

ACE European Group Limited

Annual Report and Financial Statements

31 December 2009

ACE European Group Limited

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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

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Performance in 2009

ACE European Group Limited ("AEGL") is one of Europe's leading commercial insurance and reinsurance players, with a premium base in excess of £2 billion. It is a well capitalised company operating a successful underwriting franchise throughout the UK, Ireland and Continental Europe, and has a history of delivering balanced earnings streams.

Gross written premium increased by 12.2% over prior year despite recession-related declines in both property and casualty ("P&C") and accident and health ("A&H") business and increasing competition towards the end of the year.

Pre-tax profits amounted to £262.2 million, reflecting the company's continued focus on underwriting discipline and cost control regardless of the insurance cycle. Shareholders' funds at the close of the financial year were £825.3 million, an increase of 14.4% over prior year.

AEGL continues to hold financial strength ratings of "A+ (Strong)" from Standard & Poor's and "A+ (Superior)" from A.M. Best. A.M. Best has maintained a stable outlook for the rating, whilst Standard & Poor's has assigned a positive outlook to the rating since December 2008.

Market environment

AEGL's underwriting portfolio is well balanced, with the A&H business complementing the more cyclical UK, Ireland & Continental Europe P&C retail business and the London market wholesale insurance and reinsurance business. Our product diversity allows us to focus on lines that offer the greatest potential for growth and to reduce our involvement in areas that face more competition or have less attractive returns. The company's geographic scope also provides access to a wide range of opportunities throughout the UK, Ireland and Continental Europe.

Last year we anticipated that 2009 would herald the end of the soft market. Market conditions showed some signs of improvement in the first half of the year, however, the combination of the recovery of financial

markets and the absence of a major loss event has meant we have seen little or no improvement in rating within the insurance industry.

In general, reinsurance business was firmer than insurance business and, within insurance, retail pricing was more resilient than wholesale. We have lost business in certain lines to competitors at rating levels which we believe to be inadequate, but have seen growth in areas that have experienced losses and where prices have risen – including financial institutions, political risk and trade credit, energy and aviation. AEGL also continues to benefit from a flight to quality, capability and balance sheet strength – especially in those lines of business or risk layers where price is not the single determining factor.

Achievements during the year

Adapting to the changing environment

We at ACE seek to balance our underwriting position with the needs of our clients and shareholders. Now, more than ever, clients are looking to reduce their insurance costs and we have used our proven underwriting skills to offer flexible solutions and commensurately priced alternatives. We have aligned ourselves to address clients' needs through risk engineering and risk education, have provided new forms of coverage including AEGL's environmental liability solutions, and have stepped into areas that others tend to avoid yet where we have proven expertise and will receive an appropriate return for risk such as trade credit risk and financial institutions. We will continue to look at strategic initiatives which suit our underwriting appetite throughout the coming year.

Integration of the P&C and A&H businesses in the UK & Ireland

In September, AEGL restructured its UK & Ireland P&C and A&H businesses to create two distinct segments, Major Risks and Corporate, and launched a suite of cross-class products targeting a range of business sectors. The new segments focus on delivering responsive technical expertise and service support aligned directly to the needs of brokers and clients, with dedicated underwriting and business development teams covering both P&C and A&H.

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Distribution and service

The majority of AEGL's P&C business is conducted via registered brokers, with the A&H business benefiting from the support of partners and sponsors throughout the UK and Europe. Whilst we recognise the added value brokers bring to our underwriting transactions and the tangible benefits of good relationships in arranging insurance solutions, we also endeavour to engage with clients more directly, through our established Client Advisory Boards and the appointment of client executives.

We recognise that service levels are one of the key differentiators in the insurance market and strive to ensure that AEGL's service is amongst the best in the market. The continuing success of our e-commerce platform, ACE Online, which offers brokers quick and easy access to AEGL's speciality and A&H products, is testament to our goal of further enhancing the efficiency and responsiveness of our client and broker service proposition using both traditional and technology driven methods. ACE Online offers the ability to quote, bind and issue policies online in a timely and cost effective manner and its range of A&H products has recently been extended to complement the new UK & Ireland Corporate and Major Risk segments.

Solvency II

The European Union Solvency II Directive is due to be implemented by 1st November 2012. Covering over 30 countries, it is the biggest ever exercise in establishing a single set of rules governing insurer creditworthiness and risk management, and represents a fundamental shift in regulatory requirements for the insurance industry.

AEGL's Solvency II preparation is well underway. As one of the UK's largest commercial P&C insurers, AEGL has chosen to adopt the Internal Model regime and is applying to enter into a pre-approval process with the Financial Services Authority ("FSA"). This will allow us to build our internal model and risk management framework with the benefit of input from the UK regulator. As part of this process, AEGL has completed a Solvency II "gap analysis" which provides an efficient and consolidated assessment of AEGL's risk management objectives and processes

and how these need to adapt for supervision under a Solvency II regime.

AEGL will also participate in the Committee of European Insurance & Occupational Pension Supervisors ("CEIOPS") Quantitative Impact Study 5 during 2010.

Management changes

In September 2009, Mike Reynolds joined the ACE European Group management team as Chief Financial Officer. In addition to welcoming Mike to the organisation, I would like to express our deepest thanks and appreciation to Philippa Curtis who, from 1996, led ACE's European Finance, Actuarial and Risk functions through a period of momentous development and growth. Philippa's contribution has been critical to our success and we wish her the very best for the future.

Future prospects

Although there are early signs that the global economic crisis is abating, significant risks remain and full economic recovery is not guaranteed. In the developed economies, unprecedented Government intervention has stabilised economic activity and fostered a return to modest growth in several countries, although a rapid return to the boom years prior to 2008 is unlikely.

With our clients facing continued fiscal pressures and the projected rise in unemployment we may see a diminished demand for insurance products, particularly in the emerging markets.

Most insurers' balance sheets and investment portfolios have recovered and many have reported strong earnings during 2009. However, recent results have benefited significantly from reserve releases, masking the marginal nature of current accident year profitability. The move towards Solvency II is likely to result in an increase in capital requirements for many, and in order to maintain returns on capital and continued investor support, profitability must increase.

Given the intense, persistent competition currently being experienced, 2010 will be another challenging year, with rates anticipated to be flat or even down on 2009.

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For AEGL, 2010 will see business as usual. We will aim to meet our targets by improving business retention across the board and reviewing our underwriting appetite and bandwidth as appropriate. It is more important than ever for clients to transfer risk to insurers with strong balance sheets. AEGL is first and foremost an underwriting company. We will continue to focus on our established business model: product and geographical diversity, robust risk selection, conservative risk management and, above all, capital protection.

ACE is one of the few insurers with a global network able to deliver management of international insurance programmes and ensuring local compliance with tax and other regulatory requirements. We are making significant investments to expand our capabilities in areas such as multinational client underwriting and servicing, risk management and new technologies. We are looking to increase our penetration in Continental Europe, particularly in specialty classes. We will further improve back office efficiencies. We are dedicated to constantly improving ourselves and our business, and will continue to invest in our people, our relationships and our work places to the ultimate benefit of our clients and ACE Group shareholders.

In conclusion

AEGL has substantial geographical diversity, wide ranging product capabilities, a strong underwriting culture and a team of highly talented, optimistic and motivated people. Regardless of market conditions, our strategy and approach to underwriting, pricing and expense control do not change. AEGL's performance is driven by values and is a testament to our strategy of maintaining underwriting discipline and pursuing a conservative investment policy, avoiding the more complex financial instruments that have proved so damaging to the financial markets.

We have a superb business support network encompassing claims, finance and actuarial, risk management, legal and compliance, human resources, operations and IT. All of our people know exactly what they must do to continue to build on our success and I would like to take this opportunity to thank all ACE employees throughout the UK and Europe for their hard work and dedication.

A.J. Kendrick
Chairman and Chief Executive Officer
25 March 2010

Business Review

31 December 2009

The board of AEGL has prepared this review in accordance with Section 417 of the Companies Act 2006. In addition to this statutory requirement, this report also addresses other aspects of the company's business which the board believes will be of benefit to all stakeholders.

Business objectives and strategy

AEGL is a major contributor to the ACE Group of Companies, providing approximately 19% of the ACE Group's overall gross written premium for 2009.

The ACE Group of Companies is one of a few truly global insurance and reinsurance organisations. Writing over \$19 billion of gross written premiums and with more than \$78 billion in assets at year end 2009, the ACE Group is distinguished by its underwriting expertise, superior claims handling and global franchise. It has a physical presence in more than 50 countries and conducts business in over 140, employing more than 15,000 people worldwide. As well as being one of the world's leading providers of commercial property and casualty insurance and reinsurance, ACE also has a major presence in the accident & health business and a growing life insurance operation. 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 is a major participant in the UK, Ireland and Continental European insurance markets, with acknowledged underwriting expertise, diverse products and a strong balance sheet. The underwriting portfolio encompasses property & casualty and accident & health insurance, London market, US and international specialty business and treaty reinsurance.

AEGL's key strategy focuses on an established underwriting ethos that permeates the company. It is managed to earn an underwriting profit with both insurance market and economic factors considered in the assessment of insurance risks. Underwriting discipline is fundamental to this strategy and underwriters use their skills to set pricing, terms and conditions that reflect clients' changing requirements in the current, challenging environment. The company

strives to offer superior service levels in all aspects of its operations, ranging from policy processing to engineering risk management and claims handling, and has invested in technology to improve its operational efficiency, underwriter support and broker interfaces.

AEGL is headquartered in London but can issue policies locally throughout its network of UK and European branch offices. This encourages underwriting flexibility and high levels of service for brokers and clients whilst ensuring local regulatory and tax requirements are adhered to.

AEGL is an established player in the multinational marketplace with the capability to front business and provide fully integrated international insurance programmes for clients. AEGL's dedicated and experienced international underwriting and service teams work with the ACE Group's global network of offices to provide seamless, tailored solutions to the often unique and complex needs of multinational companies which includes agreeing coverage, issuing policies, adjusting claims and moving funds, all in accordance with legislative requirements and agreed service standards. The continuing trend of companies expanding beyond their own borders makes multinational business a key priority for AEGL.

AEGL is committed to protecting and preserving its capital. It continues to operate a conservative investment strategy and has maintained its focus on cash flow management and liquidity to secure its position as a successful long term insurer.

Organisation of the business

Headquartered in the UK and with branch offices in another 19 countries across Europe, AEGL holds cross-border permissions throughout the European Economic Area and is eligible to underwrite Excess & Surplus Lines ("E&S") business in 42 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.

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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.

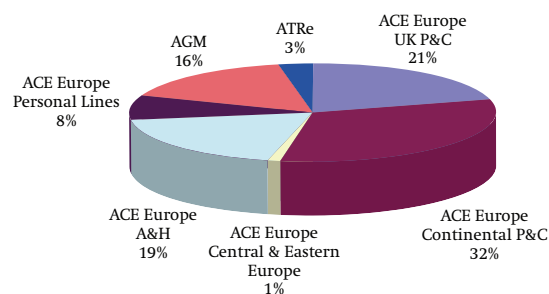
ACE Europe provides tailored insurance solutions for a diverse range of clients. Its product range includes property, primary & excess casualty, financial lines, marine cargo and construction related risks. ACE Europe also underwrites an accident & health and travel insurance portfolio, providing benefits and services to individuals, employee groups and affinity groups throughout Europe. In some cases these products are packaged under other brands or form part of another service provider’s products. 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. ACE Europe has successfully blended the knowledge of its local markets with the worldwide perspective available through the global organisation, building a significant position 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 Lloyd’s Syndicate 2488, managed by ACE Underwriting Agencies Ltd. This flexibility allows AGM to provide risk solutions to clients in over 140 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 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, 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 Lloyd’s Syndicate 2488.

AEGL, Syndicate 2488 and a number of other smaller, overseas legal entities which are overseen by the European management team collectively form the ACE European Group.

Calendar year 2009 gross written premiums split by management reporting category



AEGL benefits from comprehensive and fully integrated support functions encompassing claims, finance and actuarial, risk management, legal and compliance, human resources, operations and IT. These support services are shared between all entities managed by the ACE European Group, predominantly AEGL and Syndicate 2488.

Andrew Kendrick has been Chairman and Chief Executive Officer of ACE European Group since November 2004. The underwriting business of the company is organised into three management streams: ACE UK, led by Richard Pryce and encompassing AGM and ACE Europe UK & Ireland P&C business; Continental Europe and Central & Eastern Europe P&C, headed by David Furby; and A&H, headed by Andy Hollenberg.

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In September 2009, Mike Reynolds was appointed Chief Financial Officer, ACE European Group and was appointed to the AEGL board on 1 October 2009. Mike was previously the Chief Financial Officer of Aon Benfield, the largest global reinsurance broker in the world, and brings with him considerable finance expertise, particularly in the areas of financial management, budgeting and strategic planning.

Significant business achievements

New products

AEGL is renowned for its diverse portfolio of products and continues to enhance the value of its customer proposition by regular product innovation. Recently launched products include “ACE Evolve”, a co-ordinated insurance and risk-management solution for mid-sized companies with overseas subsidiaries or assets, a service usually offered only to large, London based multinational clients.

With European countries now committed to rapidly increasing the amount of electric power generated from renewable energy sources, and in recognition of the growing importance of alternative energy production in tackling climate change, AEGL has introduced “ACE Renewable Energy”, an innovative insurance solution which addresses the evolving needs of a fast growing business sector.

Opening of Turkey branch office & licence approval

In line with strategic expansion objectives, AEGL received authorisation to underwrite Turkish P&C and A&H insurance and reinsurance business through its office in Istanbul in June 2009. As a fast developing economy with a population of 74 million, AEGL anticipates that the local insurance market will develop substantially in the long term and represents a significant opportunity for the company.

Launch of a new look ACE online website

A new look ACE Online, AEGL's market leading e-commerce platform that enables brokers to quote, bind and issue insurance policies on-line, was launched in October 2009. In addition to functional improvements to the system, the range of products offered through the site has been expanded to include various A&H products alongside the broad range of existing specialty P&C products. The amount of

business transacted on the site since its initial launch in 2005 has grown year on year, with over 7,500 policies currently on the system.

Launch of “Progress” client magazine

Also in October 2009, AEGL launched “Progress”, a new client magazine focusing on the risk management needs of multinationals and larger corporate companies. The magazine is intended to be of educational value to risk managers and to demonstrate AEGL's understanding of the risks and opportunities facing businesses in the current economic climate. It features contributions from ACE employees, clients, brokers and academics throughout the UK and Europe and covers a diverse range of issues. The magazine was officially launched at the FERMA Congress in Prague and was distributed directly to clients and prospects throughout Europe. Progress is also available in digital format through AEGL's website.

2nd UK Client event

Following on from the success of AEGL's 2008 UK corporate client event, “Local knowledge in a global market”, a second event entitled “Working together to navigate the storm” was held in May 2009. These events bring together leading UK risk managers to discuss some of the key issues impacting UK businesses at both the national and global level.

Business environment

Following the unprecedented economic events in 2008, the global financial markets have generally experienced a good recovery, shoring up capital and strengthening balance sheets. Whilst a number of countries are reportedly emerging from recession, continuing high levels of unemployment and much reduced demand within the services sector means that the potential for a double dip recession remains, and the outlook for 2010 remains uncertain.

The insurance industry continues to see high levels of competition which, together with the absence of a major loss event in 2009, is resulting in increasing pressure on rating levels, particularly within the retail P&C business sector. Despite this, AEGL has experienced some upward rate movement in airlines, trade credit risk and financial institutions.

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AEGL will rise to the economic and market challenges through 2010 by maintaining underwriting discipline, focusing on the retention of core accounts, continuing to implement effective expense control and retaining key underwriting and support staff.

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.

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	2009	2008
Net written premiums	937.2	787.6
Combined ratio*	95.5%	101.5%
Profit before tax	262.2	2.8

* 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 a regular basis.

Results and performance

2009 produced a pre-tax operating profit of £262.2 million and a combined ratio of 95.5%. A summary of the reported financial results is shown in the following table.

£ million	2009	2008
Gross written premiums	2,202.6	1,962.7
Net written premiums	937.2	787.6
Net earned premiums	932.9	786.8
Incurred losses	580.4	524.4
Operating expenses	310.2	273.9
Equalisation reserve movement	(7.5)	(16.9)
Underwriting profit	49.8	5.4
Profit on sale of Swiss business	-	9.2
Investment return	219.2	(88.1)
Net other income (charges)	(6.8)	76.3
Net pre-tax profit	262.2	2.8
Combined ratio	95.5%	101.5%

AEGL underwrites UK, Continental Europe, US and international business which is principally transacted in sterling, euros and US dollars. For accounting purposes, the results of this business are presented in sterling. The currency risk section within Note 2 to the Financial Statements discusses currency exposure in more detail.

Production

Gross written premiums were £239.9m higher in comparison to prior year. Despite the positive impact of foreign exchange, premium growth was impacted by recession-related declines in both P&C and A&H. Client exposures were down, with many buyers seeking more affordable alternatives such as higher deductibles and lower limits, and some choosing to place their business with lower-rated, cheaper capacity in a quest to save on premium. AEGL's A&H business also continues to feel the impact of recession, driven by factors such as declines in global consumer spending, credit and travel, as well as reductions in employer related benefits such as accident insurance.

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AEGL purchases reinsurance to mitigate the impact of major events and an undue frequency of smaller losses. The principal reinsurance programme operated by AEGL during 2009 is 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. 2009 net written premiums were £149.6 million higher in comparison to prior year.

Losses

AEGL benefited from relatively light catastrophe losses during 2009 as well as from £41.7 million prior period reserve releases. Excluding catastrophe losses and prior period development, the current accident year loss ratio for the year was 66.7% – a very good performance that illustrates the strength of the company's core business.

Expenses

Operating expenses constitute commissions and general administrative expenses. The business continues to focus on the management of each of these components in order to achieve greater operational efficiencies.

Investment performance

After the turmoil in the financial markets witnessed in 2008, 2009 proved to be a strong year for investors. After continued volatility in the first quarter of 2009, in the remainder of the year credit spreads narrowed reflecting the improvement in corporate performance, lower expected downgrade and default rates together with increased demand from investors. With this backdrop, fixed income performed strongly and investors focused on minimising cash while interest rates remained at historic lows. For 2009 calendar year, AEGL generated a total investment return of 9.4% based on funds available for investment.

AEGL maintained its bias towards investment grade fixed income investments throughout the year, and at year end approximately 93% of the total investments

were allocated to investment grade portfolios. During June 2009 AEGL's modest allocation to equities was liquidated with the proceeds allocated to the high yield portfolio. Consequently, at year end, the high yield portfolio constituted the remaining 7% of the investment balances.

Financial position

Investments

AEGL maintains five active investment grade fixed income portfolios, the core currencies of which are sterling, euro and US dollars. AEGL also maintains further actively managed portfolios for US dollar high yield fixed income securities and sterling and euro denominated financial debt securities. Further 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 AEGL's investment portfolios is sterling 47%, euro 29%, US dollars 23% and other currencies 1%.

During 2009, Pacific Investment Management and Blackrock Investment Management replaced Western Asset Management as managers of AEGL's investment grade euro fixed income portfolio. Following the acquisition by Blackrock of Barclays Global Investors in the latter part of the year, Blackrock managed approximately 50% of AEGL's investments, with the remainder managed by Western Asset Management, Pacific Investment Management and Goldman Sachs Asset Management.

Global markets and economies began to stabilise at the start of the year in part as a result of the extraordinary measures taken by governments. As markets stabilised, yields narrowed dramatically resulting in strong gains for fixed income investors. Sectors which bore the brunt of the falling valuations in 2008 showed the most marked recoveries. Financial corporate bonds, asset backed, collateralised mortgage backed and high yield sectors were among the strongest performing. Conversely, yields for government bonds rose in most markets and this resulted in modest total returns for this sector.

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The sterling portfolios managed by Blackrock and Goldman Sachs hold a blend of government securities and other sectors. Both portfolios performed satisfactorily during the year, generating total returns approaching 7%. The US dollar investment grade portfolio managed by Western Asset Management maintained significant exposure to non-government sectors and generated strong total returns for the year in excess of 9%. Management of AEGL's other active investment grade fixed income portfolios was transferred to Pacific Investment Management and Blackrock during 2009 and the portfolios produced positive returns.

AEGL's high yield portfolio managed by Western Asset Management focuses on upper tier high yield fixed income, targeting average Standard & Poor's quality of "B" or higher and is therefore higher quality than the universe of high yield issues. Nevertheless, in a year in which investments with lower credit ratings typically produced the best returns, the portfolio produced strong total returns in excess of 38% for the year.

In 2009, AEGL continued to lend securities through State Street Bank and Trust with no changes to the permitted lending limits of up to 40% of the aggregate investment portfolios to approved counterparties subject to limit restrictions. AEGL and fellow ACE Group companies also continued to utilise the notional pooling facility operating with Bank Mendes Gans, a subsidiary of ING, to facilitate individual short term currency overdrafts for individual participants and hence improve immediate liquidity.

Capital

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 objectives and meet the requirements of policyholders, regulators and rating agencies whilst retaining financial flexibility by ensuring liquidity.

AEGL assesses its capital requirements using an internal model based on Individual Capital Assessment ("ICA") principles which is subject to review by the FSA. AEGL also 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. During 2009, following AEGL's third ARROW assessment, the company was issued with revised Individual Capital Guidance by the FSA. The company currently maintains a comfortable margin against each of these key capital measures based on the admissible shareholders' funds of £789.2 million. AEGL continues to develop its internal model to meet continuously developing best practice industry standards and to further embed risk and capital assessment within the business as it prepares to meet Solvency II regulatory requirements.

Ratings

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

The A.M. Best rating was affirmed in March 2009. A.M. Best's rating rationale states that the rating reflects the company's excellent stand-alone risk-adjusted capitalisation and good anticipated performance, in addition to its strong business profile in the United Kingdom and continental Europe. AEGL's rating also factors its importance to its parent company, ACE Limited.

In December 2009, Standard & Poor's ("S&P") affirmed the "A+ (Strong)" financial strength ratings on ACE Limited's core operating companies, which include AEGL. The ratings have a positive outlook. In support of the rating decisions, the S&P credit analysis report cited a number of ACE's strengths, including its global presence, diversification by product line and sector, very strong operating performance and liquidity, conservative investment portfolio, and strong capital adequacy and enterprise risk management.

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Governance

AEGL continues to work closely and further develop its relationships with its regulator, the FSA. AEGL believes that the FSA operates one of the strongest insurance related regulatory regimes in the world and the board of directors continues to support their outcomes-focused based approach to regulation and their contribution to the development of the Solvency II directive.

Corporate governance is focused upon the proper oversight of the management of the business, senior management responsibility and the effectiveness of systems and controls.

The board of directors of AEGL ("the board") is comprised of members 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 four times a year and delegates certain oversight responsibilities to two committees, the Audit Committee and the Risk Committee, under formal terms of reference. AEGL's non-executive directors take an active role in these committees, with the Audit Committee being solely comprised of non-executive directors.

The Risk and Audit committees operate a number of sub-committees including the Control Environment Sub-Committee which oversees the effectiveness and efficiency of the control environment and provides the committees with information to assess residual risk exposures.

The board reviews and approves the annual business plan for the company, which includes assessing the risk appetite for the company and considering the strategy, limits and reinsurance protections for each business class. The board also receives reports from each of the Risk and Audit committees, reviews the ICA, quarterly financial information, Treating Customers Fairly metrics and significant management decisions.

The company's strategies are approved by the board and communicated clearly throughout the business through policy statements and guidelines.

Risk & control framework

The board ensures the company operates within an established framework of effective systems of internal controls, risk management and compliance with policies, procedures, internal controls and regulatory requirements.

A principal committee of the AEGL board, the Audit Committee is responsible for oversight and review of external and internal audit processes. In the case of the external audit process, this involves working in conjunction with the ACE Group audit function to agree and monitor the nature and scope of work in the preparation of the statutory accounts and any external reporting requirements. In the case of the internal audit function, the role involves agreeing and monitoring, again in conjunction with the group audit function, the nature and scope of work to be carried out by internal audit. This is aimed at providing assurance to management that the internal control systems, agreed by executive management as being appropriate for the prudent management of the business, are operating as planned. At all times the Audit Committee is expected to challenge any aspect of these processes which it considers weak or generally poor practice.

The Risk Committee, another principal committee of the AEGL board, assists the board by providing oversight of risk management as well as overseeing the development and embedding in the business of risk management and capital assessment. The Risk Committee ensures that business risks and controls are recorded and monitored. A number of sub-committees or subject matter functions dedicated to managing specific areas of risk such as underwriting, reserve, investment, counterparty credit, operational and projects, report to the Risk Committee.

All key policies and procedures are subject to board approval and ongoing review by executive management, the Risk Committee and internal audit.

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The company is continuing to invest in the development of the risk management framework through the dedicated central risk management and capital modelling team which has been tasked with further embedding risk assessment within the business.

The company has developed a risk based framework for identifying the key risks to which each business sector, and the company as a whole, is exposed and their resultant impact on economic and regulatory capital. This framework employs ICA principles to assess risk and manage capital requirements to ensure the capital required to support AEGL's business objectives and meet the requirements of policyholders, regulators and rating agencies is in place.

The principal risks from the company's insurance and reinsurance business arise from its underwriting activities, both prospective and retrospective. Key risks include unexpected losses arising from inaccurate pricing, fluctuations in the timing, frequency and severity of claims compared to expectations, inadequate reinsurance protection and inadequate reserving. The company also faces risks relating to its investment activities, exchange rate fluctuations and business operational activities.

Underwriting risks and line sizes are continually monitored through the established peer review process and automated 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 loss outcome of the underwriting activity is continually re-assessed and considered by the Reserve Sub-Committee. With such a large and diverse book, it is vital that the company's aggregate exposures are continually monitored and adjustments made to the underwriting profile as appropriate. The company operates a dedicated catastrophe management function independent of underwriting management, whose responsibility is to model aggregate risk and determine pricing for individual policies, providing a key control to the underwriting process.

Compliance

Compliance with regulation, legal and ethical standards is a high priority for the company, and the compliance team and finance department have an important oversight role in this regard.

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 the legislation.

The financial crisis has led to increased scrutiny of financial institutions by regulators. In 2009 the FSA carried out their ARROW risk assessment. They positively commented on the company's strong underwriting focus, and expressed a view that they believe the systems and controls to be generally fit for purpose. We continue to work with the FSA on regulatory issues as they arise. AEGL employs a highly skilled and proficient workforce to manage its regulatory and compliance undertakings and aims to operate to a standard of best practice. The company enjoys good relationships with regulators in each of AEGL's jurisdictions and engages in open dialogue and communication to address and resolve any issues.

Employees

ACE is dedicated to providing a safe, healthy and ethical environment for its employees, and seeks to create a workplace where all employees, agency staff and contractors are treated equitably and with dignity and respect. ACE fully supports the rights and opportunities of all people to seek, obtain and hold employment without discrimination.

ACE is an equal opportunity employer. One of the three key ACE mission statements is to provide "superior employee value by creating a rewarding and ethical environment." In support of this, it is ACE's policy to take whatever steps reasonably practicable to promote equality of opportunity and to eliminate discrimination

Business Review

31 December 2009

in employment. The ACE Group has implemented a number of policies relating to diversity and equal opportunities including but not limited to age, disability, race, religious and sex discrimination.

Applications for employment by disabled persons are always fully considered, bearing in mind the aptitudes and abilities 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 ACE Group that the training, career development and promotion of disabled persons should, as far as possible, be identical with that of other employees.

The ACE Group's global employee share scheme provides all eligible employees with an opportunity to participate in the Group's success as measured by the potential increase in stock price. The scheme continues to operate successfully and is open to all employees with a minimum of six months service with the company.

Communication with employees is primarily effected through the corporate intranet and regular briefings and presentations by the Chief Executive Officer and local management.

Details of the number of employees and related costs can be found in note 8 to the financial statements.

ACE and the environment

Climate change affects everyone throughout the world's communities, including ACE customers and employees. The risks it poses are serious issues for the insurance industry as it is its business to provide security from the worst of the effects, including hurricanes, windstorms, flooding and drought.

The ACE Group is committed to lessening the group's impact on the environment and is a member of the US Environmental Protection Agency's Climate Leaders program. In addition to the environmental activities at the corporate level, the ACE Group has launched ACE Green, an environmental program for its global employees. As part of this initiative, the UK and other countries within Europe have formed local ACE Green

committees which are charged with viewing and assessing the environmental initiatives, actions and improvements that can be adopted across all ACE offices by staff, partners, suppliers and contractors. ACE has also launched the global site www.acegreen.com which highlights its green activity and identifies insurance products to help clients mitigate climate related risks. In October 2008, ACE announced that it will do its part to lessen its impact on the environment by reducing global greenhouse gas emissions by 8% per employee from 2006 to 2012.

ACE in the community

The ACE Group supports the communities around the world in which its employees live and work through the established "ACE Foundations" and through group sponsored volunteer initiatives. These positive contributions to the fabric of local communities return long-lasting benefits to society, employees and the group.

In addition, ACE European Group ("AEG") employees who are involved with charitable activities and fund raising in their local community or a national registered charity may apply to the ACE European Group Community Support Programme Committee ("ACS") for a financial donation to their chosen cause.

During 2009, approximately 70 requests for donations or matched funding were received from offices throughout the UK, Ireland and Continental Europe, covering a wide range of charities that included:

- Cancer research & treatment for adults and children;
- Hospices for adults and children;
- Education & special needs;
- Quality of life programmes;
- Critical illnesses; and
- Military veteran services

In addition to the requests that fulfilled the ACS criteria, a small number of donations were also made in response to external charity requests, bringing total donations made during 2009 to in excess of £91,000.

During the year, a selection of ACE employees involved in fund raising and whose charities received donations

Business Review

31 December 2009

from ACS were filmed on ACE TV sharing their activities with all AEG employees.

Just some of the other initiatives in which members of AEG participate are highlighted below:

- The Lloyd's Community Reading Partners scheme is a long running project in which employees in AEG's London office make a real difference to the lives of children in East London by devoting one lunch break every week to partner with children in a local school and help with their literacy and numeracy skills.
- AEG hosts a "Take Our Students to Work" programme aimed at secondary school students attending inner city London schools. The event, which takes place twice a year, allows students to take a peek into the daily workings of the insurance world by spending a day at AEGL's UK headquarters. In addition, AEG has initiated a new work experience scheme for 2010, where students will shadow underwriters across various business classes and are given the opportunity to present to a broker.
- AEG also participates in the annual Tower Hamlets schools public speaking competition, organised by the Lloyd's Community Programme ("LCP") and Tower Hamlets Education Business Partnership. In 2009, AEG hosted a lunch for all semi-finalists, teachers and volunteers involved in the project prior to the final of the competition, which was held at Lloyd's. Again in conjunction with the LCP, AEG helped run a sports day for children in the Tower Hamlets area. Over 500 children aged 8 and 10 participated in the event which included various sporting events which will feature in the 2012 London Olympics.

Approved by the Board of Directors

11 March 2010

Directors' Report

31 December 2009

The directors are pleased to submit their report and the audited financial statements for the year to 31 December 2009.

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.

Principal risks and uncertainties

A review of the company's principal risks and uncertainties is set out in the Business Review.

Results and dividends

The company made a profit on ordinary activities before tax for the year to 31 December 2009 of £262.2 million (2008: £2.8 million).

Shareholders' funds at the 31 December 2009 totalled £825.3 million (2008: £721.2 million). A reconciliation of the movement in shareholders' funds during the year is set out in note 18 to the financial statements.

The directors do not propose a dividend (2008: £nil).

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 2009 to the date of this report unless otherwise indicated:

Executive directors:

P M Curtis (resigned 30 September 2009)
D M A Furby
A A Hollenberg (appointed 13 August 2009)
A J Kendrick
R P Murray
R V Pryce
M T Reynolds (appointed 1 October 2009)

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' Report

31 December 2009

Financial risk management

Information on the use of financial instruments by the company and its management of financial risk is disclosed in note 2 to the financial statements. In particular the company's exposures to interest rate risk, equity price risk, currency 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 2009 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, 25 March 2010

ACE Building
100 Leadenhall Street
London
EC3A 3BP

Statement of Directors' Responsibilities

31 December 2009

The directors are required by the Companies Act 2006 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 2009. 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 2006. 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 2009 which comprise the Profit and Loss Account, the Balance Sheet, the Statement of Total Recognised Gains and Losses, and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

Respective responsibilities of directors and auditors

As explained more fully in the Statement of Directors' Responsibilities the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, 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.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of 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 2009, 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 note 19.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2009 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Independent Auditors' Report

to the members of ACE European Group Limited

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Gavin Phillips (Senior Statutory Auditor)
For and on behalf of **PricewaterhouseCoopers LLP**
Chartered Accountants and Statutory Auditors
London
25 March 2010

Profit and Loss Account

for the year ended 31 December 2009

	Note	2009 £'000	2008 £'000
Technical account – general business			
Earned premiums, net of reinsurance:			
Gross premiums written – continuing operations	3	2,201,753	1,964,080
– discontinued operations	3	873	(1,334)
Gross premiums written	3	2,202,626	1,962,746
Outward reinsurance premiums		(1,265,425)	(1,175,180)
Net premiums written		937,201	787,566
Change in the gross provision for unearned premiums		(41,035)	(3,238)
Change in the provision for unearned premiums – reinsurers' share		36,704	2,469
Earned premiums, net of reinsurance		932,870	786,797
Claims incurred, net of reinsurance:			
Claims paid:			
Gross amount	3	(1,036,876)	(931,260)
Reinsurers' share		553,798	517,297
Net paid claims		(483,078)	(413,963)
Change in the provision for claims outstanding:			
Gross amount	3	(11,581)	(163,200)
Reinsurers' share		(85,720)	52,722
Change in the net provision for claims outstanding		(97,301)	(110,478)
Claims incurred, net of reinsurance		(580,379)	(524,441)
Net operating expenses	5	(310,145)	(273,896)
Change in the equalisation provision	19	7,493	16,896
Balance on the technical account for general business		49,839	5,356

ACE European Group Limited

Profit and Loss Account

for the year ended 31 December 2009

		2009	2008
	Note	£'000	£'000
Non-technical account			
Balance on the general business technical account		49,839	5,356
Profit on sale of an operation		-	9,243
Investment income	9	199,751	187,250
Unrealised gains on investments	9	227,294	70,398
Investment expenses and charges	9	(87,572)	(105,457)
Unrealised losses on investments	9	(120,230)	(240,284)
Foreign exchange differences		(7,326)	75,062
Other income		472	1,187
Profit on ordinary activities before taxation		262,228	2,755
<i>Continuing operations</i>			
<i>Discontinued operations</i>			
		264,490	14,730
		(2,262)	(11,975)
Taxation on profit on ordinary activities	10	(81,536)	(9,004)
Profit (loss) for the financial year		180,692	(6,249)

Statement of Total Recognised Gains and Losses

for the year ended 31 December 2009

		2009	2008
		£'000	£'000
Profit (loss) for the financial year		180,692	(6,249)
Currency translation differences	17	(74,995)	89,078
Actuarial (loss) gain recognised in relation to pension schemes	17	(2,203)	3,142
Movement on deferred taxation relating to pension liability	17	617	(880)
Total recognised gains relating to the year		104,111	85,091

ACE European Group Limited

Balance Sheet

at 31 December 2009

	Note	2009 £'000	2008 £'000
Assets			
Investments			
Other financial investments	12	2,731,111	2,331,441
Financial derivative instruments	12	1,784	6,272
Deposits with ceding undertakings		-	37
		<u>2,732,895</u>	<u>2,337,750</u>
Reinsurers' share of technical provisions			
Provision for unearned premiums		341,290	321,186
Provision for claims outstanding		2,055,451	2,220,306
		<u>2,396,741</u>	<u>2,541,492</u>
Debtors – amounts falling due within one year			
Debtors arising out of direct insurance operations:			
amounts owed by policyholders		5,151	7,126
amounts owed by intermediaries		402,764	400,218
Debtors arising out of reinsurance operations		228,273	267,964
Other debtors	13	67,142	140,083
		<u>703,330</u>	<u>815,391</u>
Other assets			
Tangible assets	15	6,569	8,467
		<u>6,569</u>	<u>8,467</u>
Prepayments and accrued income			
Accrued interest and rent		42,129	46,457
Deferred acquisition costs		104,596	109,981
Other prepayments and accrued income		72,297	73,382
		<u>219,022</u>	<u>229,820</u>
Total assets excluding pension surplus		<u>6,058,557</u>	<u>5,932,920</u>
Pension surplus	1	<u>391</u>	<u>2,432</u>
Total assets		<u><u>6,058,948</u></u>	<u><u>5,935,352</u></u>

ACE European Group Limited

Balance Sheet

at 31 December 2009

		2009	2008
	Note	£'000	£'000
Liabilities			
Capital and reserves			
Called-up share capital	16	544,741	544,741
Profit and loss account	17	254,913	150,802
Merger reserve	17	25,653	25,653
Total shareholders' funds	18	825,307	721,196
Technical provisions			
Provision for unearned premiums		717,311	712,019
Provision for claims outstanding		3,655,464	3,774,395
Equalisation provision	19	52,375	59,867
		4,425,150	4,546,281
Deposits received from reinsurers		3,736	3,883
Creditors – amounts falling due within one year			
Creditors arising out of direct insurance operations		25,816	24,651
Creditors arising out of reinsurance operations		283,945	277,990
Bank overdraft	2	11,860	25,987
Other creditors including taxation and social security	20	396,512	223,546
		718,133	552,174
Other financial liabilities	12	2,514	7,178
Accruals and deferred income			
Deferred acquisition costs relating to reinsurance		49,842	55,764
Other accruals and deferred income		34,266	48,876
		84,108	104,640
Total liabilities		6,058,948	5,935,352

The financial statements on pages 20 to 46 were approved by the board of directors on 11 March 2010 and were signed on its behalf by:

M T Reynolds

Chief Financial Officer

25 March 2010

Notes to the Financial Statements

31 December 2009

1. Accounting policies

Basis of preparation

The financial statements have been prepared in accordance with The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 ("SI2008/410") relating to insurance companies' individual accounts and in accordance with the Statement of Recommended Practice on Accounting for Insurance Business issued by the Association of British Insurers ("the ABI SORP") dated December 2005 (as amended in December 2006) 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".

The company has adopted amendments to FRS 29 "Financial Instruments: Disclosures". The adoption of these amendments has no impact on prior or current year results, and 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 17), 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.

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.

Notes to the Financial Statements

31 December 2009

1. Accounting policies – continued

Provisions for claims outstanding and related reinsurance recoveries – continued

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.

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.

Notes to the Financial Statements

31 December 2009

1. Accounting policies – continued

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 3 to SI 2008/410 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 determines 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 to minimise any measurement or recognition inconsistency with the associated liabilities.

Financial assets designated as fair value through profit and loss are initially recognised at fair value with any transaction costs being expensed through the profit and loss account. For quoted investments where there is an active market, the fair value is their quoted bid price at the balance sheet date. For quoted investments where there is no active market, the fair value is determined by reference to prices for similar assets in active markets.

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 at bank and in hand

Cash at bank and in hand is cash in hand and deposits repayable on demand, less overdrafts repayable on demand. Deposits are repayable on demand if they can be withdrawn at any time without notice and without penalty or if a maturity or period of notice of not more than 24 hours or one working day has been agreed.

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 and interest rate risk arising from investing activities. These derivative financial instruments do not qualify for hedge accounting under FRS 26, Financial Instruments: Measurement.

Notes to the Financial Statements

31 December 2009

1. Accounting policies – continued

Financial Assets and Liabilities – continued

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.

Stock lending

The company is party to a securities lending agreement under which securities are lent to third parties on a short-term basis with collateral provided in return. The securities lent are not derecognised; rather they continue to be recognised within the appropriate investment classification.

Where the company is provided with collateral in the form of cash, it may hold the cash or reinvest it in other financial investments. The company recognises the cash or investments and the related obligation to return such collateral in the company's balance sheet.

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 fair 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

Notes to the Financial Statements

31 December 2009

1. Accounting policies – continued

Deferred taxation

Deferred taxation is 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 are not discounted.

Operating leases

Rents 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.

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

AEGL operates as a number of branches, each of which conducts business in a variety of transactional currencies. These branches include both UK and overseas insurance operations and a centralised treasury operation. Each of the branches is designated a functional currency.

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

Results of branches, recorded in their functional currency, are translated into sterling at average rates of exchange for the year while assets and liabilities are translated to sterling at year end exchange rates. Differences arising on translation are recorded in the statement of total recognised gains and losses.

2. Capital management & financial risk management

Capital management

AEGL assesses its capital needs on a risk management basis and maintains an efficient capital structure consistent with the company's risk profile and business requirements, and to meet regulatory requirements. The company then seeks to maintain financial strength and capital adequacy to support business growth and meet the requirements of policyholders, rating agencies and regulators, whilst retaining financial flexibility by ensuring substantial level of liquidity. Once these capital needs have been met, it is the policy of the company to distribute any surplus capital through dividends to its ultimate parent company, ACE Limited.

Notes to the Financial Statements

31 December 2009

2. Capital management & financial risk management – continued

AEGL is regulated by the FSA and as such is subject to insurance solvency regulations which specify the minimum amount and type of capital that must be held. This includes the need for capital to be assessed under the FSA's risk based Individual Capital Assessment ("ICA") regime. Accordingly, the company has developed an internal model to self assess capital requirements. This model has been the basis for which the FSA has issued Individual Capital Guidance ("ICG") to the company in 2005, 2007 and more recently in 2009 through their third ARROW review.

The company manages and monitors regulatory capital by reference to both the minimum requirements based within the EU directive, its ICA self assessed capital need, and the current ICG. The company performs the necessary tests and controls to ensure continuous and full compliance with such regulations.

The primary objectives of the company in managing capital can be summarised as follows:

- to satisfy the requirements of its policyholders, regulators and rating agencies;
- to match the profile of its assets and liabilities, taking account of the risks inherent in the business;
- to manage exposures to key risks;
- to maintain financial strength to support new business growth;
- to retain financial flexibility by maintaining strong liquidity.

Financial risk management objectives

The company is exposed to a range of financial risks through its financial assets and financial liabilities. The most important components of this financial risk are market risk (including interest rate risk, equity price risk and currency risk), liquidity risk and credit risk.

These financial risks principally arise from the investment activity of the business and consequent holdings in fixed income and equity investments, all of which are exposed to general and specific market movements. The underwriting activity of the business also generates financial risk, particularly in the form of currency risk as well as liquidity and credit risk through its insurance and reinsurance receivables and payables.

The notes below explain how financial risks are managed. The processes used to manage these risks are unchanged from previous periods, and cover areas such as investment activity through stochastic modelling of the portfolio, within its internal capital model and consequent capital requirements.

Investment activity governance

The company operates an Investment Committee which functions under terms of reference determined by the Risk Committee of the Board. The Committee is charged with establishing and effecting an appropriate investment policy for the company having regard to the financial risk appetite of 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 including AEGL. The Committee also includes the Chief Executive Officer, Chief Financial Officer and Treasurer of the company.

The investment management function is outsourced to specialist external managers: Barclays Global Investors, Western Asset Management, Goldman Sachs Asset Management, Blackrock and Pacific Investment Management. Blackrock purchased Barclays Global Investors at the end of 2009.

Notes to the Financial Statements

31 December 2009

2. Capital management & financial risk management – continued

Asset allocation policy

The Investment Committee has established a broad asset allocation policy which defines the limits for different asset types. The asset allocation policy 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 in 2009 the company only maintained allocations to high yield and equities. The policy stipulates a target range of between 75% and 95% for investment grade fixed income securities and a range of between 5% and 25% for alternative asset classes. The current allocation to alternative assets continues to sit at the lower of the target range for alternative asset classes, however, the position is regularly reviewed by the Investment Committee.

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 these guidelines.

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.

Interest rate risk arises in the fixed income investment portfolio primarily through instrument duration. Accordingly, 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.

Sensitivity analysis for interest rate risk illustrates how changes in the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates at the reporting date. To illustrate the downside risk within the fixed interest portfolio of £2,398 million at external managers as at 31 December 2009 (2008: £2,029 million), an increase of 100 basis points in interest yields across all portfolios consecutively (principally sterling, euro and US dollars) has been calculated. Such an increase would decrease the market value of the investment portfolio and lead to a decrease in the total investment return of £90.9 million and accordingly decrease total shareholders' funds by some £63.6 million.

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 and loss.

The risk in respect of equities is moderated through the asset allocation policy which limits the allocation to equities. The investment guidelines restrict individual equity holdings relative to the size of the portfolio and the benchmark constituents.

All equity holdings of £0.2 million (2008: £18 million) are listed and represent 0.1% (2008: 0.8%) of the total investment portfolio. If the value of all equity markets in which the company invests decreased by 10%, with all other variables held constant, the total investment return would remain the same.

Currency risk

The company is primarily exposed to currency risk in respect of assets and liabilities under policies of insurance denominated in currencies other than sterling. The company maintains various currency balances generated through regular business activity but the majority of the funds held are denominated in sterling, euros and US dollars. The company policy seeks to ensure that an approximate currency match of assets and liabilities is maintained, with the bulk of surplus funds held in sterling, euros and US dollars.

Notes to the Financial Statements

31 December 2009

2. Capital management & financial risk management – continued

Any component of the shareholders funds denominated in currencies other than sterling gives rise to currency risk due to exchange rate volatility relative to sterling.

The company is also exposed to currency risk in the investment portfolio as the investment guidelines allow the managers to invest a portion of the individual portfolios in securities not denominated in the designated core currency of the portfolio. However, the investment management agreements stipulate that the majority of any exposure to non-core currencies must be hedged, thus matching the risk. These allocations to non-core currencies are included within the quarterly evaluation of the currency alignment reviewed by the Investment Committee.

The accounting policy for foreign currencies is stated in note 1 to the financial statements. Profit and loss results pertaining to foreign branches are translated to sterling using the average rates of exchange for the year. Balance sheet components (monetary assets and liabilities) are translated to sterling using the rates of exchange at year end.

For the profit and loss account, the 2009 average euro/sterling and US dollar/sterling rates of €1.12/£1 and US\$1.55/£1 respectively are down on the prior period (2008: €1.28/£1 and US\$1.88/£1). Had sterling weakened by 10% against all currencies (primarily the euro and US dollar) and all other variables remained constant, the profit before tax for the year would have been £15 million less than the amount reported.

For the monetary components of the balance sheet, the year end rates used to convert euro to sterling and US dollar to sterling have risen by 6% to €1.12/£1 and 9% to US\$1.61/£1 respectively (2008: €1.06/£1 and US\$1.48/£1). Assuming sterling had weakened by 10% against all currencies (primarily the euro and US dollar) and all other variables remained constant, the effect of translating year end foreign branch net assets based on these parameters would have resulted in decreased shareholders' funds of £3.6 million, which would have appeared as a gain in the statement of total recognised gains and losses.

Liquidity risk

Liquidity risk is the risk 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.

AEGL participates in a notional pooling programme with other ACE Group companies under a facility operated by Bank Mendes Gans, a subsidiary of ING, which specialises in global liquidity management. The facility operates by the notional pooling of designated balances of the ACE Group participants in order to provide additional liquidity. ACE Group participants may overdraw individual account balances to fund immediate short term needs against credit balances held elsewhere within the pool. On this basis, AEGL maintained an overdraft in the notional pool of £41.9 million at year end. Positive cash balances of £30.0 million bring the overall net overdraft to £11.9 million as presented on the balance sheet.

The company also benefits from letter of credit facilities which can be utilised to meet certain funding needs and notional pooling facilities with other ACE Group companies which serve to provide additional liquidity.

As indicated in the balance sheet, the company's financial liabilities are all payable within one year. Non-derivative financial liabilities with contractual maturities are payable within normal terms of trade, which is on average 60 days. Non-derivative financial liabilities with contractual maturities are limited to reinsurance premiums payable and expense accruals. Derivative financial liabilities at the balance sheet date have remaining contractual maturities of £1.7 million within 1 month, £nil between 1 and 3 months, £nil between 3 months and 1 year and £0.8 million after more than one year.

Credit risk

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 through its investment activity and its insurance operations.

Notes to the Financial Statements

31 December 2009

2. Capital management & financial risk management – continued

Credit risk – investment

The company is exposed to investment credit and price risk as a result of its holdings in fixed income and equity investments.

The risk in respect of fixed income investments is moderated by the application of detailed investment guidelines which limit the size of holdings with individual issuers, restrict duration and dictate minimum credit quality, both for individual holdings and for the aggregate weighted portfolio.

Fixed income holdings of £2,430 million (2008: £2,124.5 million) represented 100% (2008: 99%) of the total investment portfolio. The average credit quality of investment portfolios using Standard and Poor's ratings remained high throughout the year and at year end was "AA". This is comparable to the previous year, despite an increase in the upper tier high yield portfolio funded through equity disposals in the second quarter of 2009. All equity holdings of £0.2 million (2008: £18.2 million) are listed and represent 0% (2008: 1%) of the total investment portfolio.

The risk in respect of equities is moderated through the asset allocation policy which limits the allocation to equities. The investment guidelines restrict individual equity holdings relative to the size of the portfolio and the benchmark constituents.

The investment guidelines seek to limit the credit risk of each of the portfolios through specifying eligible/ineligible investments; setting maximum counterparty exposures and minimum weighted credit quality and individual issuer credit quality; and requiring collateral and indemnity arrangements for stock lending transactions.

The company engages in a securities lending program from which it generates net investment income from the lending of certain of its investments to other institutions for short periods of time. The value of securities loaned is limited to 40% of the company's aggregate portfolio. Collateral is provided against the market value of the loaned securities. The market value is monitored on a daily basis with additional collateral obtained or refunded as the market value of the loaned securities changes.

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.

Credit risk – insurance operations

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 provision for claims outstanding;
- debtors arising from reinsurers in respect of claims already paid;
- amounts due from direct insurance and reinsurance policyholders; and
- amounts due from direct insurance and reinsurance intermediaries.

Ceded reinsurance is used to manage and mitigate inwards direct insurance and reinsurance risk. Ceded reinsurance does not discharge the company's liability as primary insurer. If a ceded reinsurer fails to pay a claim, the company remains liable for the payment to the policyholder. A Reinsurance Security Committee is operated by the ACE Group which analyses the creditworthiness of ceded reinsurers on a quarterly basis by reviewing their financial strength. In addition, the recent payment history of ceded reinsurers is used to update the reinsurance purchasing strategy.

With regard to direct insurance and reinsurance receivables, the company operates a committee to review broker security, a process for monitoring arrangements with managing general agents, and, in certain circumstances, the requirement for collateral to be posted by the policyholder to the benefit of the company.

Notes to the Financial Statements

31 December 2009

2. Capital management & financial risk management – continued

The assets bearing credit risk are summarised below:

	2009	2008
	£'000	£'000
Other financial investments	2,731,111	2,331,441
Derivative financial securities	1,784	6,272
Reinsurers' share of technical provisions	2,396,741	2,541,492
Debtors arising out of direct insurance operations	407,915	407,344
Debtors arising from reinsurance operations	228,273	267,964
Total assets bearing credit risk	5,765,824	5,554,513

Other financial investments and financial derivative instruments are designated as fair value through profit or loss at inception, and their performance evaluated on a fair value basis, in accordance with a documented investment strategy as detailed in note 1. The Standard and Poor's credit rating for other financial investments and derivative financial securities is detailed below.

	2009	2008
	£'000	£'000
AAA	1,583,968	1,438,921
AA	225,511	184,811
A	470,090	413,497
BBB	253,605	180,888
Below BBB or not rated	199,721	119,596
Total assets bearing credit risk	2,732,895	2,337,713

Other financial investments and derivative financial securities are neither past due nor impaired.

The amount of change, during the period and cumulatively, in the fair value of receivables that is attributed to changes in credit risk is represented by the provision for impairment against receivables past due.

Reinsurers' share of technical provisions includes claims outstanding, related claims handling costs, IBNR and unearned premium reserve. This is described along with the valuation methods in note 1. No balances are past due that have been impaired (2008: 0.04%).

Debtors arising out of direct and reinsurance operations are held at fair value less any provision for impairment as described in note 1. They include 0.9% (2008: 0.7%) that have been impaired and 31.2% (2008: 32.5%) that are past due, but not impaired. The latter is aged 27.2% to six months (2008: 28.7%), 2.4% six months to a year (2008: 1.8%) and the remaining 1.5% is older than a year (2008: 2%).

The Standard and Poor's credit rating for reinsurers share of technical provisions and debtors arising out of reinsurance operations are detailed below.

Notes to the Financial Statements

31 December 2009

2. Capital management & financial risk management – continued

	2009	2008
	£'000	£'000
AAA	50,683	61,117
AA	188,718	329,607
A	2,200,986	2,166,841
BBB	1,297	3,463
Below BBB or not rated	183,330	248,428
Total assets bearing credit risk	2,625,014	2,809,456

Where appropriate the company seeks to obtain collateral from counterparties to mitigate the credit risk exposure from insurance and reinsurance receivables. At 31 December 2009 the collateral provided to the company totalled £274.1 million (2008: £356.3 million). This balance is represented by Letters of Credit – 82.2% (2008: 100%), trust funds – 12.8% (2008: Nil) and cash – 5.0% (2008: Nil).

The maximum exposure of receivables to credit risk at the balance sheet date is the carrying value less any collateral obtained from counterparties. For the purpose of this disclosure 'receivables' comprises 'Reinsurers' share of technical provisions', 'Debtors arising out of direct insurance operations' and 'Debtors arising from reinsurance operations'. At the balance sheet date the maximum exposure of receivables to credit risk was £2,350.9 million.

3. Segmental analysis

Segmental information in the format required by the Companies Act 2006 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 2009					
Continuing operations:					
Direct insurance					
Accident and health	392,703	387,588	(111,559)	(164,432)	(70,501)
Marine, aviation and transport	128,289	130,811	(109,604)	(29,255)	(11,338)
Fire and other damage to property	633,479	631,938	(346,035)	(125,272)	(203,634)
Third party liability	518,388	496,123	(257,544)	(87,805)	(113,408)
Miscellaneous	125,700	127,038	(47,703)	(40,335)	(56,875)
Reinsurance acceptances	403,194	387,220	(176,202)	(78,905)	(94,698)
	<u>2,201,753</u>	<u>2,160,718</u>	<u>(1,048,647)</u>	<u>(526,004)</u>	<u>(550,454)</u>
Discontinued operations	873	873	190	(68)	5,738
	<u>2,202,626</u>	<u>2,161,591</u>	<u>(1,048,457)</u>	<u>(526,072)</u>	<u>(544,716)</u>
Year to 31 December 2008					
Continuing operations:					
Direct insurance					
Accident and health	354,328	355,561	(114,688)	(162,317)	(70,310)
Marine, aviation and transport	118,826	115,262	(79,752)	(27,254)	(9,713)
Fire and other damage to property	530,337	527,156	(284,047)	(114,233)	(310,863)
Third party liability	477,802	463,717	(328,678)	(89,500)	(38,413)
Miscellaneous	113,640	122,965	(8,017)	(23,326)	(69,225)
Reinsurance acceptances	369,147	376,181	(231,054)	(78,044)	68,762
	<u>1,964,080</u>	<u>1,960,842</u>	<u>(1,046,236)</u>	<u>(494,674)</u>	<u>(429,762)</u>
Discontinued operations	(1,334)	(1,334)	(48,224)	(12)	47,860
	<u>1,962,746</u>	<u>1,959,508</u>	<u>(1,094,460)</u>	<u>(494,686)</u>	<u>(381,902)</u>

Notes to the Financial Statements

31 December 2009

3. Segmental analysis – continued

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	
	2009	2008	2009	2008	2009	2008
	£'000	£'000	£'000	£'000	£'000	£'000
United Kingdom	1,069,685	955,601	102,337	118,409	481,930	436,765
Other EEA states	1,128,325	970,597	151,423	(116,786)	293,584	256,881
Other countries	4,616	36,548	8,468	1,132	44,192	27,550
	<u>2,202,626</u>	<u>1,962,746</u>	<u>262,228</u>	<u>2,755</u>	<u>819,706</u>	<u>721,196</u>

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

	2009	2008
	£'000	£'000
United Kingdom	617,839	527,010
United States of America	69,260	69,769
Continental Europe	1,214,329	1,100,348
Africa & Middle East	54,816	45,627
Asia/Pacific	65,448	52,850
Americas	59,467	46,354
Worldwide	120,594	122,122
Discontinued business	873	(1,334)
	<u>2,202,626</u>	<u>1,962,746</u>

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

The prior year's net provision for claims outstanding generated a surplus for 2009 (2008: surplus) as detailed below:

	2009	2008
	£'000	£'000
Continuing operations:		
Accident and health	7,776	9,504
Marine, aviation and transport	(9,743)	7,251
Fire and other damage to property	(15,382)	4,534
Third party liability	68,854	35,583
Miscellaneous	(3,557)	12,495
	<u>47,948</u>	<u>69,367</u>
Discontinued operations	(6,228)	(130)
	<u>41,720</u>	<u>69,237</u>

Notes to the Financial Statements

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5. Net operating expenses – technical account

	2009	2008
	£'000	£'000
Acquisition costs	346,546	324,903
Change in net deferred acquisition costs	(2,691)	516
Administrative expenses	178,707	162,674
Reinsurance commissions	(212,417)	(214,197)
	<u>310,145</u>	<u>273,896</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 £260.7 million (2008: £245.6 million), and are included within acquisition costs.

6. Auditors’ remuneration

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

	2009	2008
	£'000	£'000
Audit fees		
Fees payable to the company’s auditor for the audit of the annual accounts	345	346
Non audit fees		
Other services pursuant to legislation	386	495
Other services relating to taxation	459	406
	<u>1,190</u>	<u>1,247</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 2009

7. Operating lease rentals

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

	2009	2008
	£'000	£'000
Leasehold property	4,553	3,417

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

	2009	2008
	£'000	£'000
Within 1 year	749	498
Between two and five years	3,013	3,012
More than five years	528	288
	4,290	3,798

8. Directors and employees

	2009	2008
	£'000	£'000
Cost of staff employed by the company		
Wages and salaries	47,495	39,386
Social security costs	12,440	10,761
Other pension costs	4,697	3,786
Other staff costs	4,285	4,180
	68,917	58,113

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

	2009	2008
	No.	No.
Underwriting	617	597
Claims	127	144
Other	149	129
	893	870

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 2009

8. 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 to the directors of this company.

	2009	2008
	£'000	£'000
Aggregate emoluments and benefits	2,927	2,911
Company pension contributions to money purchase pension schemes	91	92
	<u>3,018</u>	<u>3,003</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 £876,066 (2008: £718,926) in respect of emoluments and benefits. The amount of accrued pension and accrued lump sum in relation to the highest paid director at the end of the year were £30,641 (2008: £28,053) and £153,661 (2008: £44,718) respectively.

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, two directors exercised options over the shares of ACE Limited. The highest paid director did not exercise 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. Disclosures relating to this scheme are contained within the financial statements for AIS. From 1 April 2002, pension benefits are accruing to six current directors under the ACE European Group UK Pension Plan (Stakeholder scheme).

9. Investment return

	2009	2008
	£'000	£'000
Investment income		
Income from investments	108,165	109,283
Gains on the realisation of investments	91,586	77,967
	<u>199,751</u>	<u>187,250</u>
Investment expenses and charges		
Investment management expenses	(7,804)	(8,206)
Losses on the realisation of investments	(79,768)	(97,251)
	<u>(87,572)</u>	<u>(105,457)</u>
Net unrealised gains less losses on investments		
Unrealised gains on investments	227,294	70,398
Unrealised losses on investments	(120,230)	(240,284)
	<u>107,064</u>	<u>(169,886)</u>
Total investment return	<u>219,243</u>	<u>(88,093)</u>

Notes to the Financial Statements

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10. Taxation on profit on ordinary activities

Analysis of charge in period

	2009	2008
	£'000	£'000
UK corporation taxation at 28% (2008: 28.5%)		
Current taxation on income for the period	74,467	(891)
Adjustments in respect of previous periods	(1,625)	4,119
Taxation on exceptional item*	-	2,634
	<u>72,842</u>	<u>5,862</u>
Double taxation relief	(25,391)	(1,743)
	<u>47,451</u>	<u>4,119</u>
Foreign taxation		
Current taxation on income for the period	22,412	3,383
Adjustments in respect of previous periods	12,366	1,225
	<u>34,778</u>	<u>4,608</u>
Current taxation on income for the period	82,229	8,727
Deferred taxation (note 14):		
Origination and reversal of timing differences	(582)	(515)
Adjustments in respect of previous periods	(111)	792
	<u>(693)</u>	<u>277</u>
Taxation on profit on ordinary activities	81,536	9,004

Factors affecting taxation charge for period

The taxation assessed for the period is higher (2008: higher) than the standard rate of corporation taxation in the UK (28%). The differences are explained below:

	2009	2008
	£'000	£'000
Profit on ordinary activities before taxation	262,228	2,755
Profit on ordinary activities multiplied by standard rate of corporation taxation in the UK of 28% (2008: 28.5%)	73,424	785
Effects of:		
Expenses not deductible for taxation purposes	945	1,483
Higher taxation rates on overseas earnings	3,011	1,640
Utilisation of previously unrecognised excess unrelieved foreign tax**	(5,990)	-
Other, including timing differences	98	(525)
Adjustments in respect of previous periods	10,741	5,344
Current taxation charge for period	82,229	8,727

* 'Taxation on exceptional item' represents taxation on the profit on disposal of the company's Swiss branch business.

** The company has brought forward Excess Unrelieved Foreign Tax ('EUFT') as at 31 December 2009 which may be available for relief in 2010 against the 2009 tax liability. However, there remains uncertainty as to the full amount of EUFT which may ultimately be available and therefore credit has only been taken for EUFT which can be measured with sufficient reliability.

Notes to the Financial Statements

31 December 2009

11. Dividends

During 2009 the company did not pay a dividend (2008: 14.7p per share totalling £80.0 million).

12. Other financial investments

	Market Value 2009	Cost 2009	Market Value 2008	Cost 2008
	£'000	£'000	£'000	£'000
Shares and other variable yield securities and units in unit trusts	213	136	18,163	35,040
Debt securities and other fixed interest securities	2,397,584	2,475,309	2,029,615	2,221,907
Deposits with credit institutions*	333,314	333,314	283,663	283,663
	<u>2,731,111</u>	<u>2,808,759</u>	<u>2,331,441</u>	<u>2,540,610</u>

*Deposits with credit institutions includes £277.8 million (2008: £188.8 million) of collateral in respect of stock lending arrangements (note 21).

None of the above investments, except equities, are listed on a recognised exchange.

Derivative financial instruments

	Assets 2009	Liabilities 2009	Assets 2008	Liabilities 2008
	£'000	£'000	£'000	£'000
Forward foreign currency contracts	974	1,604	5,020	5,846
Fixed income options and futures	811	911	1,252	1,332
	<u>1,784</u>	<u>2,514</u>	<u>6,272</u>	<u>7,178</u>

The cost of entering into derivative financial instruments was £27,290 (2008: £193,360).

Currency derivatives

The company utilises currency derivatives to manage 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:

	2009	2008
	£'000	£'000
Forward foreign exchange contracts	<u>43</u>	<u>6,660</u>

At 31 December 2009, the fair value of the company's currency derivatives is a loss of £0.6 million (2008: loss of £0.8 million). These amounts are based on rates of exchange at the balance sheet date, comprising £1.0 million of assets (2008: £5.0 million) and £1.6 million of liabilities (2008: £5.8 million).

Amounts of £0.1 million (2008: £1.1 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 2009

12. 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 2009, the fair value of the company's fixed income derivatives is a liability of £0.1 million (2008: liability of £0.1 million) comprising £0.8 million of assets (2008: £1.3 million) and £0.9 million of liabilities (2008: £1.4 million).

A loss of £3.4 million (2008: a gain £1.4 million) has been recognised in the profit and loss account in respect of contracts which matured in the period.

FRS 29 requires the company to classify financial instruments into a fair value hierarchy as follows:

- Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities
- Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices), and
- Level 3 – Inputs for the asset or liability that are not based on observable market data (unobservable inputs)

An analysis of financial instruments at 31 December 2009 by fair value hierarchy is set out below:

	Level 1	Level 2	Level 3	Total
	£'000	£'000	£'000	£'000
Assets:				
Shares and other variable yield securities and units in unit trusts	213	–	–	213
Debt securities and other fixed interest securities	70,076	2,315,910	11,598	2,397,584
Deposits with credit institutions	38,768	294,546	–	333,314
Derivative financial instruments	810	974	–	1,784
Total assets at fair value	109,867	2,611,430	11,598	2,732,895
Liabilities:				
Derivative financial instruments	910	1,604	–	2,514
Total liabilities at fair value	910	1,604	–	2,514

'Share and other variable yield securities and units in unit trusts' only comprise listed equities. As the fair values of these securities are based on quoted market prices they are classified within Level 1.

'Debt securities and other fixed interest securities' with active markets such as Government securities are classified within Level 1 as fair values are based on quoted market prices. For debt securities and other fixed interest securities that trade in less active markets, including corporate securities, fair values are based on the output of pricing models, the significant inputs into which include, but are not limited to, yield curves, credit risks and spreads, measures of volatility, and prepayment speeds. These debt securities and other fixed interest securities are classified within Level 2. Debt securities and other fixed interest securities for which pricing is unobservable are classified within Level 3.

Notes to the Financial Statements

31 December 2009

12. Other financial investments – continued

‘Deposits with credit institutions’ includes short terms investments, such as liquidity funds. Where such securities are traded in active markets, they are classified within Level 1 as fair values are based on quoted market prices. Where no active market exists for such securities they are typically classified within Level 2 and where pricing is unobservable, Level 3.

Where ‘Derivative financial instruments’ are actively traded the values of these securities are based on quoted market prices. Accordingly they are classified within Level 1. Instruments that are not actively traded are classified within Level 2.

During the period no significant investments were transferred between Level 1 and Level 2.

Reconciliation of Movement in Level 3 Investments

	£'000
Balance at 1 January 2009	9,394
Gains (Losses) Recognised in the Profit and Loss Account *	(438)
Gains (Losses) Recognised in the Statement of Total Recognised Gains and Losses	-
Purchases	7,650
Sales	(3,965)
Transfers in (out) of Level 3**	(1,043)
	<hr/>
Balance at 31 December 2009	<u>11,598</u>

* Gains (Losses) Recognised in the Profit and Loss Account comprise realised gains of £64,000 which are presented within Investment Income, unrealised gains of £248,000 and foreign exchange (losses) of £(750,000) all of which are presented in the Non-Technical Account. Of this amount £(20,000) relates to investments held at the end of the period and comprises £nil of realised gains (losses), £208,000 of unrealised gains (losses) and £(228,000) of foreign exchange gains (losses).

** During the period a small number of investment grade and high yield fixed interest investments were transferred into and out of Level 3 due to changes in their pricing source. The net value of the investments transferred was £1 million.

13. Other debtors

	2009	2008
	£'000	£'000
Amounts falling due within one year:		
Amounts due from group undertakings	58,489	43,796
Deferred taxation (note 14)	1,791	466
Receivable for sales of securities	257	47
Other debtors	6,605	95,774
	<hr/>	<hr/>
	<u>67,142</u>	<u>140,083</u>

Notes to the Financial Statements

31 December 2009

14. Deferred taxation

	2009	2008
	£'000	£'000
At 1 January	466	821
Foreign exchange differences	15	248
Movement relating to pension liability	538	(880)
Adjustment in respect of previous periods	111	792
Utilisation in year (note 10)	661	(515)
At 31 December	<u>1,791</u>	<u>466</u>
Analysis of asset at 31 December		
Other timing differences	1,791	466
Undiscounted deferred taxation asset as above	<u>1,791</u>	<u>466</u>

15. 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 2009	1,623	2,394	14,098	9,818	27,933
Additions	–	880	463	334	1,677
Disposals	–	(717)	(2,405)	(2,970)	(6,092)
Transfers	–	–	(5)	5	–
Foreign exchange differences	(88)	(128)	(744)	(438)	(1,398)
At 31 December 2009	<u>1,535</u>	<u>2,429</u>	<u>11,407</u>	<u>6,749</u>	<u>22,120</u>
Accumulated depreciation					
At 1 January 2009	819	1,645	9,196	7,806	19,466
Charge for the period	34	479	1,617	773	2,903
Disposals	–	(613)	(2,257)	(2,970)	(5,840)
Transfers	–	–	(1)	1	–
Foreign exchange differences	(45)	(91)	(492)	(350)	(978)
At 31 December 2009	<u>808</u>	<u>1,420</u>	<u>8,063</u>	<u>5,260</u>	<u>15,551</u>
Net book value					
31 December 2009	<u>727</u>	<u>1,009</u>	<u>3,344</u>	<u>1,489</u>	<u>6,569</u>
31 December 2008	<u>804</u>	<u>749</u>	<u>4,902</u>	<u>2,012</u>	<u>8,467</u>

Notes to the Financial Statements

31 December 2009

16. Called-up share capital

	2009	2008
	£'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 (2008: 500,000,000 Ordinary £1 shares)	500,000	500,000
250,000,000 'B' Ordinary £1 shares (2008: 250,000,000 Ordinary £1 shares)	250,000	250,000
	<u>750,000</u>	<u>750,000</u>

17. Reserves

	Share capital	Profit and loss account	Merger reserve	Total
	£'000	£'000	£'000	£'000
At 1 January	544,741	150,802	25,653	721,196
Profit for the year	-	180,692	-	180,692
Currency translation differences	-	(74,995)	-	(74,995)
Actuarial loss recognised in relation to pension schemes	-	(2,203)	-	(2,203)
Movement of deferred taxation relating to pension liability	-	617	-	617
Dividend paid (note 11)	-	-	-	-
At 31 December	<u>544,741</u>	<u>254,913</u>	<u>25,653</u>	<u>825,307</u>

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.

18. Reconciliation of movements in shareholders' funds

	2009	2008
	£'000	£'000
Profit (loss) profit for the financial year	180,692	(6,249)
Currency translation differences	(74,995)	89,078
Actuarial (loss) gain recognised in relation to pension schemes	(2,203)	3,142
Movement on deferred taxation relating to pension liability	617	(880)
Dividend paid (note 11)	-	(80,000)
Net increase in shareholders' funds	<u>104,111</u>	<u>5,091</u>
Opening shareholders' funds	721,196	716,105
At 31 December	<u>825,307</u>	<u>721,196</u>

Notes to the Financial Statements

31 December 2009

19. 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 £52.4 million (2008: £59.9 million). The decrease during the year had the effect of increasing the balance on the technical account for general business and increasing the profit on ordinary activities before taxation by £7.5 million (2008: increase of £16.9 million).

20. Other creditors including taxation and social security

	2009	2008
	£'000	£'000
Corporation taxation payable	29,812	5,160
Payable for purchases of securities	46,320	46
Other creditors	42,630	29,540
Liability for stock lending collateral (note 21)	277,750	188,800
	<u>396,512</u>	<u>223,546</u>

21. Stock lending

The company participates in stock lending activities with State Street Bank and Trust company.

	2009	2008
	£'000	£'000
Aggregate value of securities on loan at 31 December	<u>361,728</u>	<u>291,261</u>
Income from stock lending during the year	<u>1,500</u>	<u>1,310</u>

In respect of securities on loan at the year end, the company held £352.4 million (2008: £280.1 million) as collateral, the value of which fell below the value of the loan securities by 2.6% (2008: 3.8%), as a result of unrealised losses generated by the liquidity fund in which the collateral is invested. These unrealised losses are included in investment return.

Included within the £352.4 million (2008: £280.1 million) of collateral held is £277.8 million (2008: £188.8 million) in the form of cash which has been reinvested by the company. This is included on the face of the balance sheet within 'Other financial investments'.

22. Letter of credit facilities

Under a facility with Citibank NA, the value of letters of credit outstanding was £68.04 million (2008: £22.7 million) with associated collateral of £99.2 million (2008: £87.6 million). Under a facility with Lloyds TSB Bank plc, there is a further letter of credit outstanding for £0.84 million (2008: £0.8 million), equally matched by collateral. Collateral is included within other financial investments and cash at bank and in hand on the face of the balance sheet.

23. Capital commitments

No capital expenditure was authorised at 31 December 2009 which has not been provided for in these financial statements.

Notes to the Financial Statements

31 December 2009

24. Transactions with related parties

During the year the company incurred a management fee from AIS, a fellow group company of £99.7 million (2008: £98.2 million), this charge is in relation to costs incurred by AIS on behalf of AEGL and includes the cost of AIS staff engaged in the business of AEGL.

During the year, there were no other material transactions or balances between AEGL and fellow group companies, key management personnel or members of their close family.

The above disclosures are required by the Companies Act 2006. Advantage has been taken of the exemption in FRS 8 from disclosing details of transactions with ACE Limited and its subsidiary undertakings as required by that standard.

25. Ultimate parent company

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

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