ACE GROUP

STRENGTH IN NUMBERS

ANNUAL REPORT AND FINANCIAL STATEMENTS
31 DECEMBER 2007
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

Contents

Chairman's Report

31 December 2007

Performance in 2007

Since its reauthorisation in 2003, ACE European Group Limited ("AEGL") has grown to become one of Europe's leading insurance and reinsurance players, with a premium base now approaching £2 billion. Pre-tax profits for 2007 amounted to £74.0 million, reflecting the company's continued focus on underwriting discipline and cost control during a period in which underwriters were faced with increasingly challenging market conditions and relentless competition. Shareholders' funds at the close of the financial year were £716.1 million, against which a dividend of £80.0 million will be made.

Significant achievements during the year

New AEGL branches & initiatives

AEGL's strength is borne out of its diversity. Our products and services are among the most comprehensive in the market place providing insurance to a wide range of customers.

During the year, AEGL expanded its branch network with two new offices in Hungary and the Czech Republic, bringing the number of operating branches throughout the UK and Europe to 19. This increased physical presence makes it easier for brokers and clients to access AEGL's underwriting expertise.

In addition, a number of new product initiatives were launched, examples of which can be found within the Business Review. The ability of AEGL to extend both its product base and geographical scope, particularly in a softening market, ensures that we remain one of the key insurance providers in the UK and Europe.

AEGL is continually looking for ways to enhance its client and broker reach, using both traditional and technology driven methods. In April, AEGL took the lead in a unique service that will offer all UK brokers a fully transactional website to enable them to sell a range of commercial insurance products from ACE and other insurers. The service has been developed by software solutions provider Point Solutions Limited in conjunction with ACE and will give brokers the ability to provide online quotes, bind cover and issue policies direct to customers via their own websites. The service is free to implement with brokers only paying nominal hosting and transactional fees on a pay as you go basis.

ACE Life

In April 2007, the ACE Group received Financial Services Authority ("FSA") approval for the establishment of a new UK based life assurance company, ACE Europe Life Limited ("ACE Life"). Although a stand alone company, ACE Life operates in synergy with AEGL's existing network of UK and European branches and complements the company's A&H direct marketing proposition. Initially focusing on the pure protection markets, ACE Life markets term policies via existing and new distribution partners. The first ACE Life products were launched in Spain, France, Scandinavia and the UK during 2007, and roll-outs to a further two European countries are planned for 2008. AEGL's A&H team works with a diverse range of partners across Europe including financial institutions, retailers, utilities, publishers, telecommunications companies and the travel industry. Extending AEGL's existing A&H and Personal Lines range of products to life supports a deeper relationship with these partners, and levels the playing field with our major competitors.

Treating customers fairly

Treating Customers Fairly ("TCF") is a core principle of our current regulatory framework, and a key focus for the FSA. It is a principle that fits well with ACE's culture of integrity, something that all employees automatically strive to achieve. We are strongly committed to treating our customers fairly in all aspects of our business and have developed a TCF statement which defines how we adhere to the key principles of customer service in practice, particularly regarding our behaviour and interaction with customers and broking partners. While TCF is aimed predominantly at those parts of the business that deal with retail customers, the TCF statement outlines some good practices that are equally applicable and potentially value adding to our commercial relationships.

Chairman's Report

31 December 2007

Management and organisational changes

Further to the creation of ACE UK and the additional management responsibilities awarded to Richard Pryce and David Furby reported last year, in October 2007, AEGL announced the appointment of Andy Hollenberg as Senior Vice President, Accident & Health, ACE Europe. Andy brings experience from ACE's A&H business in both North America and Japan, and his rich experience will enable us to further enhance our customer proposition and to capitalise on the many opportunities for growth in Europe. Andy succeeds Edward Levin, who has moved to the position of Executive Vice President, ACE Overseas General, with responsibility for all of ACE's International A&H business.

The AEGL management team continues to have responsibility for other ACE affiliated operations in Russia, South Africa and the Middle East.

In October 2007, Kenneth Underhill was appointed as General Counsel for the ACE European Group ("AEG"). At this time of increased corporate governance and regulatory scrutiny within the insurance industry, the role of General Counsel is critical in providing legal and regulatory guidance to our management team and business operations. In this role, Ken will work to identify and analyse relevant regulatory and statutory requirements and risks that affect the ACE European Group and its business objectives, and also assist the business to implement the relevant systems and controls to address those requirements and risks.

Sue Smith joined us in January 2008 as Senior Vice President, Human Resources for the ACE European Group. Working with myself and the AEG senior management team, Sue will play an integral role in developing, implementing and effectively communicating our human resources strategy to ensure AEGL retains and recruits the best possible employees.

I am delighted to take this opportunity to formally welcome Andy, Ken and Sue to the European businesses of ACE.

Future prospects

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

In conclusion

2007 has been a particularly demanding year, and I anticipate that the insurance industry will face more challenges in years to come. AEGL has a strong franchise, a solid balance sheet, a broad product base and good producer relationships. The quality and breadth of our underwriters, claims adjusters and support staff are, I believe, second to none. The loyalty and commitment of AEGL employees has ensured that ACE met its targets in 2007 and should continue to do so in the years ahead. AEGL is a great company, with a great ethos, great people and great franchises. There is an enthusiasm and optimism in our company that endures regardless of market conditions, and I would like to take this opportunity to thank the management teams and staff throughout the UK and Europe for their hard work and dedication.

A.J. Kendrick
Chairman and Chief Executive Officer
11 March 2008

Business Review

31 December 2007

Business Review

The board of AEGL has prepared this review in accordance with Section 234ZZB of the Companies Act 1985. 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 just over 20% of the ACE Group's overall gross written premium for 2007.

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

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

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

Organisation of the business

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

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

ACE Global Markets ("AGM") is the ACE Group's specialty international underwriting business. Its parallel distribution capabilities mean that underwriting products may be offered through both AEGL and ACE European Group's Lloyds Syndicate 2488. 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 excess and surplus lines ("E&S") business, aviation, financial lines, property, marine, energy and political risks.

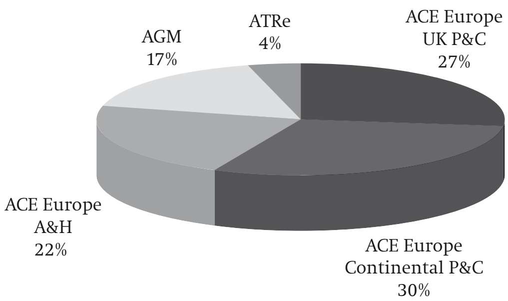
ACE Tempest Re (Europe) ("ATRe") is the ACE Group's inwards reinsurance business writing a wide-ranging portfolio across property and liability treaty classes,

Business Review

31 December 2007

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

Calendar year 2007 gross written premium split



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 P&C, headed by David Furby; and A&H, headed by Andy Hollenberg. The senior management team, consisting of Richard Pryce, David Furby and Philippa Curtis, Chief Financial Officer, assist Andrew Kendrick in setting strategic direction for the business and overseeing the day-to-day operation of the company. AEGL also benefits from its comprehensive and fully integrated support functions, which include claims, finance and actuarial, legal and compliance, human resources, operations and facilities. These support services are shared between all entities within the ACE European Group, predominantly AEGL and Syndicate 2488.

Headquartered in the UK, and with branch offices in another 18 countries across Europe, AEGL holds cross-border permissions throughout the European Economic Area, and is eligible to underwrite 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.

Significant achievements

In line with AEGL's objective of improving client and broker access to ACE underwriting expertise in Europe, in 2007, the company opened branch offices in Hungary and the Czech Republic. 2007 has seen significant percentage growth for AEGL in Central and Eastern Europe, most notably in Poland, with gross written premiums across the region increasing by over 500% in comparison to prior year.

The creation of ACE Europe Life Limited, a stand alone company which was authorised to underwrite European term life and credit life business by the FSA in April 2007, compliments the accident and health portfolio currently underwritten in AEGL and is already enhancing business opportunities within AEGL's A&H portfolio.

ACE is renowned for its excellent product range and enhances its competitive advantage by the continuous implementation of new products and initiatives. Examples of 2007 product launches include "Spectrum", an optimum all-inclusive policy specifically designed for large to medium-sized UK and Ireland-based companies with the advantage of just one point of contact to create a tailor-made combined package. There were also increased efforts to create additional cross-sell opportunities for ACE's highly-regarded stand-alone product "Environmental impairment liability", generating new business and supporting existing account retention. 2007 also saw the launch of "ComputerGuardPlus", the latest addition to ACE's range of products designed to protect businesses from the financial losses relating to IT hardware and system problems; "ACE Elite", a portfolio of liability products including D&O and Pension Trustee Liability; "ACE Renewable Energy", an innovative insurance solution for UK and Continental European renewable energy producers providing comprehensive cover across a broad scope of renewable energy risks; and the

Business Review

31 December 2007

expansion of "ACE Evolve", ACE's service proposition directly targeting emerging multi-national companies based in Continental Europe.

In 2006, AEGL's UK and Ireland service and processing functions were centralised in a new operational department in Glasgow, with duties fully transferring to the new unit during 2007. The Glasgow office now accommodates over 200 employees and is a clear demonstration of AEGL's strategy to achieve greater operational efficiencies.

Business environment

It is anticipated that the majority of AEGL's lines of business, with the exception of A&H and Personal Lines, will be under increased pressure resulting from softening market conditions in 2008.

Growth opportunities are anticipated to be relatively limited, however the company aims to increase its penetration of Continental Europe, particularly within the middle markets, and to realise new business opportunities in Portugal, Austria, Switzerland and the Nordic region.

The UK P&C and the traditional London markets are expected to remain competitive in all areas, especially within casualty and D&O. Despite the poor UK P&C industry results, there continues to be an influx of new capacity, however it is anticipated that the UK property market will see some reduction from the high levels of competition in 2007.

The top priority for 2008 is to continue to manage the cycle in an ever more challenging environment. Key strategies for achieving this goal involve strong underwriting management coupled with close actuarial involvement, particularly on new business; the retention of core accounts; creating operational efficiencies to reduce underwriting administration and improve service levels; and improving the effectiveness of distribution channels with a particular emphasis on regional penetration and cross-selling.

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.

2007 has seen some further changes in accounting policies as UK GAAP converges with International Financial Reporting Standards. The implementation of Financial Reporting Standard 29 'Financial instruments: disclosure' has enhanced disclosures relating to financial risk management.

As detailed in note 1, during the year the company identified that certain ceded reinsurance premiums had not been earned in accordance with the underlying policy terms. The premium for certain risks attaching contracts of reinsurance had not been matched to the earning profile of the inwards premium they protected. The company has calculated the impact of this issue and chosen to restate the 2006 comparatives shown in these financial statements and restate the opening reserves at 1 January 2006.

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	**2007**	**2006 (restated)**
Net written premiums	752.2	779.8
Combined ratio*	95.5%	84.5%
Profit before tax	74.0	159.1
Dividend proposed	80.0	80.0

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

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

Business Review

31 December 2007

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

Results and performance

2007 produced a pre-tax operating profit of £74.0 million and a combined ratio of 95.5%. A summary of the reported financial results is shown in the following table.

£ million	**2007**	**2006 (restated)**
Gross written premiums	1,874.8	1,962.5
Net written premiums	752.2	779.8
Net earned premiums	763.2	796.7
Incurred losses	475.6	428.6
Operating expenses	252.9	244.3
Equalisation reserve movement	13.6	16.6
Underwriting profit	21.1	107.2
Investment return	62.3	58.3
Net other income (charges)	(9.4)	(6.4)
Net pre-tax profit	74.0	159.1
Combined ratio %	95.5%	84.5%

Gross written premiums decreased by 4% over the previous year, predominantly reflecting the more challenging market conditions experienced during 2007. This reduction was in line with the company's expectations.

AEGL purchases reinsurance to mitigate the impact of major events and an undue frequency of smaller losses. The principal reinsurance programme in operation during 2007 was with an ACE Group company, ACE Tempest Reinsurance Ltd. AEGL also has the benefit, particularly for US and worldwide catastrophe exposures, of reinsurance programmes shared with other ACE companies, including ACE European Group's Lloyd's Syndicate 2488. These arrangements result in an increase in the reinsurance purchasing power of the ACE Group, which ultimately benefits all ACE subsidiaries including AEGL.

Although the year did not suffer significant US windstorm or hurricane losses, AEGL was exposed to natural catastrophe losses in Europe resulting from Windstorm Kyrill in January and the UK floods in the summer of 2007. However, the reinsurance programmes in operation during the year ensured that the net catastrophe losses were not significant at approximately £15 million in total, contributing less than 2% to the net loss ratio. In comparison, there were no catastrophe losses impacting the 2006 year.

A new high profile issue emerging in 2007 was the impact of the sub-prime crisis and subsequent credit crunch on underwriting exposures. AEGL has received a limited number of notifications in this respect in 2007, however as the financial lines book is underwritten on a claims made basis there remains potential for future claims in 2008.

The 2007 underwriting result benefited from a release of £20.5 million (2006: £64.2 million) prior year loss reserves in a number of business classes, predominantly within the ACE Europe UK P&C and AGM business units.

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 returns for 2007 exceeded those achieved in 2006 despite the turmoil in the global financial markets arising from the US sub-prime mortgage crisis. Returns in 2007 benefited from the falling yield environment which resulted in capital price appreciation for fixed income investors.

Financial position

Investments

The bulk of AEGL's investment portfolios constitute fixed income and continue to be managed by Barclays Global Investors and Western Asset Management.
The allocation policy operated by the company allows investment in alternative asset classes and during 2007 a small global equity portfolio was managed by Alliance Bernstein. In January 2008, exposure to alternative assets increased through the establishment of a new \$50 million US high yield portfolio managed by Western Asset Management.

Business Review

31 December 2007

AEGL maintains four active investment grade fixed income portfolios, the core currencies of which are sterling, euros and US dollars, and two equity portfolios investing in a broad range of European and global equities. Two passive portfolios are maintained: a sterling gilt portfolio, which acts as collateral for letter of credit issuance, and a small Swiss franc portfolio, established to meet local solvency requirements. The approximate currency split of the AEGL investment portfolios is sterling 48%, euros 32%, US dollars 16%, with other currencies totalling some 4%.

Market volatility in 2007 resulted in a wide divergence of returns between the investment managers operating to similar mandates. This was driven by a combination of their duration stance and the overall exposure to spread sectors and specific issuers. However, AEGL's direct exposure to sub-prime investments was extremely low throughout 2007, amounting to approximately £16.2 million at year end.

In 2007, 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. Once these factors have been taken into account, it is the policy of the company to distribute surplus capital to the ACE Group in the form of dividends. The directors have proposed a dividend of £80.0 million at the board meeting on 11 March 2008.

The balance sheet at 31 December 2007 discloses the shareholders' funds of the company at £716.1 million; accordingly these will be reduced by the dividend payment to be made in 2008.

AEGL assesses its capital requirements using an internal model based on Individual Capital Assessment ("ICA") principles which is then 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 2007, AEGL was issued with reduced Individual Capital Guidance by the FSA following their second Arrow assessment. The company maintains a comfortable margin against each of these key capital measures based on the admissable shareholders' funds of £663.2 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.

Ratings

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

The A.M. Best rating was affirmed in December 2007 and reflects A.M. Best's expectation that AEGL will maintain strong stand alone risk adjusted capitalisation through 2008, and also the importance of AEGL to the ACE Group. The rating also reflects AEGL's anticipated good financial performance and combined ratios, and its robust market position in the UK, across Continental Europe and increasingly in the emerging markets.

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

Business Review

31 December 2007

Governance

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

The board of directors of AEGL, the "board", is comprised 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 Board reviews and approves the annual business plan for the company, which includes strategy, limits, and reinsurance protections for each product line. The board also reviews the ICA, quarterly financial information and significant management decisions.

The company's underwriting and reinsurance 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 will involve, working in conjuction with the ACE Group audit function, agreeing and monitoring the nature and scope of work to be done 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 conjuction with the group audit function, the nature and scope of work to be carried out by internal audit, 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 will be expected to provide challenge to any aspect of these processes which it considers weak or generally poor practice.

Also a principal committee of the AEGL Board, the Risk Committee oversees the development, implementation and maintenance of embedded risk management across the business. The Risk Committee ensures that business risks and controls are recorded and monitored.

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

The company is undertaking a significant amount of development of the risk management framework through the recent establishment of a dedicated central risk management team 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 adequacy required to support business objectives, 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 our expectations; inadequate reinsurance protection; and inadequate reserving. The company also faces risks from its investment activities, exchange rate fluctuations, and business operational activities.

Underwriting risks and line sizes are continually monitored through the established peer review process

Business Review

31 December 2007

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 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 determining 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 take on 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.

Employees

ACE is dedicated to providing a safe, healthy and ethical environment for all 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 in employment. The company 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 company 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

The ACE Group is committed to lessening the company's impact on the environment and is now a member of the US Environmental Protection Agency's Climate Leaders program. In addition to the environmental activities planned 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 has formed an ACE Green committee which is charged with reviewing and assessing the environmental initiatives, actions and improvements that can be adopted across all ACE sites in the UK by staff, partners, suppliers and contractors.

Business Review

31 December 2007

In addition, ACE is a founding signatory of a major new initiative aimed at reducing the long term risk from climate change. Along with 36 other signatories, including insurers from AIG to Zurich, ACE has signed up to the "Climate Wise" initiative which will lead the way in analysing and reducing risks; support climate awareness amongst our customers; incorporate climate change into our investment strategies; inform and engage in public policy debate; and reduce the environmental impact of our businesses.

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 company-sponsored volunteer initiatives. These positive contributions to the fabric of local communities return long-lasting benefits to society, employees and the company. Examples of just some of the initiatives in which members of AEGL participated in 2007 are listed below.

In October 2007, the ACE Foundation-International contributed €200 for each European Risk Manager attending ACE's charity reception at the Red Cross museum in Geneva, following the FERMA (Federation of European Risk Managers) Congress. ACE European Group managed to raise over €40,000 for a Red Cross HIV/ AIDS educational programme in India, supporting the Red Cross's life saving work increasing awareness of HIV/AIDS among young people in India's Northern State of Utter Pradesh.

For over ten years, employees have been making a real difference to the lives of children in East London by taking part in the Lloyd's Community Reading Partners scheme, whereby volunteers give up their lunch break once a week to help pupils improve reading skills.

AEGL also participated in the "Take Our Students to Work Day", organised by Tower Hamlets Education Business Partnership. Students from inner city London schools and colleges were invited to take a peek into the daily workings of the insurance world when they spent a day at AEGL's UK headquarters and given the opportunity to shadow an insurance underwriter. In addition, ACE hosted a public speaking competition for Year 10 pupils in Tower Hamlet Schools.

ACE employees from both the Frankfurt and Leadenhall offices took part in the JP Morgan Chase 5.6km Corporate Challenge, a world-series of running events open to groups of employees from organisations within the business and public sectors. Part of the entry fee for each participant went to the event beneficiary SportsAid, the organization that provides financial and training assistance in the development of young athletes.

The ACE A&H team in Germany also raised €6,000 to *für krebskranke Kinder Frankfurt e.V.* – 'Help for Kids suffering from cancer'. Established in 1983 the association aims to improve the medical and psychological conditions of sick children, teenagers and their families.

Approved by the Board of Directors
11 March 2008

Directors' Report

31 December 2007

The directors are pleased to submit their report and the audited financial statements for the year to 31 December 2007.

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.

Results and dividends

The company made a profit on ordinary activities before tax for the year to 31 December 2007 of £74.0 million (2006 restated: £159.1 million).

The directors have proposed a dividend of £80.0 million on 11 March 2008.

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 2007 to the date of this report unless otherwise indicated:

Executive directors:

R L Cigelnik (resigned 31 January 2007)
P M Curtis
D M A Furby
A J Kendrick
M G Furgueson (resigned 18 January 2007)
E M Levin (resigned 11 March 2008)
R P Murray
R V Pryce

Non-executive directors:

R V Emerson
D S Marston
G D Williams

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

Directors' interests

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

Directors' Report

31 December 2007

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 2007 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, 11 March 2008

ACE Building
100 Leadenhall Street
London
EC3A 3BP

Statement of Directors' Responsibilities

31 December 2007

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

The directors confirm that suitable accounting policies have been used and applied consistently, with the exception of changes arising on the adoption of new accounting standards in the year, and reasonable and prudent judgements and estimates have been made in the preparation of the financial statements for the year ended 31 December 2007. 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 2007 which comprise the Profit and Loss account, the Balance Sheet, the Statement of Total Recognised Gains and Losses and the related notes. These financial statements have been prepared under the accounting policies set out therein.

Respective responsibilities of directors and auditors

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

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

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements. The information given in the Directors' Report includes that specific information presented in the Business Review that is cross referred from the Directors' Report.

In addition, we report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

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

Basis of audit opinion

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

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

Equalisation provisions

Our evaluation of the presentation of information in the financial statements has had regard to the statutory requirement for insurance companies to maintain equalisation provisions. The nature of equalisation provisions, the amounts set aside at 31 December 2007, 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.

Independent Auditors' Report

to the members of ACE European Group Limited

Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the company's affairs as at 31 December 2007 and of its profit for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the financial statements.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
London
11 March 2008

Profit and Loss Account

for the year ended 31 December 2007

	Note	2007 £'000	2006 (restated) £'000
Technical account – general business			
Earned premiums, net of reinsurance:			
Gross premiums written – continuing operations	3	**1,874,515**	1,962,095
– discontinued operations	3	**331**	358
Gross premiums written	3	**1,874,846**	1,962,453
Outward reinsurance premiums		**(1,122,696)**	(1,182,665)
Net premiums written		**752,150**	779,788
Change in the gross provision for unearned premiums		**27,309**	(26,206)
Change in the provision for unearned premiums – reinsurers' share		**(16,257)**	43,105
Earned premiums, net of reinsurance		**763,202**	796,687
Claims incurred, net of reinsurance:			
Claims paid:			
Gross amount	3	**(835,530)**	(715,064)
Reinsurers' share		**470,109**	420,729
Net paid claims		**(365,421)**	(294,335)
Change in the provision for claims outstanding:			
Gross amount	3	**(238,842)**	(373,726)
Reinsurers' share		**128,654**	239,470
Change in the net provision for claims outstanding		**(110,188)**	(134,256)
Claims incurred, net of reinsurance		**(475,609)**	(428,591)
Net operating expenses	5	**(252,871)**	(244,311)
Change in the equalisation provision	19	**(13,630)**	(16,589)
Balance on the technical account for general business		**21,092**	107,196

Profit and Loss Account

for the year ended 31 December 2007

	Note	2007 £'000	2006 (restated) £'000
Non-technical account			
Balance on the general business technical account		**21,092**	107,196
Investment income	9	**128,562**	116,526
Unrealised gains on investments	9	**31,016**	19,382
Investment expenses and charges	9	**(45,250)**	(20,452)
Unrealised losses on investments	9	**(51,981)**	(57,130)
Foreign exchange differences		**(10,331)**	(6,833)
Other income		**889**	394
Profit on ordinary activities before taxation		**73,997**	159,083
Continuing operations		**74,244**	159,527
Discontinued operations		**(247)**	(444)
Taxation on profit on ordinary activities	10	**(20,526)**	(65,799)
Profit for the financial year		**53,471**	93,284

Statement of Total Recognised Gains and Losses

for the year ended 31 December 2007

		2007 £'000	2006 (restated) £'000
Profit for the financial year		**53,471**	93,284
Currency translation differences	17	**22,255**	(4,375)
Actuarial gain recognised in relation to pension schemes	17	**799**	615
Movement on deferred taxation relating to pension liability	17	**(240)**	(203)
Total recognised gains relating to the year		**76,285**	89,321
Prior period adjustment (note 1)		**34,096**	
Total gains and losses recognised since last annual report		**110,381**	

Balance Sheet

at 31 December 2007

	Note	2007 £'000	2006 (restated) £'000
Assets			
Investments			
Other financial investments	12	**1,925,021**	1,882,194
Financial derivative instruments	12	**5,345**	7,638
Deposits with ceding undertakings		**29**	27
		1,930,395	1,889,859
Reinsurers' share of technical provisions			
Provision for unearned premiums		**289,927**	299,475
Provision for claims outstanding		**1,867,845**	1,685,015
		2,157,772	1,984,490
Debtors – amounts falling due within one year			
Debtors arising out of direct insurance operations:			
amounts owed by policyholders		**3,914**	2,406
amounts owed by intermediaries		**351,566**	335,672
Debtors arising out of reinsurance operations		**182,051**	208,089
Other debtors	13	**88,817**	93,498
		626,348	639,665
Other assets			
Tangible assets	15	**8,093**	7,575
Cash at bank and in hand	21	**176,599**	162,396
		184,692	169,971
Prepayments and accrued income			
Accrued interest and rent		**37,405**	33,727
Deferred acquisition costs		**97,675**	108,490
Other prepayments and accrued income		**52,832**	29,917
		187,912	172,134
Total assets		**5,087,119**	4,856,119

Balance Sheet

at 31 December 2007

	Note	2007 £'000	2006 (restated) £'000
Liabilities			
Capital and reserves			
Called-up share capital	16	**544,741**	544,741
Profit and loss account	17	**145,711**	149,426
Merger reserve	17	**25,653**	25,653
Total shareholders' funds	18	**716,105**	719,820
Technical provisions			
Provision for unearned premiums		**645,106**	656,272
Provision for claims outstanding		**3,110,984**	2,792,197
Equalisation provision	19	**76,763**	60,663
		3,832,853	3,509,132
Provisions for other risks and charges	14	**–**	14,624
Deposits received from reinsurers		**2,989**	2,059
Creditors – amounts falling due within one year			
Creditors arising out of direct insurance operations		**15,273**	18,478
Creditors arising out of reinsurance operations		**240,882**	242,889
Other creditors including taxation and social security	20	**175,022**	254,941
		431,177	516,308
Financial derivative instruments	12	**2,720**	7,707
Accruals and deferred income			
Deferred acquisition costs relating to reinsurance		**52,492**	46,332
Other accruals and deferred income		**47,598**	37,978
		100,090	84,310
Total liabilities excluding pension liability		**5,085,934**	4,853,960
Pension liability		**1,185**	2,159
Total liabilities		**5,087,119**	**4,856,119**

The financial statements on pages 17 to 41 were approved by the board of directors on 11 March 2008 and were signed on its behalf by:

P M Curtis
Chief Financial Officer

Notes to the Financial Statements

31 December 2007

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 (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".

Restatement of prior year profit and opening reserves at 1 January 2006

During the year the company identified that certain ceded reinsurance premiums had not historically been earned in accordance with the underlying policy terms. The premium for certain risks attaching contracts of reinsurance had not been matched to the earning profile of the inwards premium they protected. The company has calculated the impact of this issue and chosen to restate the 2006 comparatives shown in these financial statements and restate the opening reserves at 1 January 2006. This resulted in an increase in the 2006 profit before tax of £15.4 million and an increase in profit after tax of £10.8 million. The after tax adjustment relating to 2006 opening reserves was £23.3 million resulting in an overall increase in prior year net assets of £34.1 million.

Changes in accounting policies

The company has implemented FRS 29 "Financial Instruments: Disclosures". The adoption of this standard 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.

Notes to the Financial Statements

31 December 2007

1. Accounting policies – continued

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.

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.

Notes to the Financial Statements

31 December 2007

1. Accounting policies – continued

Provisions for claims outstanding and related reinsurance recoveries – continued

Reinsurance acceptances

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

Asbestos, pollution and health claims ("APH")

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

Unexpired risks provision

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

Equalisation provision

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

Financial Assets and Liabilities

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

Investments – fair value through profit and loss

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

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

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

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

Notes to the Financial Statements

31 December 2007

1. Accounting policies – continued

Cash and cash equivalents

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

Insurance and other receivables

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

Derivative financial instruments

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

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

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

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

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

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

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, the company recognises the cash and 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 bid value are calculated as the difference between net sale proceeds and purchase price. Movements in unrealised gains and losses on investments represent the difference between the valuation at the balance sheet date and their purchase price or, if they have previously been revalued, their valuation at the last balance

Notes to the Financial Statements

31 December 2007

1. Accounting policies – continued

sheet date, together with the reversal of unrealised gains and losses recognised in earlier accounting periods in respect of investment disposals in the current period.

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

Tangible assets

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

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

Deferred taxation

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

Operating leases

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

Pension costs

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

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

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

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

Foreign currencies

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

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

Notes to the Financial Statements

31 December 2007

2. Capital management & financial risk management

Capital management

AEGL maintains an efficient capital structure consistent with the company's risk profile and business requirements, and to meet regulatory requirements. Accordingly, 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, 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.

AEGL is regulated by the Financial Services Authority (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, and through their second Arrow review, more recently in 2007.

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 liquidity and credit risk through insurance and reinsurance receivables and payables.

The notes below explain how financial risks are managed. The Company has not changed the processes used to manage these risks from previous periods, and assesses these risks, (in the case of investment activity through stochastic modelling of the portfolio), in its internal capital model and consequent capital requirements.

Notes to the Financial Statements

31 December 2007

2. Capital management & financial risk management – continued

Investment activity governance

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 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, Alliance Bernstein and with effect from 2008, Goldman Sachs 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 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 of these, in 2007 the Company only maintained an allocation to equities. However, in early 2008, the Company established a small high yield portfolio to take advantage of the significant market yield widening which took place in 2007. 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 £1,721 million at external managers as at 31 December 2007 (2006: £1,630 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 £71.9 million (2006: £76.5 million) and accordingly decrease total shareholders' funds by some £50.3 million (2006: £53.3 million).

Notes to the Financial Statements

31 December 2007

2. Capital management & financial risk management – continued

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 £106 million (2006: £101 million) are listed and represent 6% (2006: 5%) 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 decrease by £10.6 million (2006: £10.1 million).

Currency risk

The Company is primarily exposed to currency risk in respect of 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 an approximate currency match of assets and liabilities is maintained, with the bulk of surplus funds matched by sterling and more modest surpluses held in euros and US dollars.

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 (assets and liabilities) are translated to sterling using the rates of exchange at year end.

For the profit and loss statement, the 2007 average euro/sterling rate of €1.47/£1 is consistent with that of the prior period (2006: €1.47/£1). However, had sterling weakened by 10% against all currencies (primarily the euro and US dollar) and all other variables remained constant, the profit for the financial year would have been £2.3 million higher than the £53.5 million reported (2006: £5.6 million increase).

For the balance sheet components, the year end rates used to convert euro to sterling of €1.38/£1 has fallen by 8% compared to the previous year end rate of exchange of €1.49/£1. Assuming sterling had weakened by a further 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 increased shareholders' funds of £38.1 million to £754.2 million (2006: £31.6 million increase).

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.

Notes to the Financial Statements

31 December 2007

2. Capital management & financial risk management – continued

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 or on demand, as are the liabilities associated with financial derivative instruments and deposits received from reinsurers.

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.

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 £1,818.6 million (2006: £1,780.8 million) represented 94% (2006: 95%) of the total investment portfolio. The average credit quality of investment portfolios using Standard and Poors ratings remained high throughout the year and stood at AA at year end, unchanged from the previous year. All equity holdings of £106.5 million (2006: £101.4 million) are listed and represent 6% (2006: 5%) 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 elegible/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 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. The Company operates a ceded Reinsurance Security Committee which reviews 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 2007

2. Capital management & financial risk management – continued

The assets bearing credit risk are summarised below:

	2007	2006 (restated)
	£'000	£'000
Other financial investments	**1,925,021**	1,882,194
Derivative financial securities	**5,345**	7,638
Reinsurers' share of technical provisions	**2,157,772**	1,984,490
Debtors arising out of direct insurance operations	**355,480**	338,078
Debtors arising from reinsurance operations	**182,051**	208,089
Cash at bank	**176,599**	162,396
Total assets bearing credit risk	**4,802,268**	4,582,885

	2007	2006 (restated)
	£'000	£'000
AAA	**1,033,367**	1,073,985
AA	**426,040**	318,039
A	**2,285,096**	2,158,579
BBB	**226,717**	215,638
Below BBB or not rated*	**831,048**	816,644
Total assets bearing credit risk	**4,802,268**	4,582,885

* Below BBB or not rated includes equities, cash (including the cash element of stock lending collateral) and debtors from direct insurance operations.

The concentration of credit risk is substantially unchanged compared to prior year.

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 laid out in note 1. Direct exposure to sub-prime mortgages and fixed income investments backed by wraps provided by financial guarantee insurers ('monolines') were low throughout 2007, standing at £6.9 million and £9.3 million respectively of the total assets bearing credit risk at year end.

Other financial investments, financial derivative instruments and cash at bank are neither past due nor impaired.

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. This balance includes 0.5% (2006: 0.9%) past due that have been impaired.

Debtors arising out of direct and reinsurance operations are held at fair value less any provision for impairment as laid out in note 1. They include 1.1% (2006: 2.0%) that have been impaired and 23.0% (2006: 32.9%) that are past due, but not impaired. The latter is aged 18.7% zero to six months (2006: 23.1%), 1.4% six months to a year (2006: 4.8%) and the remaining 3.5% is older than a year (2006: 5.0%).

Notes to the Financial Statements

31 December 2007

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 2007					
Continuing operations:					
Direct insurance					
Accident and health	**324,895**	**325,575**	**(123,087)**	**(125,200)**	**(60,570)**
Marine, aviation and transport	**106,740**	**108,776**	**(73,599)**	**(26,276)**	**(17,353)**
Fire and other damage to property	**504,744**	**511,053**	**(374,851)**	**(128,188)**	**(118,318)**
Third party liability	**490,112**	**506,565**	**(421,820)**	**(95,574)**	**(23,638)**
Miscellaneous	**111,585**	**110,137**	**11,795**	**(29,996)**	**(66,734)**
Reinsurance acceptances	**336,439**	**339,718**	**(90,967)**	**(56,661)**	**(45,329)**
	1,874,515	**1,901,824**	**(1,072,529)**	**(461,895)**	**(331,942)**
Discontinued operations	**331**	**331**	**(1,843)**	**(15)**	**790**
	1,874,846	**1,902,155**	**(1,074,372)**	**(461,910)**	**(331,152)**
Year to 31 December 2006 (restated)					
Continuing operations:					
Direct insurance					
Accident and health	295,539	293,522	(108,199)	(115,700)	(61,830)
Marine, aviation and transport	122,996	125,396	(75,058)	(25,462)	(15,400)
Fire and other damage to property	525,695	511,266	(295,907)	(104,387)	(113,733)
Third party liability	549,582	550,411	(380,455)	(89,642)	(10,892)
Miscellaneous	108,370	110,570	(80,925)	(31,354)	14,502
Reinsurance acceptances	359,913	344,724	(161,668)	(63,565)	(91,985)
	1,962,095	1,935,889	(1,102,212)	(430,110)	(279,338)
Discontinued operations	358	358	13,422	(28)	(14,196)
	1,962,453	1,936,247	(1,088,790)	(430,138)	(293,534)

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	
	2007	2006	**2007**	2006 (restated)	**2007**	2006 (restated)
	£'000	£'000	**£'000**	£'000	**£'000**	£'000
United Kingdom	**992,529**	1,116,704	**38,791**	53,059	**388,327**	430,612
Other EEA states	**839,131**	808,402	**30,785**	97,800	**308,149**	272,963
Other countries	**43,186**	37,347	**4,421**	8,224	**19,629**	16,245
	1,874,846	1,962,453	**73,997**	159,083	**716,105**	719,820

Notes to the Financial Statements

31 December 2007

3. Segmental analysis – continued

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

	2007	2006
	£'000	£'000
United Kingdom	**565,021**	603,195
United States of America	**70,384**	83,861
Continental Europe	**970,268**	936,085
Africa & Middle East	**53,416**	52,064
Asia/Pacific	**51,121**	50,149
Americas	**37,551**	35,327
Worldwide	**126,754**	201,414
Discontinued business	**331**	358
	1,874,846	1,962,453

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

The prior year's net provision for claims outstanding generated a surplus for 2007 (2006: surplus) as detailed below:

	2007	2006
	£'000	£'000
Continuing operations:		
Accident and health	**2,200**	(1,257)
Marine, aviation and transport	**6,509**	10,586
Fire and other damage to property	**6,774**	22,918
Third party liability	**(1,404)**	25,606
Miscellaneous	**6,818**	6,784
	20,897	64,637
Discontinued operations	**(393)**	(444)
	20,504	64,193

5. Net operating expenses – technical account

	2007	2006
	£'000	£'000
Acquisition costs	**295,557**	298,516
Change in net deferred acquisition costs	**18,374**	(13,397)
Administrative expenses	**152,155**	147,967
Reinsurance commissions	**(213,215)**	(188,775)
	252,871	244,311

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 £232.5 million (2006: £233.9 million), and are included within acquisition costs.

Notes to the Financial Statements

31 December 2007

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:

	2007	2006
	£'000	£'000
Audit fees		
Fees payable to the company's auditor for the audit of the annual accounts	**332**	435
Non audit fees		
Other services pursuant to legislation	**327**	563
Other services relating to taxation	**168**	202
	827	1,200

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

7. Operating lease rentals

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

	2007	2006
	£'000	£'000
Leasehold property	**3,580**	2,994

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

	2007	2006
	£'000	£'000
Within 1 year	**445**	1,579
Between two and five years	**2,338**	1,835
More than five years	**244**	240
	3,027	3,654

Notes to the Financial Statements

31 December 2007

8. Directors and employees

	2007	2006
	£'000	£'000
Cost of staff employed by the company		
Wages and salaries	**30,749**	29,306
Social security costs	**8,457**	7,978
Other pension costs	**3,267**	2,924
Other staff costs	**4,039**	5,147
	46,512	45,355

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

	2007	2006
	No.	No.
Underwriting	**573**	527
Claims	**135**	133
Other	**100**	110
	808	770

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.

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.

	2007	2006
	£'000	£'000
Aggregate emoluments and benefits	**2,968**	3,505
Company pension contributions to money purchase pension schemes	**84**	81
	3,052	3,586

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 £644,067 (2006: £576,263) 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, six directors exercised options over the shares of ACE Limited. The highest paid director did not exercise any share options during the year.

Until 31 March 2002, retirement benefits accrued under the ACE London Pension Scheme to four current directors under the final salary section. 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 2007

9. Investment return

	2007	2006
	£'000	£'000
Investment income		
Income from investments	**93,854**	82,739
Gains on the realisation of investments	**34,708**	33,787
	128,562	116,526
Investment expenses and charges		
Investment management expenses	**(6,433)**	(5,647)
Losses on the realisation of investments	**(38,817)**	(14,805)
	(45,250)	(20,452)
Net unrealised gains less losses on investments		
Unrealised gains on investments	**31,016**	19,382
Unrealised losses on investments	**(51,981)**	(57,130)
	(20,965)	(37,748)
Total investment return	**62,347**	58,326

10. Taxation on profit on ordinary activities

Analysis of charge in period

	2007	2006 (restated)
	£'000	£'000
UK corporation taxation at 30% (2006: 30%)		
Current taxation on income for the period	**36,948**	45,303
Adjustments in respect of previous periods	**(2,222)**	90
	34,726	45,393
Double taxation relief	**(12,785)**	(29,516)
	21,941	15,877
Foreign taxation		
Current taxation on income for the period	**14,595**	34,962
Adjustments in respect of previous periods	**(771)**	9,358
	13,824	44,320
Current taxation on income for the period	**35,765**	60,197
Deferred taxation (note 14):		
Origination and reversal of timing differences	**(14,606)**	4,539
Adjustments in respect of previous periods	**(633)**	1,063
	(15,239)	5,602
Taxation on profit on ordinary activities	**20,526**	65,799

Notes to the Financial Statements

31 December 2007

10. Taxation on profit on ordinary activities – continued

Factors affecting taxation charge for period

The taxation assessed for the period is higher (2006: higher) than the standard rate of corporation taxation in the UK (30%). The differences are explained below:

	2007	2006 (restated)
	£'000	£'000
Profit on ordinary activities before taxation	**73,997**	159,083
Profit on ordinary activities multiplied by standard rate of corporation taxation in the UK of 30% (2006: 30%)	**22,199**	47,725
Effects of:		
Restatement of prior year profits (note 1)	**14,613**	(4,608)
Expenses not deductible for taxation purposes	**243**	2,110
Non-taxable losses	**(89)**	–
Higher taxation rates on overseas earnings	**1,810**	5,445
Adjustments in respect of previous periods	**(2,993)**	9,448
Other, including timing differences	**(18)**	77
Current taxation charge for period	**35,765**	60,197

11. Dividends

During 2007 the company paid a dividend of 14.7p per share totalling £80.0 million (2006: 22.0p per share totalling £120.0 million).

12. Other financial investments

	Market Value 2007	**Cost 2007**	Market Value 2006	Cost 2006
	£'000	**£'000**	£'000	£'000
Shares and other variable yield securities and units in unit trusts	**106,447**	**106,532**	101,357	88,930
Debt securities and other fixed interest securities	**1,720,975**	**1,758,311**	1,629,808	1,653,615
Deposits with credit institutions	**97,599**	**97,599**	151,029	151,029
	1,925,021	**1,962,442**	1,882,194	1,893,574

All investments held are listed.

Derivative financial instruments

	Assets 2007	**Liabilities 2007**	Assets 2006	Liabilities 2006
	£'000	**£'000**	£'000	£'000
Forward foreign currency contracts	**2,656**	**1,505**	7,260	6,490
Fixed income options and futures	**2,689**	**1,215**	378	1,217
	5,345	**2,720**	7,638	7,707

Notes to the Financial Statements

31 December 2007

12. Other financial investments – continued

The cost of entering into derivative financial instruments was £148,450 (2006: £37,671).

Currency derivatives

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

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

	2007	2006
	£'000	£'000
Forward foreign exchange contracts	**35**	26

At 31 December 2007, the fair value of the company's currency derivatives is estimated to be approximately £1.2 million (2006: £0.8 million). These amounts are based on rates of exchange at the balance sheet date, comprising £2.7 million of assets (2006: £7.3 million) and £1.5 million of liabilities (2006: £6.5 million).

Amounts of £3.6 million (2006: £0.9 million) have been recognised in the profit and loss account in respect of contracts matured during the period.

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 2007, the fair value of the company's fixed income derivatives is estimated to be an asset of £1.5 million (2006: liability of £0.8 million) comprising £2.7 million of assets (2006: £0.4 million) and £1.2 million of liabilities (2006: £1.2 million).

A loss of £1.4 million (2006: loss of £0.7 million) has been recognised in the profit and loss account in respect of contracts matured in the period.

13. Other debtors

	2007	2006
	£'000	£'000
Amounts falling due within one year:		
Amounts due from group undertakings	**70,335**	67,386
Corporation tax receivable	**1,866**	–
Deferred taxation (note 14)	**821**	–
Receivable for sales of securities	**3,800**	16,963
Other debtors	**11,995**	9,149
	88,817	93,498

Notes to the Financial Statements

31 December 2007

14. Deferred taxation

	2007	2006 (restated)
	£'000	£'000
At 1 January as previously reported	(11)	1,094
Tax effect of restatement of prior year profit (note 1)	(14,613)	(10,005)
At 1 January restated	(14,624)	(8,911)
Foreign exchange differences	446	92
Movement relating to pension liability	(240)	(203)
Adjustment in respect of previous periods	633	(1,063)
Utilisation in year (note 10)	14,606	(4,539)
At 31 December	821	(14,624)
Analysis of asset (liability) at 31 December		
Tax effect of restatement of prior year profit (note 1)	–	(14,613)
Foreign equalisation provisions	–	2,761
Other timing differences	821	(2,772)
Undiscounted deferred taxation asset (liability) as above	821	(14,624)

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 2007	1,160	1,560	10,073	6,324	19,117
Additions	–	177	1,797	1,381	3,355
Disposals	–	(71)	(1,864)	(6)	(1,941)
Foreign exchange differences	90	(540)	908	412	870
At 31 December 2007	1,250	1,126	10,914	8,111	21,401
Accumulated depreciation					
At 1 January 2007	533	729	5,673	4,607	11,542
Charge for the period	26	319	910	1,005	2,260
Disposals	–	(54)	(1,489)	(2)	(1,545)
Foreign exchange differences	44	(15)	980	42	1,051
At 31 December 2007	603	979	6,074	5,652	13,308
Net book value					
31 December 2007	647	147	4,840	2,459	8,093
31 December 2006	627	831	4,400	1,717	7,575

Notes to the Financial Statements

31 December 2007

16. Called-up share capital

	2007	2006
	£'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 (2005: 500,000,000 Ordinary £1 shares)	**500,000**	500,000
250,000,000 'B' Ordinary £1 shares (2005: 250,000,000 Ordinary £1 shares)	**250,000**	250,000
	750,000	750,000

17. Reserves

	Share capital	Profit and loss account	Merger reserve	Total
	£'000	£'000	£'000	£'000
At 1 January as previously reported	544,741	115,330	25,653	685,724
Restatement of prior year profit (note 1)	–	34,096	–	34,096
At 1 January restated	544,741	149,426	25,653	719,820
Profit for the year	–	53,471	–	53,471
Currency translation differences	–	22,255	–	22,255
Actuarial gain recognised in relation to pension schemes	–	799	–	799
Movement of deferred taxation relating to pension liability	–	(240)	–	(240)
Dividend paid (note 11)	–	(80,000)	–	(80,000)
At 31 December	**544,741**	**145,711**	**25,653**	**716,105**

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.

Notes to the Financial Statements

31 December 2007

18. Reconciliation of movements in shareholders' funds

	2007	2006 (restated)
	£'000	£'000
Profit for the financial year	**53,471**	93,284
Currency translation differences	**22,255**	(4,375)
Actuarial gain recognised in relation to pension schemes	**799**	615
Movement on deferred taxation relating to pension liability	**(240)**	(203)
Dividend paid (note 11)	**(80,000)**	(120,000)
Net reduction in shareholders' funds	**(3,715)**	(30,679)
Opening shareholders' funds as previously stated	**685,724**	727,155
Restatement of prior year profits	**34,096**	23,344
Opening shareholders' funds adjusted	**719,820**	750,499
At 31 December	**716,105**	719,820

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 £76.8 million (2006: £60.7 million). 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 £13.6 million (2006: £16.6 million).

20. Other creditors including taxation and social security

	2007	2006 (restated)
	£'000	£'000
Corporation taxation payable	–	16,543
Payable for purchases of securities	**10,649**	95,026
Other creditors	**23,620**	23,795
Liability for stock lending collateral – cash (note 21)	**140,753**	119,577
	175,022	254,941

Notes to the Financial Statements

31 December 2007

21. Stock lending

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

	2007	2006
	£'000	**£'000**
Aggregate value of securities on loan at 31 December	**313,153**	239,899
Income from stock lending during the year	**620**	86

In respect of securities on loan at the year end, the company held £314.7 million (2006: £245.3 million) as collateral, the value of which exceeds the value of the loan securities by 0.5% (2006: 2.2%).

Included within the £314.7 million (2006: £245.3 million) of collateral held is £140.8 million (2006: £119.6 million) in the form of cash. This is included on the face of the balance sheet within cash at bank and in hand following a change in disclosure practice. In prior year financial statements the cash and related liability (note 20) was not disclosed separately in the balance sheet. Therefore the comparative for cash at bank and in hand and other creditors including taxation and social security have been restated.

22. Letter of credit facilities

Under a facility with Citibank NA, the value of letters of credit outstanding was £16.5 million (2006: £18.0 million) with associated collateral of £35.3 million (2006: £33.1 million). Under a facility with Lloyds TSB Bank plc, there is a further letter of credit outstanding for £0.9 million (2006: £0.9 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 2007 which has not been provided for in these financial statements.

24. 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.

25. Post balance sheet events

On 11 March 2008 the directors have proposed a dividend of 14.7p per share totalling £80,000,000.

26. 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.

The material used in this document is 50% recycled. It is produced using vegetable based inks and is printed by Royle Print – a Carbon Neutral Printer.

CarbonNeutral® printing company

FSC
Mixed Sources
Product group from well-managed forests and recycled wood or fiber

ace european group

AUSTRIA
Teinfaltstrasse 4
Vienna 1010 Wien
Austria
T: (43-1) 710 93 55
F: (43-1) 710 95 20

BELGIUM
Avenue des Nerviens 9-31
1040 Brussels
Belgium
T: (32-2) 516 9711
F: (32-2) 513 0884

CZECH REPUBLIC
International Business Centre
Pobřežní 3,
Prague 8,
Czech Republic.
T: (420) 222 351 251
F: (420) 222 351 291

DENMARK
Vestergade 2C
1456 Copenhagen K
Denmark
T: (45-333) 22 517
F: (45-333) 22 547

FINLAND
Mannerheimintie 12B
FI-00100 Helsinki
Finland
T: (358-0) 6969 2626
F: (358-0) 6969 2627

FRANCE
Le Colisée
8 Avenue de l Arche
92400 Courbevoie Cedex
Paris
France
T: (33-1) 5591 4545
F: (33-1) 4788 4510

GERMANY
Lurgiallee 10
60439 Frankfurt
Germany
T: (49-69) 756 130
F: (49-69) 746 193

GIBRALTAR
Suite 825/6
Europort
Gibraltar
T: (350) 751 22
F: (350) 751 29

HUNGARY
Regus House
Budapest Kálmán Imre
ucta
1054-Budapest
Hungary
T: (36) 1 475 1230
F: (36) 1 475 1530

IRELAND
5 Georges Dock
International Financial
Services Centre
Dublin 1
Republic of Ireland
T: (353-1) 440 1700
F: (353-1) 440 1701

ITALY
Viale Monza, 258
20128 Milan
Italy
T: (39-02) 27095-1
F: (39-02) 27095-333

NETHERLANDS
Marten Meesweg 8-10
3068 AV Rotterdam
Netherlands
T: (31-10) 289 3575
F: (31-10) 289 3599

NORWAY
C J Hambros plass 2c
0164 Oslo
Norway
T: (47) 2331-5440
F: (47) 2331-5441

POLAND
85-87 Ul. Chmielna
00-805 Warsaw
Poland
T: (48) 22 581 0750
F: (48) 22 581 1133

PORTUGAL
Av. Da Liberdade, 110
1269-046 Lisbon
Portugal
T: (351) 21 340 46 75
F: (351) 21 340 45 75

SPAIN
c/ Francisco Gervás, 13
Madrid 28020
Spain
T: (34-91) 837 49 77
F: (34-91) 837 67 76

SWEDEN
Klarabergsviadukten 90
Box 868
101 37 Stockholm
Sweden
T: (46-8) 692 5400
F: (46-8) 692 5410

SWITZERLAND
Mainaustrasse 30
CH-8008 Zürich
Switzerland
T: (41-43) 456 7600
F: (41-43) 456 7601

ACE Building
100 Leadenhall Street
London
EC3A 3BP

Tel 020 7173 7000
Fax 020 7173 7800

www.aceeuropeangroup.com