

Important notice

Scheme Creditor

2 April 2013

Ref: GHH/SJE/MMI

Direct line: 020 7951 9955

Email: sellis@uk.ey.com

Dear Sir

Municipal Mutual Insurance Limited (“MMI”)

Scheme of Arrangement

The directors of MMI “triggered” MMI’s Scheme of Arrangement (“the Scheme”) under section 425 of the Companies Act 1985 (now section 899 of the Companies Act 2006) on 13 November 2012. From that date I became responsible for the management of the MMI’s business, affairs and assets in accordance with the terms of the Scheme.

A copy of the Scheme document is available on MMI’s website: www.mminsurace.co.uk

The Levy Period

The Scheme provides that following the occurrence of a Trigger Event, a Levy may be imposed on all those Scheme Creditors which, since the Record Date, have been paid an amount or amounts in respect of Established Scheme Liabilities which, together with the amount of Elective Defence costs paid by MMI on its behalf, exceed £50,000 in aggregate. Additionally, payments made after the imposition of a Levy in respect of Established Scheme Liabilities to such Scheme Creditors will be made at a reduced rate (“the Payment Percentage”).

Guidance on expected initial Levy rate

Since 13 November 2012 I have carried out a review of the assets and liabilities of MMI, as required by the Scheme, in order to determine whether a Levy on Scheme Creditors is required as set out in the Scheme. I have concluded that such a Levy will be required in the near term and wish to advise Scheme Creditors that the initial rate of the Levy will be 15% when I raise the first Levy notice. I presented the findings of my review to the Creditors’ Committee on 12 February 2013 and have consulted with members of the committee regarding my conclusions and recommendations.

The proposed 15% Levy rate

As part of my review of the assets and liabilities of MMI, I commissioned KPMG to carry out an updated actuarial review of the insurance liabilities of MMI as at 31 December 2012. The projection of future claims is uncertain and for this reason KPMG presented a range of estimates of MMI’s remaining liabilities from a low estimate of £189 million to a high estimate of £379 million.

Using this information, other information gathered as part of my review and a range of assumed investment returns, I have modelled a number of projected outcomes for MMI. The model indicates that a Levy of between 9.5% and 28% is required to achieve a projected solvent run-off.

Having consulted with MMI’s actuaries and the Creditors’ Committee, I have concluded that the most appropriate scenario to adopt is to utilise KPMG’s midpoint estimate of remaining liabilities of £247 million and an investment return assumption of 2.5%. Using these assumptions a 15% Levy is required to achieve a projected solvent run-off. I therefore intend to set the initial Levy rate at 15%.

The Scheme requires me to review the Levy rate at least once every 12 months and includes provisions for the rate to be adjusted up or down, as the liability trends evolve and the book develops. Because of the latent nature of many of the claims that MMI is still receiving and the fact that many of

the trends in reporting continue to be adverse, the projections are subject to substantial uncertainty. It is not possible therefore to guarantee that the initial levy percentage of 15% will be sufficient or indeed the remaining liabilities will fall within the range projected by KPMG. These projections should be viewed only as a best estimate given information currently available. Scheme Creditors will receive regular updates on any movement in the actuarial projection throughout the operation of the Scheme.

The Payment Percentage

Immediately following the setting of a Levy I am required by the Scheme to instigate payment of all claims of Scheme Creditors at the Payment Percentage, being 100% less the Levy. Consequently the initial Payment Percentage will be 85%.

Post Levy claims handling procedures

Zurich currently handles claims on behalf of MMI and manages the payment of the majority of MMI's claims. In the post Levy period Zurich will continue to administer and agree settlement of claims received, but will no longer be able make indemnity payments on behalf of policyholders. The restriction on payment is due to:

- the requirement that, post Levy, the payment percentage must be applied to all payments made in respect of claims; and
- the requirement that amounts paid to Scheme Creditors are adjusted where MMI has paid Elective Defence Costs, as defined in the Scheme.

It is therefore going to be necessary for me to instigate a new procedure for the payment of claims post the Levy to accommodate the above adjustments. I am currently working with Zurich on the design and implementation of a new procedure for claims handling and payment but, due to the age and limitations inherent in the current claims database, I anticipate that this may take a number of months to complete.

Until the new system is operational, MMI will continue to pay claims in full and the Levy will not be imposed.

Timetable

MMI will provide all Scheme Creditors with their normal sixth monthly Scheme statement in April 2013. This will provide Scheme Creditors with an estimate of the Levy charge they should expect at the proposed 15% rate based upon the position as at 31 March 2013.

I am working towards finalisation of the new claims handling procedure and will provide Scheme Creditors with details of the new system once it is complete.

The Levy will only be raised once the new procedure is operational. It is not possible to give an estimate of that date but I will provide Scheme Creditors with at least 30 days notice of the proposed Levy date once it is known.

Creditor contacts and addresses

As I will need to communicate a number of important issues with Scheme Creditors I wish to check that the contact records of MMI are up to date and complete. I should therefore be grateful if you would complete and return the attached contact schedule to MMI by post or by e-mail to sw@mminsurance.co.uk.

Protected Creditors

Some creditors may be entitled to protection from the Levy and the Payment Percentage provision if they were eligible for the protection of the Policyholders Protection Board ("PPB"), now the Financial Services Compensation Scheme ("FSCS"), at the time the Scheme was approved on 30 September 1993 (the "Record Date"). Any creditor entitled to protection will be required to complete a form for submission to the FSCS for certification. I will shortly be providing creditors noted in MMI's records as

potentially protected with the relevant form to complete and return to MMI for submission to the FSCS.

If you require any further information please direct your questions in the first instance to MMI or you may contact my colleague Sarah Ellis at sellis@uk.ey.com.

Yours faithfully
For MMI

A handwritten signature in black ink, appearing to read "Gareth Hughes".

Gareth Hughes
Scheme Administrator

Please complete and return by post to Ian Willett at MMI Insurance, 29 Buckingham Gate, Westminster, London, SW1E 6NF or by email to sw@mminsurace.co.uk.

MMI Scheme of Arrangement: Scheme Creditor Contact Details

MMI Scheme Number:

Original Creditor Name:

Current Creditor Name:

**Key Creditor Contact
Name**

Title:

Department:

Address:

Postcode:

E-mail

**Direct dial telephone
number**

Office telephone number

Office fax number
