulative from the Effective Date of the Scheme, with a comparison between the cumulative year to date and budget showing variances to budget and the immediate previous year.
- A statement of quarterly cash receipts and payments showing variances to budget and the immediate previous quarter.
- An analysis of all cash and investments held as at the end of the quarter.
- A statement of net investment income for the quarter, the cumulative year to date and cumulative from the Effective Date of the Scheme.
- A statement of fees and expenses paid to professional advisors (split out individually) during the year to date and cumulative from the Effective Date of the Scheme.
- A statement detailing the major receipts and payments for the quarter year to date and cumulative from the Effective Date of the Scheme where any receipt or payment in any such period has exceeded 20% of the total.
- Scheme Claims established during the quarter and cumulative year to date comparing with actuarial projections.

10.2 The first set of quarterly reports will be made up to the final date of that calendar quarter, notwithstanding that the report may thereby not relate to a full quarter.

10.3 The Liquidators and the Committee of Inspection will agree procedures for the submission to the Committee of Inspection of the Cash Book (as defined in Rule 124(1) of the Winding-Up Rules) at least every three months in accordance with Rule 124 (2) of the Winding-Up Rules. Further, the Liquidators and the Committee of Inspection will also agree procedures for the audit of the Cash Book in accordance with Rule 126 of the Winding-Up Rules.

11. **Resolution of Conflicts of Interest**

Conflicts of interest that may arise will be regulated in accordance with the guidelines setting out the procedures for the resolution of conflicts of interest during the course of the Scheme (the "Guidelines") which have been formulated by the Liquidators and the Committee of Inspection and which are available for inspection by Scheme Creditors as detailed in Appendix V of the Explanatory Statement.

12. **Fees and Expenses**

In accordance with clause 6.4.5 of the Scheme and the terms of our appointment as Liquidators, we will submit invoices for our fees and expenses to you (or to such one or more of you to whom such power has been delegated with our prior written consent) for approval. Any Scheme Conflicts Administrator acting in his capacity as such will be required to do the same in accordance with the Guidelines.

13. **Practicalities of Reporting, Consulting and Obtaining Agreement**

13.1 Unless in any particular case we consider that more frequent reporting is required, the information referred to in this letter shall be reported to the Committee of Inspection in a quarterly report from the Liquidators to the Committee of Inspection.

13.2 Where we have said in this letter that we will consult with, or wish to obtain the agreement of, the members of the Committee of Inspection, we will aim to do so by facsimile or by telephone and only in exceptional circumstances by means of additional meetings of the Committee of Inspection if the members of the Committee of Inspection think it appropriate in any particular circumstances. We aim to inform all the members of the Committee of Inspection of the substantive view of the other members which are reported to us.

13.3 Where we have said in this letter that we will obtain the agreement of at least the majority of all of the members of the Committee of Inspection we will have regard principally to the majority in number of the Committee, but we will always be mindful of the different interests that the members of the Committee of Inspection have and our overriding obligation towards the general body of creditors of BFMIC.

14. **Governing Law and Jurisdiction**

This letter shall be governed by and construed in accordance with the law of Bermuda.

This letter sets out how we currently envisage certain aspects of our relationship with you operating in practice. We all recognize that as the operation of the Scheme progresses and our relationship develops, changes may need to be made to the procedures set out in this letter. We would welcome any proposals that you have.

Please could you acknowledge this letter to indicate your receipt of it and agreement that it accurately sets out our understanding.

Yours faithfully,

.....
Gareth Howard Hughes
Joint Liquidator

.....
Leon Anthony Joaquin
Joint Liquidator

.....
John Christopher McKenna
Joint Liquidator

We acknowledge receipt of this letter and agree that it accurately sets out our understanding:

.....
for and on behalf of
Transit Casualty Company (in Receivership)
, 1996

.....
R.H.S. St
for and on behalf of
ITT Hartford Insurance Group
September 18, 1996

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for and on behalf of
Federation of Jewish Philanthropists
, 1996

.....
for and on behalf of
The Policyholders Protection Board
, 1996

.....
for and on behalf of
International Policyholders Association
, 1996

.....
for and on behalf of
Anderson, Kill & Olick, PC
, 1996

.....
for and on behalf of
International Insurance Company
, 1996

We acknowledge receipt of a copy of this letter and agree to its terms:

.....
for and on behalf of
The Bermuda Fire & Marine
Insurance Company Limited
(in liquidation)
, 1996