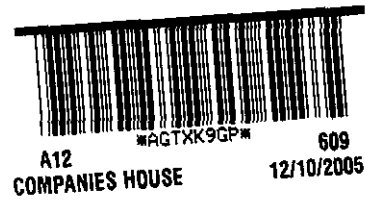


HIGHLANDS HOLDINGS (UK) LIMITED

FINANCIAL STATEMENTS

YEAR ENDED 31 DECEMBER 2004

**COMPANY REGISTERED NUMBER
3114359**



Highlands Holdings (UK) Limited

Index to the Accounts

for the year ended 31 December 2004

	<u>Page No</u>
Directors and Officers	1
Directors' Report	2 - 3
Statement of Directors' Responsibilities	4
Report of the Auditors	5 - 6
Consolidated Profit and Loss Account	7
Consolidated Statement of Total Recognised Gains and Losses	8
Consolidated Balance Sheet	9 - 10
Consolidated Cash Flow Statement	11
Company Balance Sheet	12
Notes to the Accounts	13 - 21

Highlands Holdings (UK) Limited

Directors and Officers
for the year ended 31 December 2004

Directors

Stephen Kibblehouse
Richard Plunkett
Albert Marino (Resigned 8 April 2004)

Secretary

PRO Insurance Solutions Limited

Auditors

KPMG Audit Plc, Marlborough House, Fitzalan Court, Fitzalan Road, Cardiff CF24 0TE

Bankers

Barclays Bank PLC, 54 Lombard Street, London, EC3V 9EX

Registered Office

Bruton Court, Bruton Way, Gloucester GL1 1DA

Registered Number

3114359

Highlands Holdings (UK) Limited

Report of the Directors

for the year ended 31 December 2004

Accounts

The Directors present their report and audited financial statements for the year ended 31 December 2004.

Principal Activity and Business Review

During the year to 31 December 2004, the Company did not engage in any business other than that reported by its subsidiary companies, being in the case of Highlands Insurance Company (U.K.) Limited ("HICUK") the settlement of claims and cash collections, and in respect of Highlands Underwriting Agents Limited the provision of claims handling and management services.

Between 1983 and 1994 HICUK wrote a predominantly LMX account in the London market. In addition, business written between 1972 and 1982 contains significant long-tail exposures. In view of the nature of this business, some uncertainty exists as to the ultimate loss position. An independent actuarial review was carried out at 30 September 2004, and the Directors have established reserves for expected loss development within the range predicted by this review.

Results and Dividends

The Group made a loss after taxation of £115,000 (2003: loss of £1,522,000). The Directors do not recommend the payment of a dividend for the year (2003: £nil). The Group has shareholders funds of £484,000 (2003: shareholders funds of £662,000).

This position is, however, subject to the uncertainties stated in Note 1 to these financial statements in relation to the financial circumstances of the US Group and any potential impact on the position of Highlands Insurance Company (UK) Limited.

The Directors have informed the Financial Services Authority of the financial circumstances relating to the US Group.

Directors

The Directors who served during the year were S Kibblehouse, A Marino and R Plunkett. Albert Marino resigned on 8th April 2004.

None of the Directors had any beneficial interest in the shares of the Company or any other group undertakings at any time during the year.

Auditors

During the year, the Company passed an elective resolution such that, in accordance with Section 386 of the Companies Act 1985 (as amended), the Company has dispensed with the obligation to appoint an auditor annually. As such KPMG Audit Plc will remain in position as auditor of the Company.

Highlands Holdings (UK) Limited

Report of the Directors
for the year ended 31 December 2004

By order of the Board

A. King

FOR AND ON BEHALF OF
PRO Insurance Solutions Limited
Corporate Secretary

13 SEPTEMBER

2005

Statement of Directors' Responsibilities
for the year ended 31 December 2004

Company law requires the directors to prepare financial statements for each financial year which show a true and fair view of the state of affairs of the Company and Group and of the profit or loss for that period. In preparing those financial statements, the Directors are required to:

- select suitable accounting policies and apply them consistently;
- make judgements and estimates which are reasonable and prudent;
- state whether applicable accounting standards have been followed subject to any material departures disclosed and explained in the financial statements;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume the Group will continue in business.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and to enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

**Report of the Auditor, KPMG Audit Plc, to the Members of
Highlands Holdings (UK) Limited
for the year ended 31 December 2004**

We have audited the financial statements on pages 7 to 21.

This report is made solely to the Company's Members, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's Members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept nor assume responsibility to anyone other than the Company and the Company's Members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The directors are responsible for preparing the directors' report and, as described on page 4, the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board and by our profession's ethical guidance.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if the group has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions with the group is not disclosed.

Basis of audit opinion

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board, except that the scope of our work was limited as explained below.

An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the group's circumstances, consistently applied and adequately disclosed.

We planned our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. However, in view of the financial position of the group's ultimate parent company, Highlands Insurance Group Inc, the evidence available to us to form a view on the recoverability of debtors due from Highlands Insurance Company (a wholly owned subsidiary of the ultimate parent company) was limited. The impact that this, and Highlands Insurance Group Inc's financial position generally, have on the ability of the company to be a going concern, is outlined in the notes to the financial statements.

In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Highlands Holdings (UK) Limited

**Report of the Auditor, KPMG Audit Plc, to the Members of
Highlands Holdings (UK) Limited
for the year ended 31 December 2004**

Fundamental uncertainty

In forming our opinion, we have considered the adequacy of the disclosures made in note 1 (d) to the financial statements concerning the uncertainty over the level of claims reserves held by the company, the variations in which may be significant to the net assets of the company. In view of the significance of the uncertainty inherent in this matter, we consider that it should be drawn to your attention but our opinion is not further qualified in this respect.

Going concern

In forming our opinion we have considered the adequacy of the disclosures made in the financial statements relating to the ability of the group to continue as a going concern. The financial statements have been prepared on a going concern basis, the validity of which depends upon the going concern presumption relating to Highlands Insurance Company and Highlands Insurance Group Inc.. Details of the circumstances giving rise to this uncertainty are described in Note 1 to the financial statements. Our opinion is not qualified in this respect.

Opinion

In our opinion the financial statements give a true and fair view of the state of the Group's and Company's affairs as at 31 December 2004 and of the Group's loss for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

KPMG Audit Plc

KPMG Audit Plc
Chartered Accountant
Registered Auditor

Cardiff *26 September* 2005

Highlands Holdings (UK) Limited

Consolidated Profit and Loss Account for the year ended 31 December 2004

	Notes	2004 £'000	2004 £'000	2003 £'000	2003 £'000
TECHNICAL ACCOUNT – GENERAL BUSINESS					
Earned premiums, net of reinsurance					
Gross premiums written	14	69		181	
Outwards reinsurance premiums		(174)		(207)	
			(105)		(26)
Claims incurred, net of reinsurance					
Claims paid					
Gross claims paid		(2,481)		(5,275)	
Reinsurers' share		1,397		3,510	
		(1,084)		(1,765)	
<i>Change in the provision for claims</i>	2				
Gross amount		28,694		18,522	
Reinsurers' share		(26,860)		(18,135)	
		1,834		387	
			750		(1,378)
Net operating expenses	3		-		(3)
Balance on the technical account for general business			645		(1,407)
NON-TECHNICAL ACCOUNT					
Balance on the general business technical account		645		(1,407)	
Fee income		278		178	
Investment income	4	416		489	
Unrealised gains on investments		-		-	
			1,339		(740)
Administrative expenses		(1,402)		(654)	
Investment expenses and charges	5	(20)		(39)	
Unrealised losses on investments		(32)		(89)	
Other income		-		-	
			(1,454)		(782)
Loss on ordinary activities before taxation	6		(115)		(1,522)
Taxation charge on ordinary activities	15		-		-
Loss on ordinary activities after taxation, being Retained (loss)/profit for the financial year			(115)		(1,522)

There is no material difference between the results for the current year and previous year as described in the Consolidated Profit and Loss Account and the results on an unmodified historical cost basis. Accordingly, a note of the historical cost profits and losses is not given.

All profits and losses relate to continuing operations.

The notes on pages 13 to 21 form part of these accounts

Highlands Holdings (UK) Limited

Consolidated Statement of Total Recognised Gains and Losses
for the year ended 31 December 2004

	2004 £'000	2003 £'000
Loss on ordinary activities after taxation	(115)	(1,522)
Restatement of foreign currency net assets	(63)	(206)
	<hr/>	<hr/>
Total recognised gains and losses relating to the year	(178)	(1,728)
	<hr/>	<hr/>

The notes on pages 13 to 21 form part of these accounts

Highlands Holdings (UK) Limited

Consolidated Balance Sheet for the year ended 31 December 2004

	Notes	2004 £'000	2004 £'000	2003 £'000	2003 £'000
ASSETS					
Investments					
Financial investments	9		16,216		15,834
Reinsurers' share of technical provision					
Claims outstanding	13		46,572		77,882
Debtors					
Debtors arising out of reinsurance operations		15,240		14,076	
Other debtors due from parent and subsidiary undertakings		192		64	
Trade Debtors		155		81	
Other debtors: taxes		-		-	
			15,587		14,221
Other assets					
Cash at bank and in hand			4,121		8,467
Prepayments and accrued income					
Accrued interest			141		118
Total Assets			<u>82,637</u>		<u>116,522</u>

The notes on pages 13 to 21 form part of these accounts

Highlands Holdings (UK) Limited

Consolidated Balance Sheet (continued) for the year ended 31 December 2004

	Notes	2004 £'000	2004 £'000	2003 £'000	2003 £'000
LIABILITIES					
Capital and reserves					
Called up share capital	10	4,870		4,870	
Profit and loss account	11	(4,386)		(4,208)	
Shareholders' funds attributable to equity interests	12		484		662
Technical provisions					
Claims outstanding	13		67,237		101,548
Creditors					
Arising out of reinsurance operations: group		2,081		3,000	
Arising out of reinsurance operations: other		12,598		11,094	
Other creditors		<u>116</u>		<u>146</u>	
			14,795		14,240
Accruals and deferred income					
			<u>121</u>		<u>72</u>
Total Liabilities					
			<u>82,637</u>		<u>116,522</u>

The notes on pages 13 to 21 form part of these accounts

Highlands Holdings (UK) Limited

Consolidated Cash Flow Statement for the year ended 31 December 2004

	Notes	2004 £'000	2004 £'000	2003 £'000	2003 £'000
Net cash outflow from operating activities	17		(3,867)		(4,040)
Returns on investments and servicing of finance			-		-
Taxation paid		-		-	
Capital expenditure		-		-	
Acquisitions and disposals		-		-	
Equity dividends paid		-		-	
Financing		-		-	
			-		-
Net cash (outflow)/inflow			(3,867)		(4,040)
Cash flows were invested as follows:					
Increase/(Decrease) in cash holdings			(4,346)		3,057
Net portfolio investment					
Fixed income securities		(1,945)		24	
Deposits with credit institutions		<u>2,424</u>		<u>(7,121)</u>	
			479		(7,097)
Net (application)/investment of cash flows			(3,867)		(4,040)

The notes on pages 13 to 21 form part of these accounts

Highlands Holdings (UK) Limited

Company Balance Sheet
for the year ended 31 December 2004

	Notes	2004 £'000	2004 £'000	2003 £'000	2003 £'000
ASSETS					
Investments: Shares in subsidiary undertakings	18		4,952		4,952
Total Assets			<u>4,952</u>		<u>4,952</u>
LIABILITIES					
Capital and reserves					
Called up share capital	10	4,870		4,870	
Profit and loss account	11	<u>82</u>		<u>82</u>	
Shareholders' funds attributable to equity interests	12		4,952		4,952
Total Liabilities			<u>4,952</u>		<u>4,952</u>

Approved by the Board of Directors on *September 13* 2005



DIRECTOR

The notes on pages 13 to 21 form part of these accounts

Notes to the Accounts

for the year ended 31 December 2004

1 Accounting Policies

The following accounting policies have been applied consistently in dealing with items which are considered material to the Group's financial statements.

(a) Basis of preparation

The financial statements have been prepared in accordance with the special provisions of Section 255 of, and Schedule 9A to, the Companies Act 1985 (as amended by the Companies Act 1985 (Insurance Companies Accounts) Regulations 1993).

The financial statements have also been prepared in accordance with applicable accounting standards and under the historical cost convention, modified to include the revaluation of investments, and comply with the revised Statement of Recommended Practice issued by the Association of British Insurers.

Going Concern

Highlands Insurance Company (UK) Limited ("HICUK") a subsidiary of the Company has extensive reinsurance arrangements with Highlands Insurance Company ("HIC"). Debtor balances, case reserves and IBNR in respect of such reinsurances total £22m which includes a £5m bad debt provision.

HIC is a wholly owned subsidiary of Highlands Insurance Group, Inc. (HIGI). HIC's wholly owned subsidiaries are Highlands Underwriters Insurance Company, Aberdeen Insurance Company, Highlands Casualty Company, and a controlled affiliate, Highlands Lloyds. HIC's operations are exclusively in the property and casualty insurance industry. Highlands Underwriters Insurance Company, Aberdeen Insurance Company, Highlands Casualty Company, and Highlands Lloyds have been merged into Highlands Insurance Company.

On October 31, 2002, HIGI, the publicly traded holding company, filed a voluntary petition for relief under Chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the District of Delaware. In the same filing, five non-insurance company subsidiaries also filed: Highlands Holding Company, Inc., Highlands Claims and Safety Services, Inc., Highlands Services Corporation, American Reliance, Inc. and Northwestern National Holding Company, Inc. The Court confirmed the Bankruptcy Plan effective March 31, 2003. The insurance company subsidiaries and the foreign entities were not subject to these proceedings. Under the Plan, all the public shares of HIGI were cancelled and new shares were issued to the Liquidating Trust for the benefit of the former creditors of HIGI.

In February 2002, the Texas Department of Insurance placed HIC under a supervisory order due to its financial condition. Subsequently, on the 6th November 2003, the Texas Department of Insurance placed HIC under a rehabilitation order and has since appointed a Special Deputy Commissioner to oversee the ongoing management of the company.

1 Accounting Policies (continued)

While HIC is in a state of rehabilitation, there exists a latent uncertainty over the future solvency of HICUK's major reinsurer. As a consequence, the directors of HICUK have increased their diligence to closely monitor the ongoing financial position of HIC. In addition, the HICUK directors have attempted to mitigate the increased risk by establishing a partial bad debt provision as stated above.

(b) Basis of Consolidation

The Group financial statements consolidate financial statements of the Company and its subsidiaries (note 17) for the year ended 31 December 2004.

As permitted by Section 230 of the Companies Act 1985, a separate profit and loss account dealing with the results of the Company has not been presented. The Company made neither a profit or a loss for the financial year (2003: £nil).

(c) Underwriting Transactions and Results

In the profit and loss account, premiums, claims and reinsurance are shown gross and represent those recorded based on notifications of closings received from brokers in the year. Transactions are allocated to the underwriting year of inception of the risk to which they relate. Commission is included within net operating expenses as acquisition costs.

(d) Claims Outstanding

Claims outstanding comprise provisions for the estimated cost of settling all claims incurred but unpaid at the balance sheet date whether reported or not. This provision represents the best estimate in the light of information available having regard to prudent assumptions about the level at which future claims are expected to settle.

The ultimate liability may vary as a result of subsequent information and events and may result in significant adjustments to the amount provided. Adjustments to the amounts of provisions are reflected in the financial statements for the period in which the adjustments are made. The methods used, and estimates made, are reviewed regularly by the Directors. The Directors have established reserves for expected loss development within the range predicted by the independent actuarial review which was performed as at 30 September 2004.

1 Accounting Policies (continued)

(e) Foreign Currencies

The Group operates in two principal currencies, Sterling and US dollars.

Assets, liabilities and revenue items in United States dollars have been translated to sterling at year end rates:

	2004	2003
US dollars	1.9100	1.7900

Any gain or loss arising from the retranslation of opening US dollar net assets at current year-end rates is taken directly to reserves.

Other transactions denominated in other currencies are expressed in sterling at the rate of exchange prevailing at the date of the transaction, and any gain or loss arising is included in the profit and loss account.

(f) Investment Income

Investment income comprises interest receivable, on an accruals basis, together with realised investment gains and losses. Realised gains are calculated as the difference between net sales proceeds and the valuation as at the last balance sheet date or cost if acquired during the year.

(g) Investments

Investments in subsidiary companies are stated at cost less any provision for impairment. Financial investments are stated at their market value on the balance sheet date. Unrealised gains and losses are taken to the profit and loss account.

Unrealised gains and losses on investments represent the difference between the current value of investments at the balance sheet date and their purchase price. The movement in unrealised investment gains and losses includes an adjustment for unrealised gains and losses on investments recognised in prior years.

(h) Taxation

The charge for taxation is based on the profit for the year. Deferred taxation is provided, without discounting, in accordance with Financial Reporting Standard No. 19 (FRS 19) on all timing differences between the treatment of certain items for taxation and accounting purposes which have arisen but not reversed at the balance sheet date. Deferred taxation assets are only being recognised to the extent that they are regarded as recoverable.

(i) Cedant and Reinsurer Balances

Amounts due to and from reinsurers are grossed up on an item by item basis to present gross assets and gross liabilities as required by FRS 5.

1 Accounting Policies (continued)

(j) Treatment of Goodwill

Goodwill arising on acquisition represents the difference between the fair value of the consideration paid and the fair value of the net assets acquired.

As permitted by FRS10, all goodwill previously written off directly to reserves in the year of acquisition is not reinstated.

At 31 December 2004, £1,505,000 of positive goodwill had been written off directly to the profit and loss reserve. If a subsidiary undertaking is disposed of, then the related goodwill will be reinstated and charged against profit for the financial year in the year of disposal.

(k) Fee Income

Fee income comprises fees charged to principals as well as certain expenditure reimbursed by principals for the management and servicing of underwriting activities.

2 Claims Incurred Net of Reinsurance

	<i>Gross</i> £'000	<i>Reinsurance</i> £'000	<i>Net</i> £'000
2004			
Claims Paid	2,278	1,397	881
Claims handling expenses paid	<u>203</u>	<u>-</u>	<u>203</u>
	<u>2,481</u>	<u>1,397</u>	<u>1,084</u>
Outstanding claims carried forward	67,237	46,572	20,665
Restatement of opening outstandings	5,617	4,450	1,167
Outstanding claims brought forward	<u>(101,548)</u>	<u>(77,882)</u>	<u>(23,666)</u>
	<u>(28,694)</u>	<u>(26,860)</u>	<u>(1,834)</u>
Claims incurred	<u>(26,213)</u>	<u>(25,463)</u>	<u>(750)</u>
2003			
Claims Paid	4,873	3,510	1,363
Claims handling expenses paid	<u>402</u>	<u>-</u>	<u>402</u>
	<u>5,275</u>	<u>3,510</u>	<u>1,765</u>
Outstanding claims carried forward	101,548	77,882	23,666
Restatement of opening outstandings	11,973	9,891	2,082
Outstanding claims brought forward	<u>(132,043)</u>	<u>(105,908)</u>	<u>(26,135)</u>
	<u>(18,522)</u>	<u>(18,135)</u>	<u>(387)</u>
Claims incurred	<u>(13,247)</u>	<u>(14,625)</u>	<u>1,378</u>

Highlands Holdings (UK) Limited

Notes to the Accounts (continued) for the year ended 31 December 2004

3 Net Operating Expenses

	<i>Gross £'000</i>	<i>Reinsurance £'000</i>	<i>Net £'000</i>
2004			
Acquisition costs	<u>-</u>	<u>-</u>	<u>-</u>
2003			
Acquisition costs	<u>3</u>	<u>-</u>	<u>3</u>

4 Investment Income

	<i>2004 £'000</i>	<i>2003 £'000</i>
Income from listed securities	15	7
Income from unlisted securities	221	291
Income from other sources	<u>180</u>	<u>191</u>
	<u>416</u>	<u>489</u>

Income from other sources represents income on deposits with credit institutions, short-term bank deposits and current accounts.

5 Investment Expenses and Charges

	<i>2004 £'000</i>	<i>2003 £'000</i>
Investment management expenses, including interest paid	<u>20</u>	<u>39</u>

6 Loss on Ordinary Activities before Tax

	<i>2004 £'000</i>	<i>2003 £'000</i>
Loss on ordinary activities before tax is after charging:		
Auditors' remuneration - audit	30	30
other services to auditor and associated undertakings	<u>6</u>	<u>6</u>
	<u>36</u>	<u>36</u>

Auditors' remuneration in respect of the Company was £4,000.

7 Remuneration of Directors

No Director received remuneration for services to the Group in either year.

Highlands Holdings (UK) Limited

Notes to the Accounts (continued) for the year ended 31 December 2004

8 Staff Numbers and Costs

No staff were employed by the Group in either year.

9 Investments	Current Value		Cost	
	2004 £'000	2003 £'000	2004 £'000	2003 £'000
Other financial investments				
Other fixed interest securities	2,249	4,291	2,281	4,374
Deposits with credit institutions	<u>13,967</u>	<u>11,543</u>	<u>13,967</u>	<u>11,543</u>
	<u>16,216</u>	<u>15,834</u>	<u>16,248</u>	<u>15,917</u>

10 Share Capital	2004 £'000	2003 £'000
Authorised:		
10,000,000 ordinary shares of £1	<u>10,000</u>	<u>10,000</u>
Issued, called up and fully paid:		
4,870,001 ordinary shares of £1	<u>4,870</u>	<u>4,870</u>

11 Profit and Loss Account	Company £'000	Group £'000
2004		
At 1 January	82	(4,208)
Currency translation differences on foreign currency net assets	-	(63)
Loss for the year	-	(115)
At 31 December	<u>82</u>	<u>(4,386)</u>
2003		
At 1 January	82	(2,480)
Currency translation differences on foreign currency net assets	-	(206)
Loss for the year	-	(1,522)
At 31 December	<u>82</u>	<u>(4,208)</u>

12 Reconciliation of Movements in Equity Shareholders' Funds

	Group		Company	
	2004 £'000	2003 £'000	2004 £'000	2003 £'000
Loss for the financial year	(115)	(1,522)	-	-
Restatement of foreign currency net assets	<u>(63)</u>	<u>(206)</u>	-	-
	(178)	(1,728)	-	-
Opening shareholders' funds	<u>662</u>	<u>2,390</u>	<u>4,952</u>	<u>4,952</u>
Closing shareholders' funds	<u>484</u>	<u>662</u>	<u>4,952</u>	<u>4,952</u>

Notes to the Accounts (continued)
for the year ended 31 December 2004

13 Claims Outstanding

	Gross £'000	Reinsurance £'000	Net £'000
2004			
Notified outstanding claims	36,237	28,193	8,044
Claims incurred but not reported	<u>29,905</u>	<u>24,901</u>	<u>5,004</u>
	66,142	53,094	13,048
Claims handling expenses	<u>1,095</u>	-	<u>1,095</u>
	67,237	53,094	14,143
Bad debt provision	-	<u>(6,522)</u>	<u>6,522</u>
	<u>67,237</u>	<u>46,572</u>	<u>20,665</u>
2003			
Notified outstanding claims	67,856	55,323	12,533
Claims incurred but not reported	<u>32,394</u>	<u>29,545</u>	<u>2,849</u>
	100,250	84,868	15,382
Claims handling expenses	<u>1,298</u>	-	<u>1,298</u>
	101,548	84,868	16,680
Bad debt provision	-	<u>(6,986)</u>	<u>6,986</u>
	<u>101,548</u>	<u>77,882</u>	<u>23,666</u>

14 Segmental Reporting

(a) Analysis by Class

	Direct & Fac £'000	MAT £'000	Reinsurance Property £'000	Other £'000	Total £'000
2004					
Gross premiums written and earned	-	47	12	10	69
Gross claims incurred	(537)	22,784	2,835	1,131	26,213
Gross operating expenses	-	-	-	-	-
Gross technical result	(537)	22,831	2,847	1,141	26,282
Reinsurance balance	<u>422</u>	<u>(20,716)</u>	<u>(2,837)</u>	<u>(2,506)</u>	<u>(25,637)</u>
Net technical result	<u>(115)</u>	<u>2,115</u>	<u>10</u>	<u>(1,365)</u>	<u>645</u>
Net technical provision	<u>561</u>	<u>7,706</u>	<u>2,132</u>	<u>10,266</u>	<u>20,665</u>
2003					
Gross premiums written and earned	-	110	38	33	181
Gross claims incurred	(668)	11,340	(1,450)	4,025	13,247
Gross operating expenses	-	(2)	(1)	-	(3)
Gross technical result	(668)	11,448	(1,413)	4,058	13,425
Reinsurance balance	<u>243</u>	<u>(9,981)</u>	<u>548</u>	<u>(5,642)</u>	<u>(14,832)</u>
Net technical result	<u>(425)</u>	<u>1,467</u>	<u>(865)</u>	<u>(1,584)</u>	<u>(1,407)</u>
Net technical provision	<u>476</u>	<u>11,308</u>	<u>2,091</u>	<u>9,791</u>	<u>23,666</u>

14 Segmental Reporting (Continued)

(b) Analysis of gross premiums by geographical segment

	2004 £'000	2003 £'000
United Kingdom	35	93
Rest of Europe	7	19
USA	4	9
Rest of World	<u>23</u>	<u>60</u>
	69	181
Less: Acquisition costs	<u>-</u>	<u>(3)</u>
	<u>69</u>	<u>178</u>

15 Taxation

Taxation

There is no corporation tax charge for the period.

Factors affecting tax charge for the period

	2004 £'000	2003 £'000
Loss on ordinary activities before tax	<u>(115)</u>	<u>(1,522)</u>
Loss on ordinary activities at the standard rate of corporation tax of 30%	(35)	(457)
Tax (deductible)/chargeable foreign exchange movement charged to reserves	(19)	(61)
Increase in deferred taxation asset not recognised	<u>54</u>	<u>518</u>
Tax charge for the period	<u>-</u>	<u>-</u>

At 31 December 2004, the Group had approximately £14million (2003 £14 million) of trading losses which have not been recognised as a deferred taxation asset. This is because, on the basis of all available evidence, it cannot be regarded as more likely than not that there will be suitable taxable profits against which these losses can be deducted.

16 Related Party Transactions

The ultimate controlling party is Highlands Insurance Group Inc. The Company is included within the consolidated financial statements of Highlands Insurance Group Inc. The only related party transaction is the quota share reinsurance agreement between Highlands Insurance Company (UK) Limited and Highlands Insurance Company. The amounts are disclosed under Note 1(a).

Notes to the Accounts (continued)
for the year ended 31 December 2004

17 Reconciliation of Loss on Ordinary Activities before Tax to Net Cash Outflow from Operating Activities

	2004 £'000	2003 £'000
Loss on ordinary activities before tax	(115)	(1,522)
Decrease/(Increase) in debtors, prepayments and accrued income	(1,389)	7,880
(Decrease)/Increase in creditors, accruals and deferred income	604	(7,869)
Increase/(Decrease) in net technical provisions	(3,001)	(2,469)
Realised and unrealised losses/(gains)	97	146
Exchange rate translation movement	<u>(63)</u>	<u>(206)</u>
Net cash outflow from operating activities	<u>(3,867)</u>	<u>(4,040)</u>

18 Subsidiary Undertakings

The Group owns 100% of the ordinary share capital and controls 100% of the voting rights in the following companies:

Company	Nature of Business
Highlands Insurance Company (U.K.) Limited	General Insurance
Highlands Underwriting Agents Limited	Claims handling and management services

19 Contingent Liabilities

The Group has no contingent liabilities other than those arising out of insurance contracts and other agreements entered into in the normal course of business and in respect of related litigation.

20 Ultimate Parent Company

The immediate and ultimate parent company and parent of the only group in which the Company's results are consolidated is Highlands Insurance Group Inc, incorporated in the State of Delaware, USA. Given the financial position of the Highlands Insurance Group Inc as referred to in note 1 (a), full audited accounts have not been prepared for this company.