



ace european group

A decorative graphic consisting of three overlapping rectangular blocks. A blue block is at the top left, a green block is at the bottom left, and a dark grey block is in the center, overlapping the other two. The text is centered within the dark grey block.

Annual Report and
Financial Statements
31 December 2006

ACE European Group Limited

ACE European Group Limited

Registered Office:
ACE Building
100 Leadenhall Street
London EC3A 3BP
United Kingdom

Authorised and
Regulated by the
Financial Services Authority

Registered in England
Number 1112892

ACE European Group Limited

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Chairman's Report

31 December 2006

Performance in 2006

Since its reauthorisation in 2003, ACE European Group Limited ("AEGL") has grown to become one of Europe's leading insurance and reinsurance players, with a 2006 premium base approaching £2 billion. The company has gone from strength to strength, and the 2006 financial results are most encouraging. Pre-tax profits amounted to £143.7 million, reflecting the company's continued focus on underwriting discipline and cost control during a period in which underwriters were faced with increasingly challenging market conditions and relentless competition. Shareholders' funds at the close of the financial year were £685.7 million, against which a dividend of £80.0 million will be made.

Significant achievements in 2006

AEGL prides itself on its endeavours to offer high service standards and continually analyses its business processes in order to achieve greater operational efficiencies. In line with this strategy, the company's UK & Ireland service and processing functions are being centralised in a new operational department in Glasgow's financial district, with the aim of improving delivery and providing an enhanced client and broker interface. This move forms a key part of AEGL's ongoing strategy to continually improve standards of service, while keeping pace with the insurance industry's competitive and regulatory environments.

The company embraces the continuing changes in the regulatory environment. The shift in emphasis from the Financial Services Authority's ("FSA") rules-based regulation to principle-based regulation has been demonstrated by the publication in July 2006 of the FSA's "Treating Customers Fairly" ("TCF") document. AEGL has taken a number of significant steps in making the principles of TCF an integral part of its business culture and has established a steering committee to oversee their implementation within the accident & health division. Contract certainty was also a key issue for AEGL underwriters, particularly in the UK, and remains an ongoing priority for 2007. In Continental Europe, where contract certainty is not currently a local regulatory issue, underwriters are aiming to make it a point of differentiation, thereby attracting the broking community to work with a more reliable carrier.

In October 2006, A.M. Best announced its decision to upgrade the financial strength rating of AEGL to "A+ (Superior)" from "A (Excellent)". As AEGL now carries "A+" ratings from both A.M. Best and Standard & Poor's, clients and brokers can be confident that they are doing business with a stable and reliable partner.

Management & organisational changes

Richard Pryce has had responsibility for the ACE Global Markets ("AGM") branded business written in both AEGL and Syndicate 2488 at Lloyd's since 2003. In January 2007, Richard's responsibilities were expanded to include the management of the ACE Europe branded UK & Ireland property & casualty business written through AEGL. Whilst maintaining the distinct brands of AGM and ACE Europe and their separate underwriting management structures, this new arrangement will enable both underwriting units to work more closely together, to better leverage the synergies of both brands, to achieve greater efficiencies and most importantly, to further enhance AEGL's service capabilities for both clients and brokers.

Also in early 2007, David Furby, President of ACE Continental Europe, assumed additional responsibility for AEGL's Central and Eastern Europe operations. This combined management approach will further focus strategy in relation to the company's expanding geographical presence and drive AEGL's development throughout these economic areas.

Future prospects

AEGL's core business approach focuses on maintaining underwriting discipline whilst preserving its leadership position, remaining alert to new opportunities and ensuring that service levels are amongst the best in the market. AEGL is recognised as a sound, technical underwriting company. In order to continue to build the business, we will need to focus on product development, sales and distribution, and not least, operational excellence. Management will drive process change and improvements throughout all aspects of AEGL's service delivery, building upon the company's existing strengths for service and innovation, especially in the use of technology to the benefit of clients and brokers.

Chairman's Report

31 December 2006

In conclusion

AEGL has a strong franchise, solid balance sheet, a broad product base and good producer relationships. Above all, it has talented people and a strong underwriting culture – vital ingredients in today's market. AEGL is a great company, with a great ethos, great people and great franchises. There is an enthusiasm and optimism in our company that endures regardless of market conditions, and I would like to take this opportunity to thank the management teams and staff throughout the UK and Europe for their hard work and dedication.

A J Kendrick

Chairman and Chief Executive Officer

13 March 2007

Business Review

31 December 2006

Business Review

The board of AEGL has prepared this review in accordance with Section 234ZZB of the Companies Act 1985. As well as meeting this statutory requirement, the board has extended the review to deal with other aspects of the company's business which were addressed in its Management Review last year. The board believes that this additional material will be of benefit to all stakeholders.

Business objectives and strategy

AEGL is a major contributor to the ACE Group of Companies, providing just over 20% of the ACE Group's overall gross written premium for 2006. The ACE Group is one of the world's few truly global insurance and reinsurance organisations and serves a wide variety of clients, ranging from large multinational corporations to smaller clients in local markets. With offices in more than 50 countries and the authority to transact business in over 140, the ACE Group focuses on building global operations diversified by region and business line. This diverse product mix and extensive global presence give it competitive advantage and enhanced financial stability.

AEGL underwrites a well diversified portfolio, encompassing UK and Continental Europe property & casualty and accident & health insurance, London market, US and international specialty business, and treaty reinsurance.

AEGL's key focus is on maintaining underwriting discipline and providing professional service levels which the company endeavours to be amongst the best in the market. The company will continue to capitalise on its product and geographical diversification, combined with its proven expertise as a lead insurer to secure a position as a long term insurer to many clients. The flexibility embedded within the company provides the potential, if required, to switch resources from business units where market conditions are unfavourable to those areas where there is maximum opportunity for profitable growth.

Organisation of the business

Insurance and reinsurance policies are written under the well established "ACE Europe", "ACE Global

Markets" and "ACE Tempest Re (Europe)" brands which fully capitalise on AEGL's strong platform, reputation, skill sets, financial strength ratings and consistent management philosophy. AEGL is a business facing underwriting operation with an effective delivery mechanism for clients and brokers looking for local expertise combined with global knowledge and security.

ACE Europe provides tailored insurance solutions for a diverse range of clients. Its product range includes property, primary & excess casualty, financial lines, surety, marine cargo and construction related risks. ACE Europe also underwrites an accident & health and travel insurance portfolio, providing benefits and services to individuals, employee groups and affinity groups throughout Europe. ACE Europe is renowned for its flexible and committed approach and its success can be attributed to many factors; most notably the depth of underwriting expertise and the autonomy that each regional office retains over its underwriting decisions. ACE Europe has successfully blended the knowledge of its local markets with the worldwide perspective available through the global organisation, making it a major force in Europe. The principal business segments of ACE Europe are managed as UK & Ireland property & casualty ("P&C"), Continental Europe P&C and accident & health ("A&H").

ACE Global Markets ("AGM") is the ACE Group's specialty international underwriting business. Its parallel distribution capabilities mean that underwriting products may be offered through both AEGL and Syndicate 2488 at Lloyd's. This flexibility allows AGM to provide risk solutions to clients in over 150 countries throughout the world, including a significant presence in the US. The underwriting team prides itself on its technical approach to evaluating risk and, combined with a strong commitment to high levels of service to both clients and brokers, can react quickly to a changing market. AGM's product range covers principally excess and surplus lines ("E&S") business, aviation, financial lines, property, marine, energy and political risks.

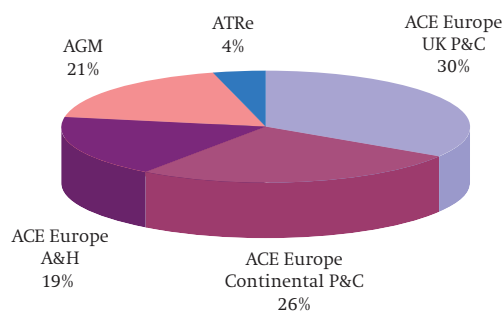
ACE Tempest Re (Europe) ("ATRe") is the ACE Group's inwards reinsurance business writing a wide-ranging portfolio across property and liability treaty classes,

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operating both in London and on the Continent. The operation is dedicated to working with both clients and brokers in a combined effort to create products that are of genuine value to all parties; this is demonstrable by its ability to quote and lead most lines of treaty business. ATRe offers clients a technical approach to risk solutions and prides itself on the team's significant underwriting and analytical experience. Treaty underwriting capabilities include casualty, property, marine and aviation, with products offered through both AEGL and Syndicate 2488 at Lloyd's.

Calendar year 2006 gross written premium split



In recognition of current market opportunities, changes and challenges, the company has been organised into three management streams: ACE UK, led by Richard Pryce and encompassing AGM and ACE Europe UK & Ireland P&C business; Continental Europe P&C, headed by David Furby; and A&H, headed by Edward Levin. This streamlined senior management team assists Andrew Kendrick in setting strategic direction for the business and overseeing the day-to-day operation of the company.

As at 31 December 2006, AEGL had branch offices in 16 countries across Europe, held cross-border permissions in 27 European Economic Area countries and was eligible to underwrite E&S business in 41 US states. AEGL is also able to underwrite risks and issue reinsurance policies to insurance companies throughout most of the world's markets on a non-admitted basis. Business is accessed by a variety of distribution methods and the company has strong relationships with the broker community, corporate partners and direct markets.

In line with AEGL's objective of improving client and broker access to ACE underwriting expertise in Europe, the company has initiated plans to open branch offices in Portugal, Hungary and the Czech Republic. Regulatory approvals were received for each of these three branches in June 2006, December 2006 and February 2007 respectively.

In late 2006, an application was submitted to the FSA to underwrite European term life and credit life business in a new UK life insurance company, ACE Europe Life Limited, to compliment the accident and health portfolio currently underwritten in AEGL.

Business environment

With the continued growth of the insurance industry capital base on the back of record results, AEGL operates in a market with a surplus of new and revitalised capacity. This, together with the recent benign claims environment has led to aggressive competition from a wide range of insurers and increased pressure on pricing, particularly in non-catastrophe exposed property and casualty lines. Product rates, terms and conditions are constantly evolving to reflect the changing market environment and AEGL prides itself on its ability to manage the business throughout the insurance cycle and achieve a profit in all product lines, regardless of market conditions. As a significant market player with a broad product offering and an expanding geographic reach, AEGL is serving the needs of an increasingly larger and more diverse customer base; as a result, new business opportunities continue to present themselves.

Presentation of financial statements

The financial statements have been prepared in accordance with the Statement of Recommended Practice on Accounting for Insurance Business issued by the Association of British Insurers and applicable accounting standards in the UK.

The year has seen some changes in accounting policies as UK GAAP converges with International Financial Reporting Standards. The accounting treatment for foreign currency transactions has been revised arising from the introduction of Financial Reporting Standard

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23 “The effects of changes in foreign exchange rates”. This has led to the restatement of the comparative profit and loss account for 2005. Financial Reporting Standard 26 ‘Financial Instruments: measurement’ has been implemented. This had the impact of grossing up the financial instruments on the balance sheet and requires further financial statement disclosure; there is no impact on the net valuation of AEGL’s financial instruments. Finally, Financial Reporting Standard 20 ‘Share based payment’ has also been introduced this year with minimal impact on AEGL.

Key performance indicators

The board has defined the following as being the financial key performance indicators (“KPIs”) for the business. These KPIs are reviewed through the quarterly board meetings.

| £ million | 2006 | 2005 (restated) |
|----------------------|-------|--------------------|
| Net written premiums | 779.8 | 846.6 |
| Combined ratio* | 86.2% | 82.7% |
| Profit before tax | 143.7 | 230.0 |
| Dividend proposed | 80.0 | 120.0 |

* Ratio of net claims incurred, commission and expenses to net premiums earned.

The board also monitors the capital needs of the company. Further details in this regard are set out in the Financial position section of this Business Review.

Management also use a variety of other performance indicators including production volumes, retention ratios, price monitoring, loss and expense analyses, and operating metrics in assessing the performance of each of the individual business segments. All financial results are monitored against plan, forecast and prior year on at least a quarterly basis.

Results and performance

2006 produced a solid pre-tax operating profit of £143.7 million and a combined ratio of 86.2%.

A summary of the reported financial results is shown in the following table.

| £ million | 2006 | 2005 (restated) |
|-------------------------------|---------|--------------------|
| Gross written premiums | 1,962.5 | 1,888.0 |
| Net written premiums | 779.8 | 846.6 |
| Net earned premiums | 784.8 | 858.2 |
| Incurred losses | 432.1 | 460.5 |
| Operating expenses | 244.3 | 249.5 |
| Equalisation reserve movement | 16.6 | 12.6 |
| Underwriting profit | 91.8 | 135.6 |
| Investment return | 58.3 | 87.3 |
| Other income (charges) | (6.4) | 7.1 |
| Net pre-tax profit | 143.7 | 230.0 |
| Combined ratio % | 86.2% | 82.7% |

In 2006, gross written premiums increased by 4%, predominantly reflecting the higher rates achieved in those lines of business impacted by the hurricane activity of 2005. This top line growth was slightly below original expectations which assumed a more significant and faster market reaction in pricing following these loss events.

The company purchases reinsurance to mitigate the impact of major events and an undue frequency of smaller losses. The principal reinsurance programme in operation during 2006 was with an ACE Group company, ACE Tempest Reinsurance Ltd. AEGL also has the benefit, particularly for US and worldwide catastrophe exposures, of reinsurance programmes shared with other ACE companies, including ACE European Group’s Lloyd’s Syndicate 2488. These arrangements result in an increase in the reinsurance purchasing power of the ACE Group, which ultimately benefits all ACE subsidiaries including AEGL.

The 2006 results benefited from lower than average large loss activity due to the absence of significant natural catastrophes during the year, particularly in comparison to the high level of hurricane activity experienced in 2005. The results also benefit from the release of prior year loss reserves in a number of business classes. Despite these factors, the 2006 combined ratio is higher than that of 2005, due principally to the increased rates for the excess of loss reinsurance protections purchased by the company.

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Operating expenses constitute commissions and general administrative expenses. The business continues to focus on the management of each of these components; the positive containment of overall expenses this year was predominantly a result of the effect of business mix on commission levels.

Investment returns for 2006 were lower than those achieved in 2005, reflecting the challenging year in respect of sterling and euro fixed income grade investments.

Financial position

The bulk of AEGL's investment portfolios continue to be managed by Barclays Global Investors and Western Asset Management. A new equity portfolio, managed by Alliance Bernstein, was established in the latter part of 2006.

AEGL maintains four active investment grade fixed income portfolios, the core currencies of which are sterling, euros and US dollars, and two equity portfolios investing in a broad range of European and global equities. Two passive portfolios are maintained: a sterling gilt portfolio, which acts as collateral for letter of credit issuance, and a small Swiss franc portfolio, established to meet local solvency requirements. The approximate currency split of the AEGL investment portfolios is sterling 51%, euros 28%, US dollars 16% and other 5%.

The year proved challenging for European investment grade fixed income investors as yields rose in the major European economies. This resulted in poor absolute total returns for the bulk of the investments held in sterling and euros. Total returns for US dollar fixed income investments were reasonable as yields rose more modestly. However, total returns benefited from a strong equity performance which continued throughout the year.

In 2006, AEGL entered into a securities lending agreement with State Street Bank and Trust which permits the lending of up to 40% of the aggregate investment portfolios to approved counterparties subject to limit restrictions. AEGL and fellow ACE Group companies also entered into a notional pooling facility

with Bank Mendes Gans, a subsidiary of ING, to facilitate individual short term currency overdrafts for individual participants and hence improve immediate liquidity.

AEGL maintains an efficient capital structure consistent with the company's risk profile and regulatory and market requirements. The company assesses its capital needs on a risk management basis, and then seeks to maintain financial strength and capital adequacy to support business growth and meet the requirements of policyholders, regulators and rating agencies whilst retaining financial flexibility by ensuring strong liquidity. After these factors have been taken into account, it is the policy of the company to distribute surplus capital to the ACE Group in the form of dividends. The directors have proposed a dividend of £80.0 million at the board meeting on 13 March 2007. The balance sheet at 31 December 2006 discloses the shareholders' funds of the company at £685.7 million; accordingly these will be reduced by the dividend payment to be made in 2007.

AEGL manages its capital levels in the context of the minimum requirement, the Capital Resources Requirement and the Enhanced Capital Requirement which computes a capital level using an allowance for industry risk factors related to premiums, reserves and assets. The FSA has also issued the company with Individual Capital Guidance derived from the company's own Individual Capital Assessment ("ICA"). The company maintains a comfortable margin against each of these key capital measures based on the adjusted shareholders' funds of £605.7 million.

AEGL holds financial strength ratings of "A+ (Superior)" by A.M. Best and "A+ (Strong)" by Standard & Poor's. Both ratings have a stable outlook.

The A.M. Best rating was upgraded from "A (Excellent)" in October 2006. The upgrade to "A+" reflects A.M. Best's expectation that AEGL will maintain strong stand alone risk adjusted capitalisation between 2006 and 2008, and also the importance of AEGL to the ACE Group. The rating also factors AEGL's good anticipated performance and solid combined ratios, and its robust market position in the UK and across Continental Europe.

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31 December 2006

The Standard & Poor's "A+" rating was affirmed in December 2006. Standard & Poor's consider AEGL to be core to the ACE Group, and hence any rating actions applied at a group level will also impact the AEGL rating. The ACE Group's major rating factors include its strong global presence, operating performance, financial flexibility and capital adequacy.

Principal risks & uncertainties and risk management

The process of risk acceptance and risk management is addressed through a framework of policies, procedures and internal controls. All policies are subject to board approval and ongoing review by management, risk committee and internal audit. Compliance with regulation, legal and ethical standards is a high priority for the company and the compliance team and finance department take on an important oversight role in this regard. A principle committee of the board, the audit committee, is responsible for satisfying itself that a proper internal control framework exists to manage financial risks and that controls operate effectively.

The company has developed a framework for identifying the risks to which each business sector, and the company as a whole, is exposed and their resultant impact on economic capital. This process is risk based and uses ICA principles to manage capital requirements and to ensure the financial strength and capital adequacy required to support the growth of the business and meet the requirements of policyholders, regulators and rating agencies is in place.

The principal risks from the general insurance and reinsurance business arise from inaccurate pricing; fluctuations in the timing, frequency and severity of claims compared to expectations; inappropriate reinsurance protection; and inappropriate reserving. AEGL's underwriting and reinsurance strategies are approved by the board and communicated clearly throughout the business through policy statements and guidelines.

The company is controlled through its board of directors, comprising of the executive management team and three non-executives. The role of a non-executive director is to constructively challenge

management, help develop proposals on strategy and to bring strong independent judgement, knowledge and experience to the board's deliberations. The board meets at least quarterly and delegates certain oversight responsibilities to committees with formal terms of reference (including audit, risk, investment, reserving and reinsurance security committees). The quarterly meetings focus upon financial information, strategic decisions and the proper oversight of the management of the business, systems and controls, and senior management responsibility.

A dedicated compliance team, as well as a dedicated internal audit team ensure that the company understands and complies with all applicable requirements. Annual affirmation of the ACE Group Code of Conduct is required of all employees and directors. As a material subsidiary of ACE Limited, a US listed company, the control environment in which the US GAAP financial statements are derived is subject to the requirements of US Sarbanes-Oxley legislation. The company has formalised documentation and tested controls to enable ACE Limited to fulfil the requirements of this legislation.

AEGL continues to develop its risk management framework. The risk committee develops and oversees the implementation of a practical framework for identifying and mitigating risk within the company. AEGL has created a risk register to record and monitor business risks and controls to support the capital modelling requirements of the ICA.

The board reviews and approves the ICA and the annual business plan for the company, which includes strategy, limits, and reinsurance protections for each line of business. Risks and line sizes are continually monitored through the established peer review process and regular exception reporting. Formal price monitoring procedures have been in place since early 2002 and form part of the standard monthly management statistics. These contribute to the quarterly actuarial review whereby the outcome of the underwriting activity is continually re-assessed and considered by the reserve committee. With such a large and diverse book, it is vital that AEGL's aggregate exposures are continually monitored and adjustments

Business Review

31 December 2006

made to the underwriting profile as appropriate. The company operates a dedicated catastrophe management function, and risks are modelled to assist in determining pricing for individual policies, providing a key control to the underwriting process.

Employees

Details of the number of employees and related costs can be found in note 7 to the financial statements.

Applications for employment by disabled persons are always fully considered, bearing in mind the aptitudes of the applicant concerned. In the event of members of staff becoming disabled, every effort is made to ensure that their employment with the company continues and that appropriate training is arranged. It is the policy of the company that the training, career development and promotion of disabled persons should, as far as possible, be identical with that of other employees.

The company participates in the policies and practices of the ACE Group to keep employees informed on matters relevant to them through regular meetings, presentations and the global intranet. The ACE Group's employee share scheme continues to operate successfully and is open to all employees.

Outlook

It is anticipated that competition will remain intense in many business classes during 2007, and as the insurance cycle continues its downwards trend, underwriters may have to forgo revenue growth in some classes to ensure a reasonable underwriting profit. However, AEGL is a large organization with broad capabilities and tremendous geographic reach, creating opportunities for growth without compromising underwriting standards.

In the current environment, there are likely to be more opportunities for premium growth within the A&H and Continental Europe P&C businesses than in AGM and the UK retail market.

One such example is the potential to grow AEGL's middle market presence in Germany. This initiative focuses on significantly increasing the volume of broker

produced accounts by delivering a broad cross-section of general and specialty tailored products through an expanded regional network of experienced underwriters. Management are also looking to complement AEGL's successful A&H operations in the Nordic region by expanding ACE Europe's P&C reach, particularly in Sweden and Denmark, to take advantage of the improving trading conditions and greater market discipline. The recently opened office in Portugal will also provide additional underwriting opportunities.

A&H objectives include accelerating the growth of AEGL's direct marketing business in both the UK and Continental Europe, with a focus on building stronger technical marketing and account management skills. Underwriters are also looking to deepen relationships with key brokers, particularly in the personal accident field. Another key priority for 2007 is the roll out of ACE branded A&H products to business partners and consumers through AEGL's expanding branch network in Central and Eastern Europe.

AEGL will continue to campaign for transparency of broker remuneration whilst strengthening relationships with the broking community. The restructuring taking place within the major international brokers will present both opportunities and challenges to the company. However, as a recognised insurer of choice by both clients and brokers, it is anticipated that business submission flow will remain robust.

In order to maintain profitability, AEGL will continue to embed operating efficiencies throughout the company, particularly with regard to the processing of underwriting transactions.

In summary, AEGL is well placed to capitalise on the insurance environment this year by focusing on the continuing proper selection, pricing and ongoing management of the risks the company accepts.

Approved by the Board of Directors

13 March 2007

Directors' Report

31 December 2006

The directors are pleased to submit their report and the audited financial statements for the year to 31 December 2006.

Principal activity

The principal activity of the company is the transaction of general insurance and reinsurance business.

Business review

A review of the company's activities and its future prospects is set out in the Business Review that precedes this Directors' Report.

Results and dividends

The company made a profit on ordinary activities before tax for the year to 31 December 2006 of £143.7 million (2005 restated: £230.0 million).

The directors have proposed a dividend of £80.0 million on 13 March 2007.

Employees

Staff based in the company's branches outside the UK are directly employed by the company. Staff that support the UK branch operations of the company are employed by an affiliate, ACE INA Services U.K. Limited. Their costs are included in management recharges from this service company.

Directors

The following have been directors from 1 January 2006 to the date of this report unless otherwise indicated:

Executive directors:

R L Cigelnik (Resigned 31 January 2007)
P M Curtis
D M A Furby
M G Furgueson (Resigned 18 January 2007)
A J Kendrick
E M Levin
R P Murray
R V Pryce

Non-executive directors:

R V Emerson
D S Marston
G D Williams

The company has the benefit of a group insurance company management activities policy effected by ACE Limited. No charge was made to the company during the year for this policy.

Directors' interests

In accordance with The Companies (Disclosure of Directors' Interests) (Exceptions) Regulations 1985 (SI 1985/802), the directors' interests in ACE Limited, the ultimate holding company, are not disclosed in these financial statements.

Directors' Report

31 December 2006

Financial risk management

Information on the use of financial instruments by the company and its management of financial risk is disclosed in note 1 to the financial statements. In particular the company's exposures to equity price risk, credit risk and liquidity risk are separately disclosed in that note. The company's exposure to cash flow risk is addressed under the headings of "Credit risk" and "Liquidity risk".

Statement as to disclosure of information to auditors

Each of the persons who is a director at the date of this report confirms that:

1. So far as each of them is aware, there is no information relevant to the audit of the company's financial statements for the year ended 31 December 2006 of which the auditors are unaware, and
2. The director has taken all steps that he/she ought to have taken in his/her duty as a director in order to make him/herself aware of any relevant audit information and to establish that the company's auditors are aware of that information.

Auditors

The company's auditors, PricewaterhouseCoopers LLP, have indicated their willingness to continue in office. On 15 January 2002 the company passed an elective resolution to dispense with the obligation to appoint auditors annually.

By Order of the Board

for and on behalf of
ACE London Services Limited
Secretary, 13 March 2007

ACE Building
100 Leadenhall Street
London
EC3A 3BP

Statement of Directors' Responsibilities

31 December 2006

The directors are required by the Companies Act 1985 to prepare financial statements for each financial period which give a true and fair view of the state of affairs of the company as at the end of the financial period and of the profit or loss of the company for the financial period.

The directors confirm that suitable accounting policies have been used and applied consistently, with the exception of changes arising on the adoption of new accounting standards in the year, and reasonable and prudent judgements and estimates have been made in the preparation of the financial statements for the year ended 31 December 2006. The directors also confirm that applicable accounting standards have been followed and that the financial statements have been prepared on a going concern basis.

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

The directors are responsible for the maintenance and integrity of the company's or the parent company's website on which these accounts may be published. Legislation in the UK concerning the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Independent Auditors' Report

to the members of ACE European Group Limited

We have audited the financial statements of ACE European Group Limited for the year ended 31 December 2006 which comprise the Profit and Loss account, the Balance Sheet, the Statement of Total Recognised Gains and Losses and the related notes. These financial statements have been prepared under the accounting policies set out therein.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

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 whether in our opinion the information given in the Directors' Report is consistent with the financial statements. The information given in the Directors' Report includes that specific information presented in the Business Review that is cross referred from the Directors' Report.

In addition, we report to you if, in our opinion, the company 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 other transactions is not disclosed.

We read other information contained in the Annual Report, and consider whether it is consistent with the audited financial statements. This other information comprises only the Chairman's Report, the Business Review and the Directors' Report. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. 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 company's circumstances, consistently applied and adequately disclosed.

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

Equalisation provisions

Our evaluation of the presentation of information in the financial statements has had regard to the statutory requirement for insurance companies to maintain equalisation provisions. The nature of equalisation provisions, the amounts set aside at 31 December 2006, and the effect of the movement in those provisions during the year on shareholders' funds, the balance on the general business technical account and profit before tax, are disclosed in notes 1 and 18 respectively.

Independent Auditors' Report

to the members of ACE European Group Limited

Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the company's affairs as at 31 December 2006 and of its profit for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the financial statements.

PricewaterhouseCoopers LLP

Chartered Accountants and Registered Auditors

London

13 March 2007

Profit and Loss Account

for the year ended 31 December 2006

| | Note | 2006 £'000 | 2005 (restated) £'000 |
|---|------|------------------|-----------------------------|
| Technical account – General Business | | | |
| Earned premiums, net of reinsurance: | | | |
| Gross premiums written – continuing operations | 2 | 1,962,095 | 1,885,904 |
| – discontinued operations | 2 | 358 | 2,078 |
| Gross premiums written | | 1,962,453 | 1,887,982 |
| Outward reinsurance premiums | | (1,182,665) | (1,041,368) |
| Net premiums written | | 779,788 | 846,614 |
| Change in the gross provision for unearned premiums | | (26,206) | 18,108 |
| Change in the provision for unearned premiums – reinsurers' share | | 31,253 | (6,503) |
| Earned premiums, net of reinsurance | | 784,835 | 858,219 |
| Claims incurred net of reinsurance: | | | |
| Claims paid: | | | |
| Gross amount | 2 | (715,064) | (978,576) |
| Reinsurers' share | | 420,729 | 716,293 |
| Net paid claims | | (294,335) | (262,283) |
| Change in the provision for claims outstanding: | | | |
| Gross amount | 2 | (373,726) | (150,389) |
| Reinsurers' share | | 235,962 | (47,829) |
| Change in the net provision for claims outstanding | | (137,764) | (198,218) |
| Claims incurred, net of reinsurance | | (432,099) | (460,501) |
| Net operating expenses | 4 | (244,311) | (249,458) |
| Change in the equalisation provision | 18 | (16,589) | (12,609) |
| Balance on the technical account for general business | | 91,836 | 135,651 |

Profit and Loss Account

for the year ended 31 December 2006

| | Note | 2006 £'000 | 2005 (restated) £'000 |
|--|------|----------------|-----------------------------|
| Non-technical account | | | |
| Balance on the general business technical account | | 91,836 | 135,651 |
| Investment income | 8 | 116,526 | 121,580 |
| Unrealised gains on investments | 8 | 19,382 | 21,913 |
| Investment expenses and charges | 8 | (20,452) | (27,934) |
| Unrealised losses on investments | 8 | (57,130) | (28,243) |
| Foreign exchange differences | | (6,833) | 6,554 |
| Other income | | 394 | 1,436 |
| Other charges, including value adjustments | | - | (918) |
| Profit on ordinary activities before taxation | | 143,723 | 230,039 |
| <i>Continuing operations</i> | | 144,167 | 227,738 |
| <i>Discontinued operations</i> | | (444) | 2,301 |
| Taxation on profit on ordinary activities | 9 | (61,191) | (77,813) |
| Profit for the financial year | | 82,532 | 152,226 |

Statement of Total Recognised Gains and Losses

for the year ended 31 December 2006

| | | 2006 £'000 | 2005 (restated) £'000 |
|---|----|---------------|-----------------------------|
| Profit for the financial year | | 82,532 | 152,226 |
| Currency translation differences | 16 | (4,375) | (7,927) |
| Actuarial gain (loss) recognised in relation to pension schemes | 16 | 615 | (1,470) |
| Movement on deferred taxation relating to pension liability | 16 | (203) | 498 |
| Total recognised gains relating to the year | | 78,569 | 143,327 |

Balance Sheet

at 31 December 2006

| | Note | 2006 £'000 | 2005 (restated) £'000 |
|--|------|-------------------------|-----------------------------|
| Assets | | | |
| Investments | | | |
| Other financial investments | 11 | 1,882,194 | 1,790,347 |
| Financial derivative instruments | 11 | 7,638 | 2,939 |
| Deposits with ceding undertakings | | 27 | 182 |
| | | <u>1,889,859</u> | <u>1,793,468</u> |
| Reinsurers' share of technical provisions | | | |
| Provision for unearned premiums | | 250,766 | 235,240 |
| Provision for claims outstanding | | 1,685,015 | 1,498,943 |
| | | <u>1,935,781</u> | <u>1,734,183</u> |
| Debtors – amounts falling due within one year | | | |
| Debtors arising out of direct insurance operations: | | | |
| amounts owed by policyholders | | 2,406 | 2,576 |
| amounts owed by intermediaries | | 335,672 | 361,385 |
| Debtors arising out of reinsurance operations | | 208,089 | 173,660 |
| Other debtors | 12 | 93,498 | 79,966 |
| | | <u>639,665</u> | <u>617,587</u> |
| Other assets | | | |
| Tangible assets | 14 | 7,575 | 7,965 |
| Cash at bank and in hand | | 42,819 | 31,979 |
| | | <u>50,394</u> | <u>39,944</u> |
| Prepayments and accrued income | | | |
| Accrued interest and rent | | 33,727 | 31,262 |
| Deferred acquisition costs | | 108,490 | 95,565 |
| Other prepayments and accrued income | | 29,917 | 20,279 |
| | | <u>172,134</u> | <u>147,106</u> |
| Total assets | | <u><u>4,687,833</u></u> | <u><u>4,332,288</u></u> |

ACE European Group Limited

Balance Sheet

at 31 December 2006

| | Note | 2006 £'000 | 2005 (restated) £'000 |
|--|------|------------------|-----------------------------|
| Liabilities | | | |
| Capital and reserves | | | |
| Called-up share capital | 15 | 544,741 | 544,741 |
| Profit and loss account | 16 | 115,330 | 156,761 |
| Merger reserve | 16 | 25,653 | 25,653 |
| Total shareholders' funds | 17 | 685,724 | 727,155 |
| Technical provisions | | | |
| Provision for unearned premiums | | 656,272 | 662,556 |
| Provision for claims outstanding | | 2,792,197 | 2,497,908 |
| Equalisation provision | 18 | 60,663 | 44,532 |
| | | 3,509,132 | 3,204,996 |
| Provisions for other risks and charges | 13 | 11 | - |
| Deposits received from reinsurers | | 2,059 | 897 |
| Creditors – amounts falling due within one year | | | |
| Creditors arising out of direct insurance operations | | 18,478 | 26,580 |
| Creditors arising out of reinsurance operations | | 242,889 | 190,957 |
| Other creditors including taxation and social security | 19 | 135,364 | 98,932 |
| | | 396,731 | 316,469 |
| Financial derivative instruments | 11 | 7,707 | 2,092 |
| Accruals and deferred income | | | |
| Deferred acquisition costs relating to reinsurance | | 46,332 | 43,779 |
| Other accruals and deferred income | | 37,978 | 33,980 |
| | | 84,310 | 77,759 |
| Total liabilities excluding pension liability | | 4,685,674 | 4,329,368 |
| Pension liability | | 2,159 | 2,920 |
| Total liabilities | | 4,687,833 | 4,332,288 |

The financial statements on pages 15 to 37 were approved by the board of directors on 13 March 2007 and were signed on its behalf by:

P M Curtis
Chief Financial Officer

Notes to the Financial Statements

31 December 2006

1. Accounting policies

Basis of preparation

The financial statements have been prepared in accordance with the provisions of Section 255 of, and Schedule 9A to, the Companies Act 1985, the Statement of Recommended Practice on Accounting for Insurance Business issued by the Association of British Insurers ("the ABI SORP") dated December 2005 and applicable accounting standards in the United Kingdom. The company is a wholly owned subsidiary within the ACE Limited group and is included within the consolidated financial statements of ACE Limited, which are publicly available. Consequently, the company has taken advantage of the exemption from preparing a cash flow statement under the terms of FRS1 (revised) "Cash Flow Statements".

Changes in accounting policies

The company has adopted FRS 23 "The effects of changes in foreign exchange rates" in full in these financial statements. The adoption of this standard represents a change in accounting policy and the comparative figures have been restated accordingly. The standard requires the results of foreign branches to be converted to sterling at average, rather than closing rates of exchange. There is no change to the application of closing rates for converting the assets and liabilities of foreign branches to sterling.

The effect of the change in accounting policy has resulted in an increase in the prior year profit before tax of £368,000. The impact on the current year is to increase the profit before tax by £1,658,000. There is no impact on the net asset value of the company in either year.

The company has implemented FRS 26 "Financial Instruments: Measurement". The adoption of this standard has no impact on prior or current year results, but does increase total assets and total liabilities by £2,092,000 in the prior year. The impact on the current year is to increase the total assets and total liabilities by £7,638,000. There is no impact on the net asset value of the company in either year.

Continuing and discontinued operations

Discontinued operations include business underwritten by ACE European Group Limited ("AEGL") prior to its reauthorisation by the Financial Services Authority ("FSA") in 2003. This business included UK marine and aviation business underwritten until 1994, accident and health business underwritten until 1995 and United States surplus lines business underwritten until 1998. Following the group reconstruction in 2005 (see note 16), discontinued operations now also include marine and aviation business underwritten by ACE Insurance S.A.-N.V. in the London market prior to 1999. All other operations are classified as continuing.

Premiums written

Premiums written, which are stated gross of brokerage but exclusive of premium taxes, relate to business incepted during the year, together with adjustments made in the year to premiums written in prior accounting periods. Estimates are made of pipeline premiums, representing amounts due but not yet received or notified to the company by intermediaries.

Unearned premiums

Unearned premiums represent the proportion of premiums written in the year that relate to unexpired terms of policies in force at the balance sheet date, calculated on the basis of established risk profiles or time apportionment as appropriate.

Acquisition costs

Acquisition costs comprise brokerage, commissions and other related expenses, and are deferred over the period in which the related premiums are earned.

Notes to the Financial Statements

31 December 2006

1. Accounting policies – continued

Claims incurred

Claims incurred comprise the estimated cost of all claims occurring during the year, whether reported or not, including related direct and indirect expenses and adjustments to claims outstanding from previous years. Where applicable, deductions are made for reinsurance, salvage and other recoveries.

Provision for claims outstanding and related reinsurance recoveries

The provision for claims outstanding is assessed on an individual case basis and is based on the estimated ultimate cost of all claims notified but not settled by the balance sheet date, together with the provision for related claims handling costs.

The provision also includes the estimated cost of claims incurred but not reported (“IBNR”) at the balance sheet date based on statistical methods.

These methods generally involve projecting from past experience of the development of claims over time to form a view of the likely ultimate claims to be experienced for more recent underwriting, having regard to variations in the business accepted and the underlying terms and conditions. For the most recent years, where a high degree of volatility arises from projections, estimates may be based in part on output from rating and other models of the business accepted and assessments of underwriting conditions. The amount of salvage and subrogation recoveries is separately identified and, where material, reported as an asset.

The reinsurers’ share of the provision for claims outstanding is based on the amounts of outstanding claims and projections for IBNR, net of estimated irrecoverable amounts, having regard to the reinsurance programme in place for the class of business, the claims experience for the year and the current security rating of the reinsurance companies involved. A number of statistical methods are used to assist in making these estimates.

The two most critical assumptions as regards the provision for claims outstanding are that the past is a reasonable predictor of the likely level of claims development, and that the rating and other models used for current business are fair reflections of the likely level of ultimate claims to be incurred.

The directors consider that the provision for gross claims outstanding and related reinsurance recoveries is fairly stated on the basis of the information currently available to them. However, the ultimate liability will vary as a result of subsequent information and events and this may result in significant adjustments to the amounts provided. Adjustments to the amounts of claims provisions established in prior years are reflected in the financial statements for the period in which the adjustments are made. The methods used, and the estimates made, are reviewed regularly.

When calculating the provision for claims outstanding, the reported business segments are subject to specific issues, as set out below:

Fire and other damage to property; marine, aviation and transport; accident and health

These business segments are predominantly “short tail”; that is, there is not a significant delay between the occurrence of the claim and the claim being reported to the company. The costs of claims notified to the company at the balance sheet date are estimated on a case by case basis to reflect the individual circumstances of each claim. The ultimate expected cost of claims is projected from this data by reference to statistics, which show how estimates of claims incurred in previous periods have developed over time to reflect changes in the underlying estimates of the cost of notified claims and late notifications.

Notes to the Financial Statements

31 December 2006

1. Accounting policies – continued

Provisions for claims outstanding and related reinsurance recoveries – continued

Third party liability (including marine and aviation liability)

Liability claims are longer tail than the classes of business described above and so a larger element of the provision for claims outstanding relates to IBNR. Claims estimates for the company's liability business are derived from a combination of loss ratio based estimates and an estimate based upon actual claims experience using a predetermined formula whereby greater weight is given to actual claims experience as time passes. The initial estimate of the loss ratio based on the experience of previous years adjusted for factors such as premium rate changes and claims inflation, and on the anticipated market experience, is an important assumption in this estimation technique. In respect of liability claims, the assessment of claims inflation and anticipated market experience is particularly sensitive to the level of court awards and to the development of legal precedent on matters of contract and tort. The liability class of business is also subject to the emergence of new types of latent claims but no allowance is included for this as at the balance sheet date.

Reinsurance acceptances

This business segment includes both short tail and long tail business, and is subject to the issues laid out in the preceding two sections above.

Asbestos, pollution and health claims ("APH")

The company has some exposure to APH from its discontinued operations. There may be a long delay between the occurrence and notification of these types of claim. In estimating the cost of claims the company considers the type of risks written historically that may give rise to exposure to these risks, notifications received from policyholders, the nature and extent of the cover provided, the current legal environment, changes in the effectiveness of clean up techniques and industry benchmarks of the typical cost of claims of this kind and of total expected insured losses. The company is protected by way of a stop loss agreement with a fellow group undertaking from any adverse development arising from such exposures in its marine and aviation account for 1991 and prior years.

Unexpired risks provision

A provision for unexpired risks is made where claims and related expenses arising after the end of the financial period in respect of contracts concluded before that date, are expected to exceed the unearned premiums and premiums receivable under these contracts, after the deduction of any acquisition costs deferred. The provision for unexpired risks is calculated by reference to classes of business which are managed together, after taking into account relevant investment return.

Equalisation provision

Amounts are set aside as equalisation provisions in accordance with the FSA's Handbook for the purpose of mitigating exceptionally high loss ratios in future years. The amounts provided are not liabilities because they are in addition to the provisions required to meet the anticipated ultimate cost of settlement of outstanding claims at the balance sheet date. Notwithstanding this, they are required by Schedule 9A to the Companies Act 1985 to be included within technical provisions.

Financial Assets and Liabilities

The company recognises a financial asset or a financial liability on its balance sheet when it becomes a party to the contractual provisions of the instrument. On initial recognition the company determine the category of financial instrument and values it accordingly. The classification depends on the purpose for which the investments are acquired.

Investments – fair value through profit and loss

A financial asset is classified into this category at inception if they are acquired principally for the purpose of selling in the short term, if they form part of a portfolio of financial assets in which there is evidence of short-term profit-taking, or if so designated by management to minimise any measurement or recognition inconsistency with the associated liabilities.

Notes to the Financial Statements

31 December 2006

1. Accounting policies – continued

Financial assets designated as fair value through profit or loss at inception are those that are managed, and their performance evaluated on a fair value basis, in accordance with a documented investment strategy. Information about these financial assets is provided internally on a fair value basis to the company's key management including the board and investment committee.

Financial assets carried at fair value through profit or loss are initially recognised at fair value with any transaction costs being expensed through the profit and loss account. The fair value of quoted investments is their quoted bid price at the balance sheet date.

Realised gains and losses and unrealised gains and losses arising from changes in the fair value of financial assets at fair value through profit or loss, are included in the profit and loss account in the period in which they arise.

Cash and cash equivalents

Cash and cash equivalents are short term, highly liquid deposit investment balances that are subject to insignificant changes in value and are readily convertible into known amounts of cash. Cash equivalents comprise financial assets with less than three months maturity from the date of acquisition.

Insurance and other receivables

Insurance and other receivables are recognised at fair value less any provision for impairment. Any impairment of a receivable will be recognised if there is evidence that the company will not be able to collect the amounts receivable according to the original terms of the receivable.

Derivative financial instruments

The company uses derivative financial instruments to hedge its exposure to foreign exchange risk arising from investing activities. These derivative financial instruments do not qualify for hedge accounting under FRS 26, Financial Instruments: Measurement.

Derivative financial instruments are measured on initial recognition, and subsequently, at fair value. The gain or loss on remeasurement to fair value is recognised immediately in the profit and loss account. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and valuation techniques as appropriate. All derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative.

The fair value of interest rate swaps is the estimated amount that the company would receive or pay to terminate the swap at the balance sheet date, taking into account current interest rates and the current creditworthiness of the swap counterparties. The fair value of forward exchange contracts is their quoted market price at the balance sheet date.

Financial assets and liabilities are offset and the net amount reported in the balance sheet only when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously.

In accordance with its treasury policy, the company does not hold or issue derivative financial instruments for trading purposes.

Purchases and sales of securities and currencies are recognised on trade date – the date on which the company commits to purchase or sell the asset.

Notes to the Financial Statements

31 December 2006

1. Accounting policies – continued

Investment return

Investment return comprises all investment income, realised investment gains and losses and movements in unrealised gains and losses, net of investment expenses, charges and interest. FRS 3 “Reporting Financial Performance” and the ABI SORP require that, for insurance entities, both realised and unrealised investment gains and losses be included as part of investment return in the profit and loss account. Dividends are recorded on the date on which the shares are quoted ex-dividend. Interest and expenses are accounted for on an accruals basis.

Realised gains and losses on investments carried at bid value are calculated as the difference between net sale proceeds and purchase price. Movements in unrealised gains and losses on investments represent the difference between the valuation at the balance sheet date and their purchase price or, if they have previously been revalued, their valuation at the last balance sheet date, together with the reversal of unrealised gains and losses recognised in earlier accounting periods in respect of investment disposals in the current period.

Stock lending fees are recognised as earned on a pro rata basis over the period of lending.

Tangible assets

Tangible assets are capitalised and depreciated by equal annual instalments over their estimated useful lives as follows:

| | |
|---|--|
| Land and buildings | Over the shorter of the lease term or 50 years |
| Motor vehicles | 4 years |
| Leasehold improvements | Over the remaining period of the lease |
| Fixtures and fittings | 5 years |
| Computer, office equipment and software | up to 5 years |

Deferred taxation

Deferred taxation has been recognised as a liability or asset if transactions have occurred at the balance sheet date that give rise to an obligation to pay more taxation in future, or a right to pay less taxation in future. An asset is not recognised to the extent that the transfer of economic benefits in future is uncertain. Deferred tax assets and liabilities recognised have not been discounted.

Operating leases

Rentals payable under operating leases are charged to the profit and loss account as incurred over the lease term.

Pension costs

The company operates a small number of funded defined benefit pension schemes in Continental Europe with assets held in separate trustee-administered funds. The pension asset or liability recognised in the balance sheet is the value of the schemes’ assets less the present value of the schemes’ liabilities.

The pension cost for the schemes is analysed between current service cost, past service cost and net return on pension schemes. Current service cost is the actuarially calculated present value of the benefits earned by the active employees in each period. Past service costs, relating to employee service in prior periods arising in the current period as a result of the introduction of, or improvement to, retirement benefits, are recognised in the profit and loss account on a straight-line basis over the period in which the increase in benefits vest.

Net expected return comprises the expected return on the pension scheme assets less interest on scheme liabilities.

Notes to the Financial Statements

31 December 2006

1. Accounting policies – continued

The actuarial gains and losses which arise from valuations and from updating the latest actuarial valuations to reflect conditions at the balance date are taken to the statement of total recognised gains and losses for the period. The attributable deferred taxation is shown separately in the statement of total recognised gains and losses.

Foreign currencies

Foreign currency transactions are accounted for at the exchange rates prevailing at the date of the transactions. Gains and losses resulting from the settlement of such transactions, and from the revaluation to year end exchange rates of monetary assets and liabilities, are recognised in the profit and loss account.

Results of foreign branches are translated into sterling at average exchange rates for the year while monetary assets and liabilities are translated into sterling at year end exchange rates. Differences arising on translation are recorded in the Statement of Total Recognised Gains and Losses.

Financial risk management

The Investment function

The company operates an investment committee which functions under terms of reference determined by the board. The committee is charged with establishing and effecting an appropriate investment policy for the company. In addition, the committee has the responsibility for recommending the appointment and removal of investment managers, for reviewing the managers' performance and for reporting on all other material aspects of the investment function.

The investment committee comprises senior ACE management and is chaired by the Chief Executive Officer of ACE Asset Management, the Group's investment specialists who provide advisory services to ACE Group companies. The committee also includes the Chief Financial Officer and Treasurer of the company.

The investment management function is out-sourced to specialist external managers, principally Barclays Global Investors and Western Asset Management.

Asset allocation policy

The investment committee has established a broad asset allocation policy which defines the limits for different asset types. The asset allocation cites two major asset classes: investment grade fixed income securities and alternative assets. Alternative assets can include equities, high yield and emerging market instruments although of these, the company currently only maintains equities. The policy stipulates a range of between 75% and 95% for investment grade fixed income securities and a range of between 5% and 25% for alternative asset classes.

Investment guidelines

Investment management agreements have been established with the external investment managers. The agreements include specific guidelines for each individual portfolio in order to limit risks arising from duration, equity price, currency, liquidity, credit and counterparty exposures. The managers provide quarterly affirmation of compliance with the guidelines.

Duration and interest rate risk

The company is exposed to interest rate risk primarily through its investments in fixed interest securities and (to the extent that claims inflation is correlated to interest rates) its liabilities to policyholders.

Notes to the Financial Statements

31 December 2006

1. Accounting policies – continued

The investment guidelines include restrictions relating to the maximum weighted average duration of the portfolio. The restriction is stated by reference to the permissible duration variance compared to the customised benchmark index by which the external investment managers' performance is assessed. The benchmarks have been established to provide comparable duration to the insurance liabilities.

Equity price risk

The company is exposed to equity price risk as a result of its holdings in equity investments, classified as financial assets at fair value through profit or loss.

The company exposure to equity price risk is moderated through the asset allocation policy which limits this category of asset and the investment guidelines. The investment guidelines restrict individual equity holdings relative to the size of the portfolio and the benchmark constituents.

Currency risk

The company maintains various currency balances generated through regular trading activity. The majority of the funds held are denominated in sterling although significant euro and US dollar balances are also maintained. The company policy seeks to ensure an approximate currency match of assets and liabilities is maintained, with any surplus held in sterling and euros. The smaller euro component of the surplus gives rise to currency risk due to sterling/euro exchange rate volatility.

The investment guidelines typically allow the managers to invest a portion of the individual portfolios in securities not denominated in the designated core currency of the portfolio. These allocations to non-core currencies are included within the quarterly evaluation of the currency alignment reviewed by the investment committee.

Liquidity risk

Liquidity risk is the potential that the company is unable to meet its obligations as they fall due. To counter this risk, the company aims to maintain funds in the form of cash or cash equivalents to meet known cash flows. In addition, the asset allocation policy and the investment guidelines are structured in order to ensure that funds are predominantly held in investment grade fixed income securities, the proceeds of which are readily realisable.

The company also benefits from letter of credit facilities which can be utilised to meet certain funding needs.

Credit risk and counterparty limits

Credit risk is the risk that a counterparty will be unable to pay amounts in full when due. The company is exposed to credit risk as a result of its regular insurance and reinsurance activity. The areas of key exposure are:

- reinsurers' share of insurance liabilities;
- amounts due from reinsurers in respect of claims already paid;
- amounts due from insurance policyholders; and
- amounts due from insurance intermediaries.

Notes to the Financial Statements

31 December 2006

1. Accounting policies – continued

Reinsurance is used to manage insurance risk. Reinsurance does not discharge the company's liability as primary insurer. If a reinsurer fails to pay a claim, the company remains liable for the payment to the policyholder. The company operates a reinsurance security committee. The creditworthiness of reinsurers is considered on a quarterly basis by reviewing their financial strength. In addition, the recent payment history of reinsurers is used to update the reinsurance purchasing strategy. With regard to direct insurance receivables, the company operates a broker security committee and a process for monitoring arrangements with managing general agents.

The company is also exposed to credit risk in respect of its investment portfolio with the key risks being:

- amounts due from corporate bond issuers; and
- counterparty risk with respect to derivative transactions.

The investment guidelines seek to limit the credit risk of each of the portfolios through:

- Minimum weighted credit quality;
- Minimum individual issuer credit quality;
- Maximum counterparty exposures, and
- Specification of eligible/ineligible investments.

The assets bearing credit risk are summarised below:

| | 2006 | 2005 (restated) |
|---|------------------|--------------------|
| | £'000 | £'000 |
| Shares and other variable yield securities and units in unit trusts | 101,357 | 105,259 |
| Debt Securities and other fixed interest securities | 1,629,808 | 1,607,648 |
| Deposits with credit institutions | 151,029 | 77,440 |
| Derivative financial securities | 7,638 | 2,939 |
| Reinsurers' share of technical provisions | 1,935,781 | 1,734,183 |
| Debtors arising out of direct insurance operations | 338,078 | 363,961 |
| Debtors arising from reinsurance operations | 208,089 | 173,660 |
| Cash at bank | 42,819 | 31,979 |
| | <u>4,414,599</u> | <u>4,097,069</u> |

The concentration of credit risk is substantially unchanged compared to prior year. No credit limits were exceeded during the period.

The company maintains strict control limits on open derivative positions, by both amount and term. The amount subject to credit risk at any one time is limited to the current fair value of derivative financial assets.

Notes to the Financial Statements

31 December 2006

2. Segmental analysis

Segmental information in the format required by the Companies Act 1985 is as follows:

| | Gross premiums written | Gross premiums earned | Gross claims incurred | Gross operating expenses | Reinsurance balance |
|--|------------------------------|-----------------------------|-----------------------------|--------------------------------|------------------------|
| | £'000 | £'000 | £'000 | £'000 | £'000 |
| Year to 31 December 2006 | | | | | |
| Continuing operations: | | | | | |
| Direct insurance | | | | | |
| Accident and health | 295,539 | 293,522 | (108,199) | (115,700) | (61,830) |
| Marine, aviation and transport | 122,996 | 125,396 | (75,058) | (25,462) | (15,400) |
| Fire and other damage to property | 525,695 | 511,266 | (295,907) | (104,387) | (115,472) |
| Third party liability | 549,582 | 550,411 | (380,455) | (89,642) | (24,513) |
| Miscellaneous | 108,370 | 110,570 | (80,925) | (31,354) | 14,502 |
| Reinsurance acceptances | 359,913 | 344,724 | (161,668) | (63,565) | (91,985) |
| | <u>1,962,095</u> | <u>1,935,889</u> | <u>(1,102,212)</u> | <u>(430,110)</u> | <u>(294,698)</u> |
| Discontinued operations | 358 | 358 | 13,422 | (28) | (14,196) |
| | <u>1,962,453</u> | <u>1,936,247</u> | <u>(1,088,790)</u> | <u>(430,138)</u> | <u>(308,894)</u> |
| Year to 31 December 2005 (restated) | | | | | |
| Continuing operations: | | | | | |
| Direct insurance | | | | | |
| Accident and health | 277,041 | 271,304 | (105,732) | (109,588) | (41,631) |
| Marine, aviation and transport | 99,092 | 98,945 | (49,488) | (22,242) | (12,081) |
| Fire and other damage to property | 499,698 | 519,675 | (385,629) | (117,131) | 27,166 |
| Third party liability | 544,492 | 543,692 | (292,434) | (96,190) | (81,606) |
| Miscellaneous | 146,900 | 148,837 | (80,288) | (38,623) | (29,843) |
| Reinsurance acceptances | 318,681 | 321,558 | (247,065) | (56,273) | (20,499) |
| | <u>1,885,904</u> | <u>1,904,011</u> | <u>(1,160,636)</u> | <u>(440,047)</u> | <u>(158,494)</u> |
| Discontinued operations | 2,078 | 2,079 | 31,671 | 844 | (31,168) |
| | <u>1,887,982</u> | <u>1,906,090</u> | <u>(1,128,965)</u> | <u>(439,203)</u> | <u>(189,662)</u> |

The reinsurance balance represents the credit (charge) to the technical account from the aggregate of all items relating to outwards reinsurance.

Analysis by geographic area – origin

| | Gross written premiums | | Profit before taxation | | Net assets | |
|------------------|------------------------|--------------------|------------------------|--------------------|----------------|----------------|
| | 2006 | 2005 (restated) | 2006 | 2005 (restated) | 2006 | 2005 |
| | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 |
| United Kingdom | 1,116,704 | 1,105,485 | 47,890 | 163,603 | 407,935 | 532,190 |
| Other EEA States | 808,402 | 752,740 | 88,616 | 63,803 | 262,288 | 185,452 |
| Other countries | 37,347 | 29,757 | 7,217 | 2,633 | 15,501 | 9,513 |
| | <u>1,962,453</u> | <u>1,887,982</u> | <u>143,723</u> | <u>230,039</u> | <u>685,724</u> | <u>727,155</u> |

Notes to the Financial Statements

31 December 2006

2. Segmental analysis – continued

Gross written premium information by destination (location of risk) as required by SSAP 25 is as follows:

| | 2006 | 2005 (restated) |
|--------------------------|------------------|--------------------|
| | £'000 | £'000 |
| United Kingdom | 603,195 | 635,450 |
| United States of America | 83,861 | 57,315 |
| Continental Europe | 936,085 | 839,180 |
| Africa & Middle East | 52,064 | 44,358 |
| Asia/Pacific | 50,149 | 41,146 |
| Americas | 35,327 | 30,422 |
| Worldwide | 201,414 | 238,033 |
| Discontinued business | 358 | 2,078 |
| | <u>1,962,453</u> | <u>1,887,982</u> |

3. Movement in prior year's provision for claims outstanding

The prior year's net provision for claims outstanding generated a surplus for 2006 (2005: surplus) as detailed below:

| | 2006 | 2005 |
|-----------------------------------|---------------|---------------|
| | £'000 | £'000 |
| Continuing operations: | | |
| Accident and health | (1,257) | 2,232 |
| Marine, aviation and transport | 10,586 | 3,599 |
| Fire and other damage to property | 22,918 | 22,175 |
| Third party liability | 25,606 | 14,996 |
| Miscellaneous | 6,784 | 1,400 |
| | <u>64,637</u> | <u>44,402</u> |
| Discontinued operations | (444) | (2,148) |
| | <u>64,193</u> | <u>42,254</u> |

Notes to the Financial Statements

31 December 2006

4. Net operating expenses – technical account

| | 2006 | 2005 (restated) |
|--|----------------|--------------------|
| | £'000 | £'000 |
| Acquisition costs | 298,516 | 289,879 |
| Change in net deferred acquisition costs | (13,397) | 3,230 |
| Administrative expenses | 147,967 | 146,093 |
| Reinsurance commissions | (188,775) | (189,744) |
| | <u>244,311</u> | <u>249,458</u> |

Administrative expenses include costs that are incurred by ACE INA Services U.K. Limited (“AIS”), a fellow group undertaking, and recharged to the company in the form of management charges. In particular, this charge includes the cost of the AIS staff engaged in the business of AEGL.

Total commissions for direct insurance accounted for by the company during the year amounted to £233.9 million (2005 restated: £229.3 million), and are included within acquisition costs.

5. Auditors' remuneration

During the year the company (including its overseas branches) obtained the following services from the company's auditor at costs as detailed below:

| | 2006 | 2005 |
|--|--------------|--------------|
| | £'000 | £'000 |
| Audit fees | | |
| Fees payable to the company's auditor for the audit of the annual accounts | 435 | 399 |
| Non audit fees | | |
| Other services pursuant to legislation | 563 | 552 |
| Other services relating to taxation | 202 | 157 |
| | <u>1,200</u> | <u>1,108</u> |

Other services pursuant to legislation includes reports under section 404 of the US Public Company Accounting Reform and Investor Protection Act 2002.

Notes to the Financial Statements

31 December 2006

6. Operating lease rentals

The total rentals under operating leases, charged as an expense in the profit and loss account, are disclosed below:

| | 2006 | 2005 (restated) |
|--------------------|-------|--------------------|
| | £'000 | £'000 |
| Leasehold property | 2,994 | 2,899 |

The company has the following annual operating lease commitments in respect of leasehold property analysed between those expiring:

| | 2006 | 2005 |
|----------------------------|-------|-------|
| | £'000 | £'000 |
| Within 1 year | 1,579 | 413 |
| Between two and five years | 1,835 | 2,128 |
| More than five years | 240 | 112 |
| | 3,654 | 2,653 |

7. Directors and employees

| | 2006 | 2005 (restated) |
|--|--------|--------------------|
| | £'000 | £'000 |
| Cost of staff employed by the company | | |
| Wages and salaries | 29,306 | 26,937 |
| Social security costs | 7,978 | 7,692 |
| Other pension costs | 2,924 | 3,257 |
| Other staff costs | 5,147 | 3,537 |
| | 45,355 | 41,423 |

The average number of employees of the company during the year was as follows:

| | 2006 | 2005 |
|--------------|------|------|
| | No. | No. |
| Underwriting | 527 | 521 |
| Claims | 133 | 134 |
| Other | 110 | 96 |
| | 770 | 751 |

The disclosures above relate to staff based in the company's branches outside the UK who are directly employed by the company. Staff that support the UK branch operations of the company and centralised functions that are managed in the UK, are employed by AIS and their costs are incorporated in management recharges from this service company. For disclosure purposes, it is not practical to allocate these amounts to the underlying entities to which the staff provide services.

Notes to the Financial Statements

31 December 2006

7. Directors and employees – continued

Directors' emoluments

All directors received emoluments from AIS in respect of their services to ACE Group companies. The cost of these emoluments is incorporated within the management recharges from AIS. For disclosure purposes, it is not practical to allocate these amounts to the underlying entities to which the directors provide services. Consequently, the following amounts represent the total emoluments paid by AIS in respect of the directors of this company.

| | 2006 | 2005 |
|---|--------------|--------------|
| | £'000 | £'000 |
| Aggregate emoluments and benefits | 3,505 | 2,942 |
| Company pension contributions to money purchase pension schemes | 81 | 77 |
| | <u>3,586</u> | <u>3,019</u> |

Included in the above amounts paid by AIS in respect of the directors of this company, the highest paid director was paid a total of £576,263 (2005: £517,572) in respect of emoluments and benefits.

The aggregate emoluments above do not include share based remuneration. All executive directors are entitled to shares in ACE Limited under long-term incentive plans. During the year, four directors exercised options over the shares of ACE Limited. The highest paid director did not exercise any share options during the year.

Until 31 March 2002, retirement benefits accrued under the ACE London Pension Scheme to four current directors under the final salary section and to one current director under the money purchase section. Disclosures relating to this scheme are contained within the financial statements for AIS. From 1 April 2002, pension benefits are accruing to five current directors under the ACE European Group UK Pension Plan (Stakeholder scheme).

8. Investment return

| | 2006 | 2005 (restated) |
|--|-----------------|--------------------|
| | £'000 | £'000 |
| Investment income | | |
| Income from investments | 82,739 | 78,529 |
| Gains on the realisation of investments | 33,787 | 43,051 |
| | <u>116,526</u> | <u>121,580</u> |
| Investment expenses and charges | | |
| Investment management expenses | (5,647) | (5,989) |
| Losses on the realisation of investments | (14,805) | (21,945) |
| | <u>(20,452)</u> | <u>(27,934)</u> |
| Net unrealised gains less losses on investments | | |
| Unrealised gains on investments | 19,382 | 21,913 |
| Unrealised losses on investments | (57,130) | (28,243) |
| | <u>(37,748)</u> | <u>(6,330)</u> |
| Total investment return | <u>58,326</u> | <u>87,316</u> |

Notes to the Financial Statements

31 December 2006

9. Taxation on profit on ordinary activities

Analysis of charge in period

| | 2006 | 2005 (restated) |
|--|----------------|--------------------|
| | £'000 | £'000 |
| UK corporation taxation at 30% (2005: 30%) | | |
| Current taxation on income for the period | 45,303 | 74,597 |
| Adjustments in respect of previous periods | 90 | 516 |
| | <u>45,393</u> | <u>75,113</u> |
| Double taxation relief | (29,516) | (18,904) |
| | <u>15,877</u> | <u>56,209</u> |
| Foreign taxation | | |
| Current taxation on income for the period | 34,962 | 22,234 |
| Adjustments in respect of previous periods | 9,358 | 2,998 |
| | <u>44,320</u> | <u>25,232</u> |
| Current taxation on income for the period | 60,197 | 81,441 |
| Deferred taxation (note 13): | | |
| Origination and reversal of timing differences | (69) | 249 |
| Adjustments in respect of previous periods | 1,063 | (3,877) |
| | <u>994</u> | <u>(3,628)</u> |
| Taxation on profit on ordinary activities | 61,191 | 77,813 |
| Factors affecting taxation charge for period | | |
| The taxation assessed for the period is higher (2005: higher) than the standard rate of corporation taxation in the UK (30%). The differences are explained below: | | |
| | 2006 | 2005 (restated) |
| | £'000 | £'000 |
| Profit on ordinary activities before taxation | 143,723 | 230,039 |
| Profit on ordinary activities multiplied by standard rate of corporation taxation in the UK of 30% (2005: 30%) | 43,117 | 69,012 |
| Effects of: | | |
| Expenses not deductible for taxation purposes | 2,110 | 1,634 |
| Non-taxable losses | - | (403) |
| Higher taxation rates on overseas earnings | 5,445 | 3,217 |
| Adjustments in respect of previous periods | 9,448 | 3,514 |
| Other, including timing differences | 77 | 4,467 |
| Current taxation charge for period | 60,197 | 81,441 |

Notes to the Financial Statements

31 December 2006

10. Dividends

During 2006 the company paid a dividend of 22.0p per share totalling £120,000,000 (2005: 28.5p per share totalling £155,149,000).

11. Other financial investments

| | Market Value 2006 | Cost 2006 | Market Value 2005 | Cost 2005 |
|--|----------------------|------------------|----------------------|------------------|
| | £'000 | £'000 | £'000 | £'000 |
| Shares and other variable yield securities and units in unit trusts | 101,357 | 88,930 | 105,259 | 88,660 |
| Debt securities and other fixed interest securities | 1,629,808 | 1,653,615 | 1,607,648 | 1,605,958 |
| Deposits with credit institutions | 151,029 | 151,029 | 77,440 | 77,440 |
| | <u>1,882,194</u> | <u>1,893,574</u> | <u>1,790,347</u> | <u>1,772,058</u> |

All investments held are listed.

Derivative financial instruments

| | Assets 2006 | Liabilities 2006 | Assets 2005 | Liabilities 2005 |
|------------------------------------|----------------|---------------------|----------------|---------------------|
| | £'000 | £'000 | £'000 | £'000 |
| Forward foreign currency contracts | 7,260 | 6,490 | 2,215 | 1,446 |
| Fixed income options and futures | 378 | 1,217 | 724 | 646 |
| | <u>7,638</u> | <u>7,707</u> | <u>2,939</u> | <u>2,092</u> |

The cost of entering into derivative financial instruments was £37,671 (2005: £999).

Currency derivatives

The company utilises currency derivatives to manage the majority of its currency exposure which arises through the acquisition of investments in currencies other than the designated core currency of the investment portfolio.

At the balance sheet date, the total notional amount of outstanding forward foreign exchange contracts to which the company is committed are as follows:

| | 2006 | 2005 |
|------------------------------------|-----------|--------------|
| | £'000 | £'000 |
| Forward foreign exchange contracts | <u>26</u> | <u>(745)</u> |

At 31 December 2006, the fair value of the company's currency derivatives is estimated to be approximately £0.8 million (2005: £0.8 million). These amounts are based on rates of exchange at the balance sheet date, comprising £7.3 million of assets (2005: £2.2 million) and £6.5 million of liabilities (2005: £1.4 million).

Amounts of £0.9 million (2005: £4.1 million) have been recognised in the profit and loss account in respect of contracts matured during the period.

Notes to the Financial Statements

31 December 2006

11. Other financial investments – continued

The company does not currently designate its foreign currency denominated debt as a hedging instrument for the purpose of hedging the translation of its foreign operations.

Fixed income options and futures

Options and futures contracts on fixed income securities may be utilised by the investment managers as part of their strategy to mitigate duration risk, enhance yield or to obtain exposure to a particular instrument or market.

At 31 December 2006, the fair value of the company's fixed income derivatives is estimated to be a liability of £0.8 million comprising £0.4 million of assets (2005: £0.7 million) and £1.2 million of liabilities (2005: £0.6 million).

A loss of £0.7 million (2005: gain of £0.4 million) has been recognised in the profit and loss account in respect of contracts matured in the period.

12. Other debtors

| | 2006 | 2005 |
|--------------------------------------|---------------|---------------|
| | £'000 | £'000 |
| Amounts falling due within one year: | | |
| Amounts due from group undertakings | 67,386 | 39,219 |
| Deferred taxation (note 13) | - | 1,094 |
| Receivable for sales of securities | 16,963 | 32,119 |
| Other debtors | 9,149 | 7,534 |
| | <u>93,498</u> | <u>79,966</u> |

13. Deferred taxation

| | 2006 | 2005 |
|---|-------------|--------------|
| | £'000 | £'000 |
| At 1 January | 1,094 | (2,534) |
| Foreign exchange differences | (111) | - |
| Utilisation in year (note 9) | (994) | 3,628 |
| At 31 December | <u>(11)</u> | <u>1,094</u> |
| Analysis of (liability) asset at 31 December: | | |
| Trading losses | (2) | - |
| Foreign equalisation provisions | 2,761 | (2,790) |
| Deferred acquisition costs | (39) | 39 |
| Other timing differences | (2,731) | 3,845 |
| Undiscounted deferred taxation (liability) asset as above | <u>(11)</u> | <u>1,094</u> |

Notes to the Financial Statements

31 December 2006

14. Tangible assets

| | Land and Buildings | Motor Vehicles | Leasehold improvements, fixtures and fittings | Computer office equipment and software | Total |
|---------------------------------|--------------------------|-------------------|--|---|---------------|
| | £'000 | £'000 | £'000 | £'000 | £'000 |
| Cost | | | | | |
| At 1 January 2006 | 1,324 | 1,474 | 9,664 | 6,163 | 18,625 |
| Additions | – | 338 | 1,555 | 691 | 2,584 |
| Disposals | (141) | (220) | (998) | (527) | (1,886) |
| Foreign exchange differences | (23) | (32) | (148) | (3) | (206) |
| At 31 December 2006 | <u>1,160</u> | <u>1,560</u> | <u>10,073</u> | <u>6,324</u> | <u>19,117</u> |
| Accumulated depreciation | | | | | |
| At 1 January 2006 | 546 | 645 | 5,304 | 4,165 | 10,660 |
| Charge for the period | 29 | 238 | 1,253 | 728 | 2,248 |
| Disposals | (32) | (142) | (797) | (308) | (1,279) |
| Foreign exchange differences | (10) | (12) | (87) | 22 | (87) |
| At 31 December 2006 | <u>533</u> | <u>729</u> | <u>5,673</u> | <u>4,607</u> | <u>11,542</u> |
| Net book value | | | | | |
| 31 December 2006 | <u>627</u> | <u>831</u> | <u>4,400</u> | <u>1,717</u> | <u>7,575</u> |
| 31 December 2005 | <u>778</u> | <u>829</u> | <u>4,360</u> | <u>1,998</u> | <u>7,965</u> |

The charge for depreciation for the year ending 31 December 2005 (restated) was £2.8 million.

15. Called-up share capital

| | 2006 | 2005 |
|---|----------------|----------------|
| | £'000 | £'000 |
| Allotted, issued and fully paid: | | |
| 376,567,035 'A' Ordinary £1 shares | 376,567 | 376,567 |
| 168,174,109 'B' Ordinary £1 shares | 168,174 | 168,174 |
| | <u>544,741</u> | <u>544,741</u> |
| Authorised: | | |
| 500,000,000 'A' Ordinary £1 shares (2005: 500,000,000 Ordinary £1 shares) | 500,000 | 500,000 |
| 250,000,000 'B' Ordinary £1 shares (2005: 250,000,000 Ordinary £1 shares) | 250,000 | 250,000 |
| | <u>750,000</u> | <u>750,000</u> |

Notes to the Financial Statements

31 December 2006

16. Reserves

| | Share capital | Profit and loss account | Merger reserve | Total |
|---|------------------|----------------------------|-------------------|----------------|
| | £'000 | £'000 | £'000 | £'000 |
| As at 1 January | 544,741 | 156,761 | 25,653 | 727,155 |
| Profit for the year | - | 82,532 | - | 82,532 |
| Currency translation differences | - | (4,375) | - | (4,375) |
| Actuarial gain recognised in relation to pension schemes | - | 615 | - | 615 |
| Movement of deferred taxation relating to pension liability | - | (203) | - | (203) |
| Dividend paid (note 10) | - | (120,000) | - | (120,000) |
| At 31 December 2006 | 544,741 | 115,330 | 25,653 | 685,724 |

On 1 January 2005 the company issued 376,567,035 £1 shares in consideration for the transfer of the assets, liabilities and obligations of ACE Insurance S.A.-N.V. The transfer was treated as a group reconstruction under FRS 6 and consequently merger accounting principles were applied. The merger reserve was the difference between the net asset value of the transferred business and the nominal value of the shares issued by the company as consideration.

17. Reconciliation of movements in shareholders' funds

| | 2006 | 2005 (restated) |
|--|-----------|--------------------|
| | £'000 | £'000 |
| Profit for the financial year | 82,532 | 152,226 |
| Currency translation differences | (4,375) | (7,927) |
| Actuarial gain (loss) recognised in relation to pension schemes | 615 | (1,470) |
| Movement on deferred taxation relating to pension liability | (203) | 498 |
| Dividend paid (note 10) | (120,000) | (155,149) |
| Net reduction to the shareholders' funds | (41,431) | (11,822) |
| Opening shareholders' funds | 727,155 | 738,977 |
| Closing shareholders' funds | 685,724 | 727,155 |

18. Equalisation provision

As laid out in the accounting policies, an equalisation provision is established in the financial statements. The effect of this provision is to reduce shareholders' funds by £60,663,000 (2005: £44,532,000). The increase during the year had the effect of reducing the balance on the technical account for general business and decreasing the profit on ordinary activities before taxation by £16,589,000 (2005 restated: £12,609,000).

Notes to the Financial Statements

31 December 2006

19. Other creditors including taxation and social security

| | 2006 | 2005 |
|-------------------------------------|----------------|---------------|
| | £'000 | £'000 |
| Corporation taxation payable | 16,543 | 36,699 |
| Payable for purchases of securities | 95,026 | 48,364 |
| Other creditors | 23,795 | 13,869 |
| | <u>135,364</u> | <u>98,932</u> |

20. Stock lending

During 2006 the company entered into stock lending activities with State Street Bank and Trust company.

| | 2006 |
|--|----------------|
| | £'000 |
| Aggregate value of securities on loan at 31 December | <u>239,899</u> |
| Income from stock lending during the year | <u>86</u> |

In respect of securities on loan at the year end, the company held £245,283,000 as collateral, the value of which exceeds the value of the loan securities by 2.2%.

21. Letter of credit facilities

Under a facility with Citibank NA, the value of letters of credit outstanding was £18.0 million (2005: £17.3 million) with associated collateral of £33.1 million (2005: £37.4 million). Under a facility with Lloyds TSB Bank plc, there is a further letter of credit outstanding for £0.9 million (2005: £1.0 million), equally matched by collateral. Collateral is included within Cash at bank and in hand on the face of the balance sheet.

22. Capital commitments

No capital expenditure was authorised at 31 December 2006 which has not been provided for in these financial statements.

23. Transactions with related parties

Advantage has been taken of the exemption provided in FRS 8 from disclosing details of transactions with ACE Limited and its subsidiary undertakings.

24. Post balance sheet events

The directors have proposed a dividend of 14.7p per share totalling £80,000,000.

25. Ultimate parent company

The ultimate holding company is ACE Limited, a company registered in the Cayman Islands, with its headquarters in Bermuda and quoted on the New York Stock Exchange. Copies of the ultimate holding company's consolidated accounts can be obtained from Investor Relations at ACE Global Headquarters, 17 Woodbourne Avenue, Hamilton HM 08, Bermuda.



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