



ace european group

A decorative graphic consisting of three overlapping rectangular blocks. A blue block is at the top left, a green block is at the bottom left, and a dark grey block is in the middle right, overlapping the other two.

Annual Report and
Financial Statements
31 December 2005

ACE European Group Limited

ACE European Group Limited

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

Authorised and
Regulated by the
Financial Services Authority

Registered in England
Number 1112892

ACE European Group Limited

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Chairman's Report

31 December 2005

Introduction

ACE European Group Limited ("AEGL") is headquartered in the UK, and has established branches in 15 European countries. During 2005, the company expanded its operations by establishing a branch office in Poland to complement its freedom of services permissions in the European Union accession countries.

AEGL maintains FSA licences in all 18 general accounting classes and it has a full set of freedom of services permissions to provide insurance services in all EEA countries and it also has permissions to operate in Switzerland, Jersey and Guernsey. The company has been listed on the National Association of Insurance Commissioners quarterly listing of alien Excess & Surplus lines ("E&S") insurers since 1 October 2004 and is E&S eligible in 41 US states. AEGL is also able to underwrite risks and issue reinsurance policies to insurance companies throughout most of the world's markets. Business is accessed by a variety of distribution methods and the company has strong relationships with the broker community, corporate partners and direct markets.

From 2003, ACE Global Markets and ACE Tempest Re (Europe) branded business has been written by AEGL and Syndicate 2488 at Lloyd's, collectively known as ACE European Group. ACE Global Market's portfolio, which is an international and US dominated book of business, is managed by an experienced team of underwriters and claim specialists. Factors influencing the broker's decision to place business with the company or the syndicate include licensing E&S eligibility and capitalisation, but predominantly reflect client and broker preference.

Until 31 December 2004, the ACE Group of Companies operated a Belgian registered insurance company, ACE Insurance S.A.-N.V., through which all ACE Europe branded property & casualty ("P&C") and accident & health ("A&H") business was written. On 1 January 2005, all of ACE Insurance S.A.-N.V.'s assets, liabilities and obligations were transferred to AEGL under a group reconstruction, and from this date onwards all ACE Europe branded business has been written by AEGL. ACE Europe branded business has continued to be

managed by the same experienced teams of underwriters and claims specialists, thereby ensuring client continuity and the maintenance of the company's lead underwriting capabilities. This transfer has resulted in the formation of one of the largest FSA regulated P&C insurance and reinsurance companies, with a premium income for 2005 approaching £2 billion.

Performance in 2005

2005 was an outstanding year for AEGL. The company's continued focus on underwriting discipline and cost control has resulted in a 2005 pre-tax profit for the financial year of £229.7 million, notwithstanding the challenging market environment and increased levels of competition experienced throughout the year. The financial success of the underwriting operations is further evidenced by the excellent 2005 combined ratio, which we define as the total of net claims incurred and net operating expenses as a percentage of net earned premiums, of 82.7%.

The most significant loss events impacting the company in the year were Hurricanes Katrina, Rita and Wilma. These losses were substantially mitigated by the group and third party reinsurance protections in place.

Financial strength

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

The AM Best rating was affirmed in August 2005 and reflects the company's excellent risk-adjusted capitalisation and strong anticipated performance in addition to its strong business position in the UK and Continental Europe. AEGL's rating also reflects A.M. Best's view of its strategic importance to the ACE Group.

The Standard & Poor's rating was affirmed in November 2005. Standard & Poor's consider AEGL to be core to the ACE Group, and hence any rating actions applied at a group level will also impact the AEGL rating. The ACE Group's major rating factors include its strong global presence, operating performance, financial flexibility and capital adequacy.

Chairman's Report

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Future prospects

The insurance industry is highly competitive with many companies offering similar coverages. Product rates, terms and conditions have historically changed depending on the timing of the insurance cycle.

Following the challenging market conditions experienced during 2005, it is anticipated that gradual improvements will be seen in those business classes impacted by the hurricane activity, such as US property, energy and reinsurance. AEGL's core business approach focuses on maintaining underwriting discipline whilst preserving its leadership position, remaining alert to new opportunities and ensuring that service levels are amongst the best in the market. As a result, the company will remain well positioned to capitalise on the insurance environment in 2006 and reap the benefits of its product diversification and geographical reach, even if the anticipated improvements in the product rating environment are not fully realised.

AEGL will continue to embed operating efficiencies throughout the company, particularly with regard to underwriting and processing, and to further the campaign for transparency of broker remuneration whilst strengthening relationships with the broking community. AEGL is also committed to achieving the contract certainty targets as set out by the Financial Services Authority ("FSA").

In conclusion

In a year of major challenges where catastrophes dominated the headlines around the world, the company managed to navigate a softening market and maintain underwriting discipline. It successfully met the ongoing challenges of FSA regulation, a significant step in maintaining the confidence of brokers, clients and ACE Limited shareholders.

2005 has given everyone at AEGL the opportunity to reflect on the remarkable progress that has been made in substantially increasing the company's geographical scope, underwriting capabilities and profitability. One of the company's primary aims was to position AEGL in the top three competitive tier as a "must quote" company in specialist lines of business. This has been substantially achieved in 2005. Meeting this objective

would not have been possible without the hard work, dedication and innovation of AEGL's employees. It is their integrity and commitment to serving the best interests of our clients that makes AEGL the company and the market leader it is today.

A J Kendrick

Chairman and Chief Executive Officer

14 March 2006

Management Review

31 December 2005

Business objectives and strategy

ACE European Group Limited (“AEGL”) underwrites a well diversified portfolio, encompassing UK and Continental Europe property & casualty and accident & health, and London market US and international specialty business. The company differentiates itself from others in the market by its experience and expertise in the wide range of products offered and the quality of its underwriting and claims service.

AEGL is a major contributor to the ACE Group of Companies, providing approximately 20% of the ACE Group’s overall gross written premium for 2005. The ACE Group is one of the world’s few truly global insurance and reinsurance organisations and serves a wide variety of clients, ranging from large multinational corporations to smaller clients in local markets. With offices in more than 50 countries and the authority to transact business in over 140, the ACE Group focuses on building global operations diversified by region and business line. This diverse product mix and extensive global presence give it competitive advantage and enhanced financial stability.

AEGL’s key focus is on maintaining underwriting discipline and ensuring that service levels are amongst the best in the market, allowing the company to capitalise on its product diversification and extensive geographical reach.

Organisation of the business

Insurance and reinsurance policies are written under the well established “ACE Europe”, “ACE Global Markets” and “ACE Tempest Re (Europe)” brands which fully capitalise on AEGL’s strong platform, reputation, skill sets, financial strength ratings and consistent management philosophy. The result is a business facing underwriting operation, built on ACE’s policy of devolving underwriting authority by empowering people in the regions, which is an effective delivery mechanism for brokers and clients looking for local expertise combined with global knowledge and security.

ACE Europe is the principal retail brand for AEGL, providing a range of tailored property and liability,

financial lines and accident and health solutions for a diverse range of clients. ACE Europe is renowned for its flexible and committed approach in providing insurance solutions across all product lines. Success can be attributed to many factors; most notably the depth of underwriting expertise, tailored underwriting and the autonomy that each regional office retains over its underwriting decisions. ACE Europe has successfully blended the knowledge of its local markets with the worldwide perspective available through the global organisation, making it a major force in Europe. The principal business segments of ACE Europe are managed as UK & Ireland property & casualty, Continental Europe property & casualty and accident & health.

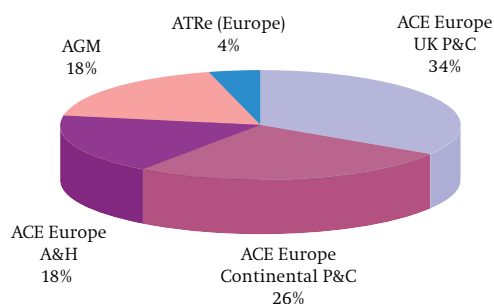
ACE Global Markets (“AGM”) is the ACE Group’s specialty international business and its unique parallel distribution means that underwriting products may be offered through both AEGL and Syndicate 2488 at Lloyd’s. This flexibility allows AGM to provide risk solutions to clients in 150 countries throughout the world, including a significant presence in the US. The underwriting team prides itself on a 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.

Management Review

31 December 2005

2005 gross written premiums split by business brand:



Note: The above represents only the proportion of AGM business written by AEGL. AGM branded business is also written by Syndicate 2488 at Lloyd's.

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.

On 1 January 2005, the assets, liabilities and obligations of ACE Insurance S.A.-N.V. were transferred to AEGL in exchange for shares as part of the group reconstruction. This group reconstruction has been accounted for according to the merger accounting principles set out in Financial Reporting Standard 6 "Acquisitions & Mergers". Under these principles the comparatives for the year ended 31 December 2004 have been restated on a combined basis, as though AEGL and the business of ACE Insurance S.A.-N.V. had always been combined in a single legal entity. As a result of this restatement, the total shareholders' funds, or net asset value, of AEGL shown in last year's financial statements of £176.6 million has been increased to £739.0 million. Similarly, gross written premium disclosed last year for 2004 at £395.0 million is now disclosed at £2,032.7 million.

This year has seen a change in the accounting treatment of proposed dividends arising from Financial Reporting Standard 21 "Events after the balance sheet date". At the same board meeting at which these financial statements were approved, the directors proposed a dividend. Previously such a dividend would have been recognised in the year end financial statements. Under the new rules, the dividend is recorded only by way of note to the financial

statements (see note 24) and not recognised as a liability at the balance sheet date. It has been considered appropriate to report AEGL's capital position after deduction of this proposed dividend within this management review.

Financial results

2005 produced a pre-tax operating profit of £229.7 million in comparison to £294.1 million in 2004. A summary of the financial results is shown in the table below.

£ million	2005	2004 (restated)
Gross written premiums	1,884.9	2,032.7
Net written premiums	845.3	960.9
Net earned premium	856.9	863.7
Incurred losses	459.8	381.3
Operating expenses	249.1	237.6
Equalisation reserve movement	12.5	18.4
Underwriting profit	135.5	226.4
Investment return	87.1	90.0
Other income (charges)	7.1	(22.3)
Net pre-tax profit	229.7	294.1
Combined ratio %	82.7%	71.7%

Gross written premiums in 2005 fell by 7% in comparison to those of 2004. This slight decline reflects the deterioration in market conditions, particularly in P&C business, and the company's selective approach to underwriting in a competitive environment.

The company purchases reinsurance to mitigate the impact of major events and an undue frequency of smaller losses. The principal reinsurance programme in operation during 2005 is with an ACE Group company, ACE Tempest Reinsurance Limited. AEGL also has the benefit, particularly for US and worldwide catastrophe exposures, of reinsurance programmes shared with other ACE companies, including ACE European Group's Lloyd's Syndicate 2488. These arrangements result in an increase in the reinsurance purchasing power of the ACE Group, which ultimately benefits all ACE subsidiaries including AEGL. The reinsurance spend as a percentage of gross written premiums in 2005 was

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55%, broadly in line with that of 2004 (53%). The consistency from year to year is reflective of the fact that the limits and retentions on the principal reinsurances with ACE Group companies remained substantially unchanged between 2004 and 2005.

The loss ratio reflects the impact of the US hurricane activity during the latter half of 2005, primarily Hurricanes Katrina, Rita and Wilma. The company recorded a loss, net of reinsurance recoveries, of £45.4 million for these events, primarily within the AGM and ATRe businesses. In addition, 2005 benefited from modest releases of prior year loss reserves.

AEGL has maintained its focus on the control of expenses. The acquisition ratio is broadly in line with that of 2004, with commission costs benefiting from the continued efforts of underwriters to manage commissions in a soft market. The programme of improvements to increase the operational effectiveness of AEGL has continued throughout 2005, particularly in relation to the underwriting and processing environment. Operational improvements will continue to be part of the key strategic plan, and will ultimately benefit the expense ratio. Administrative expenses continue to be carefully monitored and controlled so as to minimise the impact on the combined result.

Significant improvements to the AEGL balance sheet were achieved during the year. In accordance with the CIGNA acquisition agreement, a major Part VII transfer was effected under UK law, resulting in the elimination of £311 million of reinsurance recoverable assets and an equivalent elimination of the gross liability. The balance sheet has also been strengthened by a significant increase in capital following the transfer of the assets and liabilities of ACE Insurance S.A.-N.V. on 1 January 2005. This has resulted in a very robust capital position, with shareholders' funds standing at £727.2 million at 31 December 2005.

Financial position

AEGL maintains an efficient capital structure consistent with the company's risk profile and regulatory and market requirements. The company assesses its capital needs on a risk management basis, and then seeks to maintain financial strength and capital adequacy to

support business growth and meet the requirements of policyholders, regulators and rating agencies whilst retaining financial flexibility by ensuring strong liquidity. After these factors have been taken into account it is the policy of the company to distribute surplus capital to the ACE Group in the form of dividends.

The directors have proposed a dividend of £120.0 million at the board meeting on 14 March 2006. The balance sheet discloses the shareholders' funds of the company at £727.2 million. For the purposes of assessing AEGL's capital position, it is appropriate to deduct the proposed dividend and use adjusted shareholders' funds of £607.2 million.

The FSA is the insurance regulator for AEGL. Capital levels are reported to the FSA and managed by the company on the basis of a number of measures. The minimum requirement is the Capital Resources Requirement ("CRR"). In addition, the FSA introduced an Enhanced Capital Requirement ("ECR") measure which computes a capital level using an allowance for industry risk factors related to premiums, reserves and assets.

In 2004, the FSA introduced new solvency regulations called the Individual Capital Adequacy Standard ("ICAS") Framework. As part of the ICAS Framework, all insurance companies must produce an Individual Capital Assessment ("ICA") representing their own risk-based assessment of capital required to support their business. Following review of the ICA with the FSA, Individual Capital Guidance ("ICG") is issued to the company. During 2005, the company completed its ICA and the FSA advised AEGL of its ICG. Using the adjusted shareholders' funds of £607.2 million, the company maintains a comfortable margin against each of these key capital measures.

Treasury management

The group reconstruction effected on 1 January 2005 has led to a substantial rationalisation of the AEGL investment management process. These changes included combining the AEGL investment portfolios, changing investment managers and updating investment guidelines. AEGL now maintains four

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active investment grade fixed income portfolios, the core currencies of which are Sterling, Euros and US Dollars, and an equity portfolio investing in a broad range of European equities. Two passive portfolios are maintained: a Sterling gilt portfolio, which acts as collateral for letter of credit issuance, and a small Swiss Franc portfolio, established to meet local solvency requirements. Most of the mandates provide the investment managers with scope to hold a proportion of the assets in currencies other than the designated core currency of the portfolio, although the majority of the exposure must be hedged back to the core currency. The approximate currency split of the AEGL investment portfolios is Sterling 51%, Euros 25%, US Dollars 17% and other 7%.

The recent changes have resulted in a streamlined structure with regard to external investment managers, with Western Asset Management and Barclays Global Investors acting in this capacity for all active portfolios. Western Asset Management replaced Wellington Management Company as managers of the US Dollar fixed income portfolio in 2005 and managed funds totalling £963 million at 31 December 2005. Barclays Global Investors managed a Sterling fixed income portfolio and European equities throughout 2005 and ended the year with assets under management of £783 million. Both managers produced satisfactory investment returns, relative to both the AEGL benchmarks and at the absolute return level.

Corporate governance and risk management

The company is controlled through its board of directors, comprising of the executive management team and three non-executives. The role of non-executive director is to constructively challenge management, help develop proposals on strategy and to bring strong independent judgement, knowledge and experience to the board's deliberations. The board meets at least quarterly and delegates certain oversight responsibilities to committees with formal terms of reference (including audit, risk, investment, reserving and reinsurance security committees).

The quarterly meetings focus upon financial information, strategic decisions and the proper oversight of the management of the business, systems and controls, and senior management responsibility.

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

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

The board reviews and approves the ICA as well as the annual business plan for the company, which includes strategy, limits, and reinsurance protections for each line of business. Risks and line sizes are continually monitored through the established peer review process and regular exception reporting. Formal price monitoring procedures have been in place since early 2002 and form part of the standard monthly management statistics. These contribute to the quarterly actuarial review whereby the outcome of the underwriting activity is continually re-assessed. With such a large and diverse book, it is vital that AEGL's aggregate exposures are continually monitored and adjustments made to the underwriting profile as appropriate. The company operates a dedicated catastrophe management function, and risks are modelled to assist in determining pricing for individual policies, providing a key control to the underwriting process.

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31 December 2005

Outlook for 2006

2005 was a year that the insurance industry will remember for its unprecedented number of Atlantic storms and record natural catastrophe losses. As a result of its geographic and business diversity, AEGL weathered this year successfully. To date, 2006 has seen a stabilisation of market conditions and significant improvements in terms and conditions for those business classes impacted by the hurricanes. AEGL will continue to capitalise on its strengths throughout the year, with the aims of continuing to be the insurer of choice for the company's many UK, European and global clients and replicating its substantial contribution to the results of the ACE Group.

Approved by the Board of Directors

14 March 2006

Directors' Report

31 December 2005

The directors are pleased to submit their report and the audited financial statements for the year to 31 December 2005.

Principal activity

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

Review of business and future developments

On 1 January 2005, the company accepted the transfer of the net assets, liabilities and obligations of ACE Insurance S.A.-N.V., its affiliate. As a consequence, the company has become the ACE Group's principal UK and Continental European carrier.

This group reconstruction has been accounted for according to the merger accounting principles set out in Financial Reporting Standard ("FRS") 6 "Acquisitions and Mergers", as described in note 2 to the financial statements. Accordingly, the financial statements for the year to 31 December 2005, have been presented, and for the prior year restated, as if the business of the company and that of ACE Insurance S.A.-N.V. had been operating in the company throughout the current and prior accounting periods.

A detailed review of the business and comments on future developments can be found in the Management Review that precedes this Directors' Report.

Results and dividends

The company made a profit on ordinary activities before tax for the year to 31 December 2005 of £229.7 million (2004 restated: £294.1 million).

The directors have proposed a final dividend of £120.0 million. Following the adoption of FRS 21 "Events after the balance sheet date", this final proposed dividend is not shown as an appropriation of 2005 profit or shown as a liability in the 2005 balance sheet.

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 2005 as of the date of this report unless otherwise indicated:

Executive directors:

C L Bach	(Resigned 17 August 2005)
R L Cigelnik	
P M Curtis	
D M A Furby	(Appointed 2 October 2005)
M G Furgueson	
A J Kendrick	
E M Levin	(Appointed 2 October 2005)
R P Murray	
R V Pryce	

Non-executive directors:

R V Emerson
D S Marston
G D Williams

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

Directors' interests

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

Financial risk management

The Investment Function

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

Directors' Report

31 December 2005

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

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

Asset allocation policy

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

Investment guidelines

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

Duration and interest rate risk

The 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. The benchmarks have been established to provide comparable duration to the insurance liabilities.

Equity price risk

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

Currency risk

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

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

Liquidity risk

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

The company also enjoys the benefit of letter of credit facilities which can be utilised to meet certain funding needs.

Directors' Report

31 December 2005

Credit risk and counterparty limits

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

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

The company is also exposed to credit risk through the use of reinsurance to manage insurance risk.

Reinsurance does not discharge the company's liability as primary insurer. If a reinsurer fails to pay a claim, the company remains liable for the payment to the policyholder. The company operates a reinsurance security committee. The creditworthiness of reinsurers is considered on a quarterly basis by reviewing their financial strength. In addition, the recent payment history of reinsurers is used to update the reinsurance purchasing strategy.

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, 14 March 2006

ACE Building
100 Leadenhall Street
London
EC3A 3BP

Statement of Directors' Responsibilities

31 December 2005

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

The directors confirm that suitable accounting policies have been used and applied consistently, with the exception of changes arising on the adoption of new accounting standards in the year, and reasonable prudent judgements and estimates have been made in the preparation of the financial statements for the year ended 31 December 2005. The directors also confirm that applicable accounting standards have been followed and that the financial statements have been prepared on a going concern basis.

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

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

Independent Auditors' Report

to the members of ACE European Group Limited

We have audited the financial statements of ACE European Group Limited for the year ended 31 December 2005 which comprise the profit and loss account, the balance sheet, the statement total of recognised gains and losses and the related notes. These financial statements have been prepared in accordance with the accounting policies set out therein.

Respective responsibilities of directors and auditors

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

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose.

We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

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

We read other information contained in the annual report and consider whether it is consistent with the audited financial statements. The other information comprises only the Chairman's Report, the Management Review, and the Directors' Report. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Equalisation provisions

Our evaluation of the presentation of information in the financial statements has had regard to the statutory requirement for insurance companies to maintain equalisation provisions in respect of general insurance business. The nature of equalisation provisions, the amount set aside at 31 December 2005, and the effect of the movement in those provisions during the year on shareholders' funds, the balance on the general business technical account and profit before tax, are disclosed in notes 1 and 19 respectively.

Opinion

In our opinion the financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the company's affairs as at 31 December 2005 and of its profit for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers LLP

Chartered Accountants and Registered Auditors
London
14 March 2006

Profit and Loss Account

for the year ended 31 December 2005

	Note	2005 £'000	2004 (restated) £'000
Technical account – General Business			
Earned premiums, net of reinsurance:			
Gross premiums written – continuing operations	3	1,882,778	2,032,298
– discontinued operations	3	2,078	443
Gross premiums written		1,884,856	2,032,741
Outward reinsurance premiums		(1,039,525)	(1,071,867)
Net premiums written		845,331	960,874
Change in the gross provision for unearned premiums		18,043	(153,882)
Change in the provision for unearned premiums – reinsurers' share		(6,440)	56,681
Earned premiums, net of reinsurance		856,934	863,673
Claims incurred net of reinsurance:			
Claims paid:			
Gross amount	3	(977,586)	(505,438)
Reinsurers' share		715,741	324,947
Net paid claims		(261,845)	(180,491)
Change in the provision for claims outstanding:			
Gross amount	3	(149,729)	(452,686)
Reinsurers' share		(48,189)	251,889
Change in the net provision for claims outstanding		(197,918)	(200,797)
Claims incurred, net of reinsurance		(459,763)	(381,288)
Net operating expenses	5	(249,121)	(237,636)
Change in the equalisation provision	19	(12,541)	(18,396)
Balance on the technical account for general business		135,509	226,353

Profit and Loss Account

for the year ended 31 December 2005

	Note	2005 £'000	2004 (restated) £'000
Non-technical account			
Balance on the general business technical account		135,509	226,353
Investment income	9	121,323	90,472
Unrealised gains on investments	9	21,880	34,667
Investment expenses and charges	9	(27,877)	(19,000)
Unrealised losses on investments	9	(28,182)	(16,079)
Other finance income		(82)	(98)
Other income		7,929	1,506
Other charges, including value adjustments		(829)	(23,761)
Profit on ordinary activities before taxation		229,671	294,060
<i>Continuing operations</i>		<i>227,370</i>	<i>294,029</i>
<i>Discontinued operations</i>		<i>2,301</i>	<i>31</i>
Taxation on profit on ordinary activities	10	(77,755)	(105,548)
Profit for the financial year		151,916	188,512

Statement of Total Recognised Gains and Losses

for the year ended 31 December 2005

		2005 £'000	2004 (restated) £'000
Profit for the financial year		151,916	188,512
Currency translation differences	17	(7,621)	(1,845)
Actuarial loss recognised in relation to pension schemes	17	(1,464)	(600)
Movement on deferred taxation relating to pension liability	17	496	203
Total recognised gains relating to the year		143,327	186,270
Prior year adjustment on adoption of FRS 17	17	(514)	
Total gains and losses recognised since the last annual report		142,813	

ACE European Group Limited

Balance Sheet

at 31 December 2005

	Note	2005 £'000	2004 (restated) £'000
Assets			
Investments			
Other financial investments	12	1,791,194	1,581,204
Deposits with ceding undertakings		182	71
		<u>1,791,376</u>	<u>1,581,275</u>
Reinsurers' share of technical provisions			
Provision for unearned premiums		235,240	234,948
Provision for claims outstanding		1,498,943	1,532,017
		<u>1,734,183</u>	<u>1,766,965</u>
Debtors – amounts falling due within one year			
Debtors arising out of direct insurance operations:			
amounts owed by policyholders		2,576	–
amounts owed by intermediaries		361,385	441,391
Debtors arising out of reinsurance operations		173,660	131,596
Other debtors	13	79,966	181,187
		<u>617,587</u>	<u>754,174</u>
Other assets			
Tangible assets	15	7,965	9,470
Cash at bank and in hand		31,979	71,131
		<u>39,944</u>	<u>80,601</u>
Prepayments and accrued income			
Accrued interest and rent		31,262	28,735
Deferred acquisition costs		95,565	94,491
Other prepayments and accrued income		20,279	23,007
		<u>147,106</u>	<u>146,233</u>
Total assets		<u><u>4,330,196</u></u>	<u><u>4,329,248</u></u>

ACE European Group Limited

Balance Sheet

at 31 December 2005

	Note	2005 £'000	2004 (restated) £'000
Liabilities			
Capital and reserves			
Called-up share capital	16	544,741	544,741
Profit and loss account	17	156,761	8,972
Merger reserve	17	25,653	185,264
Total shareholders' funds	18	727,155	738,977
Technical provisions			
Provision for unearned premiums		662,556	666,262
Provision for claims outstanding		2,497,908	2,329,180
Equalisation provision	19	44,532	31,991
		3,204,996	3,027,433
Provisions for other risks and charges	14	-	2,534
Deposits received from reinsurers		897	2,029
Creditors – amounts falling due within one year			
Creditors arising out of direct insurance operations		26,580	20,853
Creditors arising out of reinsurance operations		190,957	230,441
Other creditors including taxation and social security	20	98,932	225,423
		316,469	476,717
Accruals and deferred income			
Deferred acquisition costs relating to reinsurance		43,779	41,043
Other accruals and deferred income		33,980	39,399
		77,759	80,442
Total liabilities excluding pension liability		4,327,276	4,328,132
Pension liability		2,920	1,116
Total liabilities		4,330,196	4,329,248

The financial statements on pages 14 to 33 were approved by the board of directors on 14 March 2006 and were signed on its behalf by:

P M Curtis
Chief Financial Officer

Notes to the Financial Statements

31 December 2005

1. Accounting policies

Basis of preparation

The financial statements have been prepared in accordance with the provisions of Section 255 of, and Schedule 9A to, the Companies Act 1985, the Statement of Recommended Practice on Accounting for Insurance Business issued by the Association of British Insurers ("the ABI SORP") dated December 2005 and applicable accounting standards in the United Kingdom. No cash flow statement is presented since FRS 1 (revised) "Cash Flow Statements" exempts the company from the requirement to do so as the consolidated financial statements of ACE Limited, the ultimate parent company, include a cash flow statement.

On 1 January 2005, the company accepted the transfer of the net assets, liabilities and obligations of ACE Insurance S.A.-N.V., a fellow group undertaking. The group reconstruction has been accounted for using the merger accounting principles set out in FRS 6 "Acquisitions and Mergers". Accordingly, the financial information for the prior year has been restated as if the combined entity had been established throughout the prior accounting period.

Changes in accounting policies

The company has adopted FRS 17 "Post Retirement Benefits" in full in these financial statements. The adoption of this standard represents a change in accounting policy and the comparative figures have been restated accordingly. The company operates a small number of funded defined benefit pension schemes in Continental Europe with assets held in separate trustee-administered funds. The most significant schemes are in Germany and the Netherlands. The effect of the change in accounting policy has resulted in the creation of a liability in the balance sheet of £2.9 million (2004: £1.1 million). The impact on the prior year is an increase in profit before tax for the year of £74,000.

The presentational requirements of FRS 25 "Financial Instruments: Disclosure and Presentation" have been adopted. There was no impact on the profit and loss account or the balance sheet for the current or prior year as a result of this change.

Following adoption of FRS 21 "Events after the Balance Sheet Date", dividends proposed but not approved at the balance sheet date are no longer included as a liability on the balance sheet. The March 2006 proposed dividend has not been reflected as an appropriation of profit or as a liability.

Continuing and discontinued operations

Discontinued operations include business underwritten by AEGL prior to its reauthorisation by the 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, discontinued operations now also include marine and aviation business underwritten by ACE Insurance S.A.-N.V. in the London market prior to 1999. All other operations are classified as continuing.

Premiums written

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

Unearned premiums

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

Acquisition costs

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

Notes to the Financial Statements

31 December 2005

1. Accounting policies – continued

Claims incurred

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

Provision for claims outstanding and related reinsurance recoveries

The provision for claims outstanding is assessed on an individual case basis and is based on the estimated ultimate cost of all claims notified but not settled by the balance sheet date, together with the provision for related claims handling costs. The provision also includes the estimated cost of claims incurred but not reported (“IBNR”) at the balance sheet date based on statistical methods.

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

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

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

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

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

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

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

Notes to the Financial Statements

31 December 2005

1. Accounting policies – continued

Provisions for claims outstanding and related reinsurance recoveries – continued

Third party liability (including marine and aviation liability)

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

Reinsurance acceptances

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

Asbestos, pollution and health claims (APH)

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

Unexpired risks provision

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

Equalisation provision

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

Investments

Investments in marketable securities are stated at their mid-market value at the balance sheet date.

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.

Notes to the Financial Statements

31 December 2005

1. Accounting policies – continued

Investment return – continued

Realised gains and losses on investments carried at mid-market 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.

Tangible assets

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

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

Deferred taxation

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

Operating leases

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

Pension costs

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

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

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

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

The accounts of branch operations are maintained in their respective local currencies. Foreign currency transactions occurring in these branches are converted into local currency at the rate of exchange prevailing at the date of the transaction. Assets and liabilities denominated in foreign currencies are translated into local currency at the rate of exchange prevailing at the balance sheet date and gains or losses arising are recorded in the profit and loss account.

The assets, liabilities and results of branch operations are translated into Sterling at the rate of exchange prevailing at the balance sheet date. The gains or losses arising in respect of brought forward assets and liabilities are recorded in the statement of total recognised gains and losses.

Notes to the Financial Statements

31 December 2005

2. Group reconstruction

On 1 January 2005 ACE European Group Limited ("AEGL") acquired the assets, liabilities and obligations of an affiliate, ACE Insurance S.A.-N.V. (SANV).

AEGL issued 376,567,035 £1 shares to SANV as consideration for this transaction. As a consequence, SANV became a holding company of AEGL. The transaction is treated as a group reconstruction under Financial Reporting Standard 6 "Acquisitions and Mergers". In consequence, merger accounting principles apply and the results of the entity have been presented as if the combined entity had been established throughout the prior accounting period.

No adjustments were necessary to achieve consistency of accounting policies.

Analysis of the profit and loss accounts for the year to 31 December 2004

	AEGL	SANV business	Total
	£'000	£'000	£'000
Gross written premiums			
Continuing operations	394,825	1,637,473	2,032,298
Discontinued operations	103	340	443
	<u>394,928</u>	<u>1,637,813</u>	<u>2,032,741</u>
Profit on ordinary activities before taxation			
Continuing operations	11,832	282,197	294,029
Discontinued operations	5,626	(5,595)	31
	<u>17,458</u>	<u>276,602</u>	<u>294,060</u>
Taxation on profit on ordinary activities	(5,607)	(99,941)	(105,548)
Profit for the financial year	11,851	176,661	188,512
Other recognised gains and losses arising in the year	-	(2,242)	(2,242)
Total recognised gains and losses arising in the year	<u>11,851</u>	<u>174,419</u>	<u>186,270</u>

Shareholders' funds as at 1 January 2005

	£'000
AEGL	176,632
SANV business	562,345
Total	<u>738,977</u>

Note 17 reconciles shareholders' funds of £738,977,000 to the £578,852,000 shareholders' funds at 1 January 2005 prior to the application of changes in accounting policies referred to in note 1.

Notes to the Financial Statements

31 December 2005

3. Segmental analysis

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

	Gross premiums written	Gross premiums earned	Gross claims incurred	Gross operating expenses	Reinsurance balance
	£'000	£'000	£'000	£'000	£'000
Year to 31 December 2005					
Continuing operations:					
Direct insurance					
Accident and health	276,582	270,849	(105,582)	(108,115)	(42,835)
Marine, aviation and transport	98,928	98,779	(49,418)	(21,943)	(12,430)
Fire and other damage to property	498,870	518,804	(385,081)	(115,557)	27,952
Third party liability	543,588	542,781	(292,017)	(94,896)	(83,967)
Other	146,657	148,588	(80,174)	(38,104)	(30,706)
Reinsurance acceptances	318,153	321,019	(246,714)	(55,517)	(21,092)
	1,882,778	1,900,820	(1,158,986)	(434,132)	(163,078)
Discontinued operations	2,078	2,079	31,671	844	(31,168)
	<u>1,884,856</u>	<u>1,902,899</u>	<u>(1,127,315)</u>	<u>(433,288)</u>	<u>(194,246)</u>
Year to 31 December 2004 (restated)					
Continuing operations:					
Direct insurance					
Accident and health	293,365	289,280	(109,309)	(105,108)	(58,432)
Marine, aviation and transport	102,318	87,096	(44,686)	(20,908)	(11,605)
Fire and other damage to property	563,674	535,895	(204,614)	(115,160)	(168,171)
Third party liability	575,059	498,385	(299,369)	(89,249)	(17,381)
Other	153,485	148,664	(29,583)	(37,316)	(43,432)
Reinsurance acceptances	344,397	319,095	(291,540)	(51,116)	63,244
	2,032,298	1,878,415	(979,101)	(418,857)	(235,777)
Discontinued operations	443	444	20,977	(67)	(21,285)
	<u>2,032,741</u>	<u>1,878,859</u>	<u>(958,124)</u>	<u>(418,924)</u>	<u>(257,062)</u>

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

Analysis by geographic area – origin

	Gross written premiums		Profit (loss) before taxation		Net assets	
	2005	2004 (restated)	2005	2004 (restated)	2005	2004 (restated)
	£'000	£'000	£'000	£'000	£'000	£'000
United Kingdom	1,103,654	1,219,783	163,341	167,935	532,190	577,850
Other EEA States	751,494	761,662	63,701	123,388	185,452	152,027
Other countries	29,708	51,296	2,629	2,737	9,513	9,100
	<u>1,884,856</u>	<u>2,032,741</u>	<u>229,671</u>	<u>294,060</u>	<u>727,155</u>	<u>738,977</u>

Notes to the Financial Statements

31 December 2005

3. Segmental analysis – continued

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

	2005	2004 (restated)
	£'000	£'000
United Kingdom	634,395	700,876
United States of America	57,220	47,183
Continental Europe	837,789	938,364
Africa & Middle East	44,285	45,347
Asia/Pacific	41,078	51,885
Americas	30,372	37,009
Worldwide	237,639	211,634
Discontinued business	2,078	443
	<u>1,884,856</u>	<u>2,032,741</u>

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

The prior year's net provision for claims outstanding generated a surplus for 2005 (2004: surplus) as detailed below:

	2005	2004 (restated)
	£'000	£'000
Continuing operations:		
Accident and health	2,232	(1,771)
Marine, aviation and transport	3,599	(3,774)
Fire and other damage to property	22,175	24,206
Third party liability	14,996	24,752
Other	1,400	18,720
	<u>44,402</u>	<u>62,133</u>
Discontinued operations	(2,148)	(3,002)
	<u>42,254</u>	<u>59,131</u>

Notes to the Financial Statements

31 December 2005

5. Net operating expenses – technical account

	2005	2004 (restated)
	£'000	£'000
Acquisition costs	289,321	293,302
Change in deferred acquisition costs	3,218	(12,389)
Administrative expenses	145,849	140,315
Reinsurance commissions	(189,267)	(183,592)
	<u>249,121</u>	<u>237,636</u>

Administrative expenses includes 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 £228.8 million (2004: £225.1 million), and are included within acquisition costs.

6. Auditors remuneration

During the year the company obtained the following services from the company's auditor at costs as detailed below:

	2005	2004 (restated)
	£'000	£'000
Audit services	950,868	1,082,640
Tax services	156,813	488,234
	<u>1,107,681</u>	<u>1,570,874</u>

7. Operating lease rentals

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

	2005	2004 (restated)
	£'000	£'000
Leasehold property	<u>3,054</u>	<u>3,433</u>

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

	2005	2004 (restated)
	£'000	£'000
Within 1 year	413	1,080
Between two and five years	2,128	1,791
More than five years	112	1,007
	<u>2,653</u>	<u>3,878</u>

Notes to the Financial Statements

31 December 2005

8. Directors and employees

	2005	2004 (restated)
	£'000	£'000
Cost of staff employed by the company		
Wages and salaries	26,937	25,668
Social security costs	7,692	2,597
Other pension costs	3,257	2,066
Other staff costs	3,537	3,118
	<u>41,423</u>	<u>33,449</u>

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

	2005	2004 (restated)
	No.	No.
Underwriting	521	488
Claims	134	126
Other	96	96
	<u>751</u>	<u>710</u>

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 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.

Directors' emoluments

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

	2005	2004 (restated)
	£'000	£'000
Aggregate emoluments and benefits	2,942	2,259
Company pension contributions to money purchase pension schemes	77	61
	<u>3,019</u>	<u>2,320</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 £517,572 (2004: £621,000) in respect of emoluments and benefits.

The aggregate emoluments above do not include share based remuneration. All executive directors are entitled to shares in ACE Limited under long-term incentive plans. During the year, five directors exercised options over the shares of ACE Limited.

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

Notes to the Financial Statements

31 December 2005

9. Investment return

	2005	2004 (restated)
	£'000	£'000
Investment income		
Income from other financial investments	78,395	57,281
Gains on the realisation of investments	42,928	33,191
	<u>121,323</u>	<u>90,472</u>
Investment expenses and charges		
Investment management expenses	(5,979)	(4,558)
Losses on the realisation of investments	(21,898)	(14,442)
	<u>(27,877)</u>	<u>(19,000)</u>
Net unrealised gains less losses on investments		
Unrealised gains on investments	21,880	34,667
Unrealised losses on investments	(28,182)	(16,079)
	<u>(6,302)</u>	<u>18,588</u>
Total investment return	<u><u>87,144</u></u>	<u><u>90,060</u></u>

Notes to the Financial Statements

31 December 2004

10. Taxation on profit (loss) on ordinary activities

Analysis of charge in period

	2005	2004 (restated)
	£'000	£'000
UK corporation taxation at 30% (2004: 30%)		
Current taxation on income for the period	74,548	54,862
Adjustments in respect of previous periods	516	(3,460)
	<u>75,064</u>	<u>51,402</u>
Double taxation relief	(18,904)	–
	<u>56,160</u>	<u>51,402</u>
Foreign taxation		
Current taxation on income for the period	22,225	43,818
Adjustments in respect of previous periods	2,998	3,288
	<u>25,223</u>	<u>47,106</u>
Current taxation on income for the period	81,383	98,508
Deferred taxation (note 14):		
Origination and reversal of timing differences	249	6,224
Adjustments in respect of previous periods	(3,877)	816
	<u>(3,628)</u>	<u>7,040</u>
Taxation on profit on ordinary activities	77,755	105,548

Factors affecting taxation charge for period

The taxation assessed for the period is higher (2004: higher) than the standard rate of corporation taxation in the UK (30%).

The differences are explained below:

	2005	2004 (restated)
	£'000	£'000
Profit on ordinary activities before taxation	229,671	294,060
Profit on ordinary activities multiplied by standard rate of corporation taxation in the UK of 30% (2004: 30%)	68,902	88,218
Effects of:		
Expenses not deductible for taxation purposes	1,634	8,414
Reversal of prior year technical reserve disclaimed	–	(2,421)
Utilisation of taxation losses	–	(807)
Non-taxable losses	(403)	3,140
Higher taxation rates on overseas earnings	3,217	5,236
Adjustments in respect of previous periods	3,514	(177)
Other, including timing differences	4,519	(3,095)
Current taxation charge (credit) for period	81,383	98,508

Notes to the Financial Statements

31 December 2005

11. Dividends

During 2005 the company paid a dividend obligation of £155,149,000 which had been transferred from ACE Insurance S.A.-N.V.

12. Other financial investments

	Market Value 2005	Cost 2005	Market Value 2004 (restated)	Cost 2004 (restated)
	£'000	£'000	£'000	£'000
Shares and other variable yield securities and units in unit trusts	105,259	88,660	85,585	69,415
Debt securities and other fixed interest securities	1,607,648	1,605,958	1,440,734	1,424,954
Derivatives	847	999	2,086	66
Deposits with credit institutions	77,440	77,440	52,799	52,799
	<u>1,791,194</u>	<u>1,773,057</u>	<u>1,581,204</u>	<u>1,547,234</u>

All investments held are listed.

The derivative balance represents the market value of various put and call options together with bond and interest rate futures.

The derivative balance is made up of the following:

	Market Value 2005	Cost 2005	Market Value 2004 (restated)	Cost 2004 (restated)
	£'000	£'000	£'000	£'000
Forward foreign currency contracts	769	-	50	-
Futures	(646)	7	1,030	4
Options	724	992	1,006	62
	<u>847</u>	<u>999</u>	<u>2,086</u>	<u>66</u>
			2005	2004 (restated)
			£'000	£'000
Gain (loss) in investment return			<u>(3,675)</u>	<u>41</u>

All derivatives are recognised as either assets or liabilities on the balance sheet and are measured at fair value, with the changes in fair value reflected as unrealised gains and losses in the profit and loss account. The fair value is based on market quotes or valuations provided by third party investment managers. The company participates in derivative instruments to mitigate financial risks, principally arising from the investment holdings. Derivative instruments used for this purpose include interest rate futures, options, interest rate swaps and foreign currency forward contracts, primarily to manage duration and foreign currency exposure, enhance portfolio yield or obtain an exposure to a particular financial market.

Notes to the Financial Statements

31 December 2005

13. Other debtors

	2005	2004 (restated)
	£'000	£'000
Amounts falling due within one year:		
Amounts due from group undertakings	39,219	48,004
Deferred taxation (note 14)	1,094	-
Receivable for sales of securities	32,119	118,816
Other debtors	7,534	14,367
	<u>79,966</u>	<u>181,187</u>

14. Deferred taxation

	2005	2004 (restated)
	£'000	£'000
At 1 January	2,534	(4,506)
Utilisation in year (note 10)	(3,628)	7,040
At 31 December	<u>(1,094)</u>	<u>2,534</u>
Analysis of liability (asset) at 31 December:		
Trading losses	-	(1,055)
Foreign equalisation provisions	2,790	2,560
Deferred acquisition costs	(39)	728
Unrealised gains (losses) on investments	-	3,381
Other timing differences	(3,845)	(3,080)
Undiscounted deferred taxation liability (asset) as above	<u>(1,094)</u>	<u>2,534</u>

Notes to the Financial Statements

31 December 2005

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 2005	2,297	1,838	9,560	6,775	20,470
Transfers	-	-	(282)	282	-
Additions	4	248	1,779	780	2,811
Disposals	(939)	(560)	(1,127)	(1,432)	(4,058)
Foreign exchange differences	(38)	(52)	(266)	(242)	(598)
At 31 December 2005	1,324	1,474	9,664	6,163	18,625
Accumulated depreciation					
At 1 January 2005	666	870	4,569	4,895	11,000
Transfers	-	-	65	(65)	-
Charge for the period	39	243	1,770	783	2,835
Disposals	(144)	(444)	(975)	(1,269)	(2,832)
Foreign exchange differences	(15)	(24)	(125)	(179)	(343)
At 31 December 2005	546	645	5,304	4,165	10,660
Net book value					
31 December 2005	778	829	4,360	1,998	7,965
31 December 2004 (restated)	1,631	968	4,991	1,880	9,470

The charge for depreciation for the year ending 31 December 2004 (restated) was £2.1 million.

16. Called-up share capital

	2005	2004 (restated)
	£'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
	544,741	544,741
Authorised:		
500,000,000 'A' Ordinary £1 shares (2004: 500,000,000 Ordinary £1 shares)	500,000	500,000
250,000,000 'B' Ordinary £1 shares (2004: 250,000,000 Ordinary £1 shares)	250,000	250,000
	750,000	750,000

Notes to the Financial Statements

31 December 2005

17. Reserves

	Share capital	Profit and loss account	Merger reserve	Total
	£'000	£'000	£'000	£'000
At 1 January prior to application of changes in accounting policies	544,741	8,458	25,653	578,852
Prior year adjustments (note 1):				
Adjustment for defined benefit pension schemes, FRS 17	-	514	-	514
Reversal of dividend obligation	-	-	159,611	159,611
As at 1 January restated	544,741	8,972	185,264	738,977
Profit for the year	-	151,916	-	151,916
Currency translation differences	-	(3,159)	(4,462)	(7,621)
Actuarial loss recognised in relation to pension schemes	-	(1,464)	-	(1,464)
Movement of deferred taxation relating to pension liability	-	496	-	496
Dividend obligation paid (note 11)	-	-	(155,149)	(155,149)
At 31 December 2005	544,741	156,761	25,653	727,155

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 has been treated as a group reconstruction under FRS 6 and consequently merger accounting principles have been applied. The merger reserve is the difference between the net asset value of the transferred business and the nominal value of the shares issued by the company as consideration. The group reconstruction had no impact on the profit and loss account of AEGL as at 1 January 2005. The dividend obligation reversed as at 31 December 2004 of £159,611,000 was denominated in Euros. The dividend obligation paid in 2005 amounted to a sterling equivalent of £155,149,000.

18. Reconciliation of movements in shareholders' funds

	2005	2004 (restated)
	£'000	£'000
Profit for the financial year	151,916	188,512
Currency translation differences	(7,621)	(1,845)
Actuarial loss recognised in relation to pension schemes	(1,464)	(600)
Movement on deferred taxation relating to pension liability	496	203
Dividend obligation paid (note 11)	(155,149)	-
Net addition (reduction) to the shareholders' funds	(11,822)	186,270
Opening shareholders' funds	738,977	552,707
Closing shareholders' funds	727,155	738,977

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 £44,532,000 (2004: £31,991,000). The increase during the year had the effect of reducing the balance on the technical account for general business and decreasing the profit on ordinary activities before taxation by £12,541,000 (2004: £18,396,000).

Notes to the Financial Statements

31 December 2005

20. Other creditors including taxation and social security

	2005	2004 (restated)
	£'000	£'000
Corporation taxation payable	36,699	73,969
Payable for purchases of securities	48,364	132,928
Other creditors	13,869	18,526
	<u>98,932</u>	<u>225,423</u>

21. Letter of credit facilities

Under a facility with Citibank NA the value of letters of credit outstanding was £17.3 million (2004: £14.8 million) with associated collateral of £37.4 million (2004: £21.7 million). Under a facility with Lloyds TSB Bank plc, there is a further letter of credit outstanding for £1.0 million (2004: £1.0 million), equally matched by collateral.

22. Capital commitments

No capital expenditure was authorised at 31 December 2005 which has not been provided for in these financial statements.

23. Transactions with related parties

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

24. Post balance sheet events

The directors have proposed a dividend of £120.0 million. Following the adoption of FRS 21, "Events after the balance sheet date", this final dividend is not shown as an appropriation of 2005 profit or shown as a liability in the balance sheet at 31 December 2005.

25. Ultimate parent company

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



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