Beazley Group plc Annual report and accounts 2006



# About us

About Specialty lines We are the lead underwriter in many lines of specialty insurance and reinsurance including challenging areas such as professional liability, directors' and officers' liability,

About Property Our expert underwriters, based in London, USA and Singapore, cover About Reinsurance We help to protect the balance sheets of a significant proportion of the world's leading general insurers and many of our clients have been with us for over 20 years.

About Marine We participate in the insurance of about 10% of the world's ocean-going tonnage and lead the voyage and tow business in the London market. We insure

www.beazley.com

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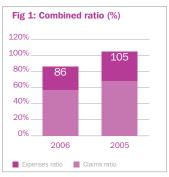
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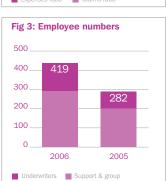
# Financial highlights and key indicators

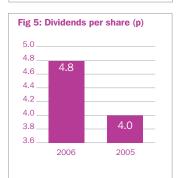


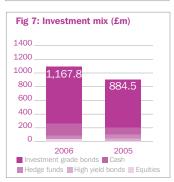


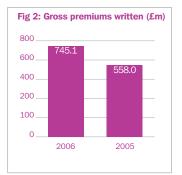
	2006	2005
Capacity – managed syndicates (£m)	830.0	742.0
Beazley Group plc share	78%	70%
Gross premiums written (£m)	745.1	558.0
Net premiums written (£m)	574.3	425.8
Net earned premiums (£m)	509.6	372.3
Profit before tax (£m)	86.8	16.1
Profit before tax and foreign exchange adjustments on non-monetary items (£m)	96.2	7.9
Claims ratio	53%	73%
Expenses ratio	33%	32%
Combined ratio	86%	105%
Average rate increase	6%	
Employee numbers	419	282
Underwriters	123	82
Support and group	296	200
Cash and investments (£m)	1,167.8	884.5
Average investment return	4.9%	4.2%

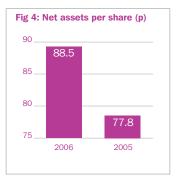














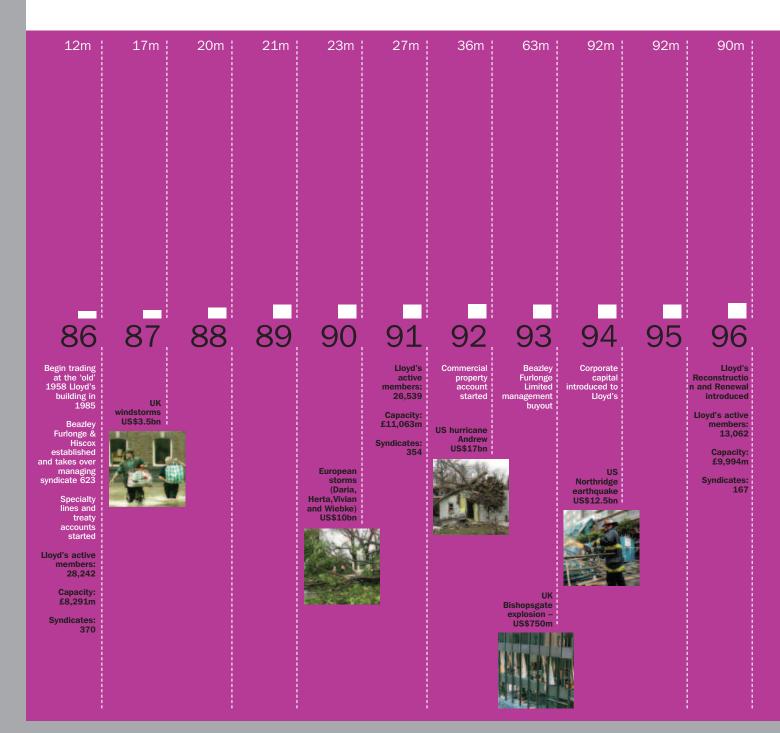


# Our vision

To continue to build a premier risk-taking business measured by results and reputation.

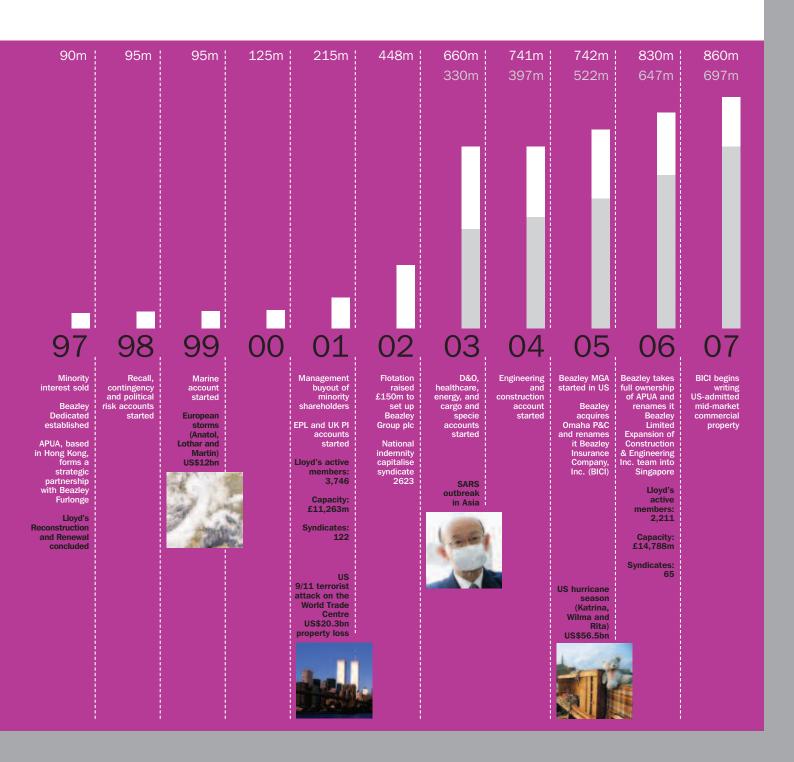
# Our strategy

- Provide our customers with access to our global network;
- Proactively manage claims; and
- Make informed underwriting decisions.



Key
Total Beazley syndicates' capacity (£)
Group share of capacity (£)

timeline are estimated to Figures shown in timeline are estimated losses to insurance industry



Beazley Annual Report 2006

Our 20th anniversary year of business has been an exciting and challenging time. We achieved record profits before tax of £86.8m in strong underwriting conditions.

# Chairman's statement



The board is pleased to announce record profits before tax of £86.8m (2005: £16.1m). As we predicted in our previous annual report, we have benefited from strong underwriting conditions following last year's hurricane losses, combined with strong returns from our investment balances. We were well placed to make the most of the opportunities presented, maintaining our strategy of controlled risk-taking. We are very proud of this result which comes during the 20th anniversary of Beazley Furlonge Limited as a managing agency at Lloyd's.

# **Underwriting performance**

In 2006 we wrote gross premiums of £745.1m (2005: £558.0m) – a 34% increase year on year. This was driven by both our increased ownership of the combined premium capacity of syndicates 623 and 2623 – we owned 78% in 2006 (2005: 70%) – and an increase in the combined premium capacity to £830m in 2006 (2005: £742m). Premium capacity increased largely due to the rise in insurance rates which we were expecting following the catastrophic events of 2005. We also took a larger share of the risks which we know well – our average line size is now 21.3% (2005: 20.2%).

Our combined ratio fell to 86% (2005: 105%). The reduction is mainly due to the claims ratio which fell to 53% (2005: 73%). Investors will recall that the 2005 loss ratio

was impacted by the hurricane losses (estimated impact 18%) and we have also been able to make claims reserve releases from our medium tail specialty lines business which have developed better than originally expected. Although it is too early to make any further releases at this stage, we hope that 2007 should see further favourable claims development.

Our investment performance has also been strong. We have achieved investment income of £48.3m (2005: £31.6m), a return of 4.9% (2005: 4.2%). This has been driven through higher US dollar and sterling interest rates throughout the period. The bond portfolio remains relatively short in duration, with an average duration of 11 months, enabling us to make the most of interest rate increases.

In our business review, Andrew Beazley describes in detail the strong progress which we are making in becoming a premier risk-taking business. Our strategy of recruiting high-calibre underwriting, claims and support personnel, combined with creating improved opportunities to access insurance business, have all contributed to this achievement. During the year we have recruited 39 underwriters and 11 claims professionals, and established offices in Hong Kong, Singapore, Paris, Chicago, San Francisco and New York, as well as a number of satellite offices throughout the UK.



## **US** business

The US business has made good progress in 2006. This business, which commenced trading in early 2005, operates its own managing general agent (MGA), which writes insurance business both through Lloyd's and through its own admitted US insurance company. The US businesses are completely integrated within the relevant lines of business in London. The US initiative aims to improve our access to customers who would not traditionally use Lloyd's as an insurance carrier. The key to this initiative is getting the right people who will maintain our levels of commitment and professionalism in developing the business and whose underwriting approach is consistent with ours. During 2006 we wrote US\$68.9m (2005: US\$15.4m) through the MGA, of which US\$35.9m was written through the admitted insurance company and US\$33.0m on behalf of our Lloyd's syndicates. The business gathered momentum during the year and we are now seeing consistently improving premium volumes month on month.

## Capita

During the period we strengthened our capital position through a lower tier 2 debt issue which raised £150m at an interest rate of 7.25%. The issue was underwritten by JP Morgan Cazenove and Royal Bank of Scotland, and was five times oversubscribed, demonstrating the confidence which the financial markets have in Beazley.

The funds will be used to support both our underwriting at Lloyd's, replacing the existing £72m subordinated loan, and providing further funds to support the ongoing development of our US business. To add further support to our future plans we have also retained £50m of the syndicated letter of credit facility (currently undrawn) led by Lloyds TSB.

#### Dividend

The board proposes an increased final dividend of 3.2p (2005: 2.5p), bringing the full year dividend to 4.8p (2005: 4.0p), an increase of 20%. The final dividend will be paid on 10 May 2007 to shareholders registered on 13 April 2007.

# **Board changes**

During the year Marty Becker, Dan Jones and Gordon Hamilton joined the Beazley Group board as non-executive directors. Marty has more than 28 years' experience in the insurance industry where he is currently serving as chairman and chief executive officer at both Max Re and LaSalle Holdings Re. Dan joined us with over 20 years' experience in insurance broking, most recently with Marsh Inc. Gordon, who joined in September, has over 30 years' experience as an audit partner at Deloitte & Touche LLP and its predecessor practices, specialising in UK-listed company audits, with extensive experience of board and audit committees.

Joe Sargent, who chaired the group during the IPO in 2002, and Tom Sullivan, who served as a non-executive director on our audit and remuneration committees for a number of years, both retired from the group in 2006. I'd like to extend my thanks on behalf of the group to both Joe and Tom for their considerable contribution and guidance to the group.

#### Conclusion

2006 was a good year for Beazley following the turbulent times arising from the hurricane losses in 2005. We have strong positions in our chosen market areas from which to take advantage of favourable underwriting conditions. The group continues to search out new opportunities to create value for shareholders in a dynamic and creative way.

# Jonathan Agnew

Chairman

In our 20th year as a managing agent at Lloyd's we are pleased to announce a group profit before tax of £86.8m. Rates remain firm and our business is prospering in such strong underwriting conditions.

# Business review

2006 was a good year both for the group and the insurance industry. With the right people in the right places, we saw growth across the business and took advantage of the opportunities presented by profitable underwriting conditions. Throughout the year we continued to deliver our strategic initiatives in line with our vision and are focused on what we're good at: risk-taking and claims management.

#### Strategy

We continue in our vision to build a premier risk-taking business measured by results and reputation. The four main strategic themes are:

- Diversification maintaining a well balanced and diversified book of business;
- Cycle management delivering profit at all points of the insurance cycle;
- Distribution target markets must be broker led markets with sustainable profitability; and
- Talent we must be able to leverage the depth and experience of our staff.

The enablers which will help us achieve this are:

- Access to our business worldwide.
   Developing new ways of providing our
   customers with access to our insurance
   products will help us grow our products
   profitably;
- Proactively managed claims.
   A proactive claims management capability can be a source of competitive advantage for the group. Consequently we are making significant investment in this area; and

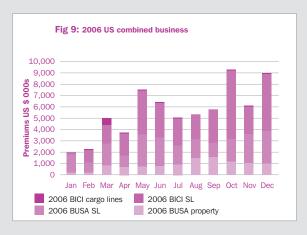
Informed underwriting decisions.
 The knowledge and expertise of our underwriters is central to our ability to develop the classes of business we write.
 We have attracted and hired staff with complementary skills to help our underwriters in making their business decisions.

# Access to our business worldwide US business development

Our US business continued to make progress in its first full year of operation. The business writes insurance through an MGA, which writes business both for our syndicates at Lloyd's and our admitted insurance company, Beazley Insurance Company Inc. (BICI). In 2006 we wrote US\$68.9m (2005: US\$15.4m) of premiums through the US, with US\$35.9m coming from the admitted insurance company.

Of the teams that write this business, specialty lines is the largest, having written US\$22.7m on behalf of the syndicates and an additional US\$34.6m through the insurance company in 2006. The US specialty lines team writes a variety of professional indemnity and directors' and officers' liability insurance, focusing on small to mid-sized customers, who traditionally may not have accessed insurance through Lloyd's. Our second largest US team is the property group, which writes high value homeowners business in the Carolinas, Florida and Georgia, and wrote premiums of US\$10.3m in 2006. The remaining premiums of US\$1.3m were written by our US cargo team.





To illustrate the growth during the year, Figure 9 above shows our premiums written per month during 2006. The chart provides encouraging signs for 2007.

As the company is still in a start-up phase the costs of the operation are disproportionate to its ultimate steady state position. These costs include recruitment, marketing, IT development and legal fees along with the infrastructure costs allowing us to offer admitted market policies in addition to our Lloyd's surplus lines products. Headcount increased from 44 to 100 by the end of December. We do not anticipate that the benefits of this increase will start to be realised until 2008.

We are pleased with progress made to date, having made a number of key hires and proved our ability to attract the level of talent to complement our London skills. We have also established broker contacts through a strong marketing campaign which will aid us in executing this important initiative.

# Commercial property initiative

During 2006 we developed a commercial property insurance service for the mid-sized market segment through our admitted US insurance company. This will complement our existing US commercial property business written through Lloyd's. We recruited Mark Bernacki, formerly of Liberty Mutual Group, to lead the initiative. The service embodies the flexibility and breadth of coverage valued by brokers and their clients. A new and comprehensive tool has been developed on our BeazleyTrade IT platform to facilitate efficient underwriting. In developing product pricing, we employed actuarial techniques

and drew on our underwriting experience, whilst allowing for competitive and market considerations. The initiative was formally launched in February 2007.

## Extended coverage through branch network

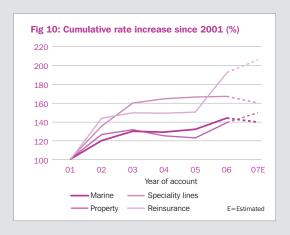
During the year we have strengthened our position and opened branch offices across a number of locations. We completed the purchase of the Asia Pacific Underwriting Agency (APUA) in January 2006, a managing agent operating through Hong Kong, and renamed the company Beazley Limited (Hong Kong). We previously owned 79.8% of this business. The acquisition provides access to the local market and is primarily focused on professional indemnity insurance. In 2006 it wrote £2.2m of premiums on behalf of the two syndicates. We also set up a small operation in Paris in September to write similar business.

In November, we established a presence in Singapore for our engineering team, which forms part of the property group. This team will write specialist engineering risks and will be managed from the UK. Given the nature of the Asian market, in which business tends to be placed almost entirely within the region, Singapore provides the perfect hub to access this type of business.

To build our UK cargo business line, and to gain access to the local UK markets, we established offices in Manchester and Leeds during 2006, adding to our existing offices in Birmingham and Colchester.

The map below shows the full range of our branch network as at the end of 2006.





# Business review continued

# **Proactively managed claims** Unlocking the value in claims

During 2006, we continued to invest in developing our claims service. Improved underwriting and pricing capabilities, maintenance of our high client retention rates, lowered cost of the claims, and improved confidence in our results and reserving, all result in a significant improvement to the service we provide our clients.

70% of our claims managers in specialty lines are litigators sourced from partner and senior associate roles in top law firms. Most managers have over 10 years' experience and expertise in specialist areas, such as insurance of architects and engineers, medical malpractice and employment practices. In the US, we established claims operations that are responsible for managing claims emanating out of both our Lloyd's business and our US carrier. With the right people in place, we focused our efforts in three areas. We integrated our claims managers and underwriters by product line to give the managers a thorough and detailed understanding of the clients and their claims, enhancing our credibility, essential in thirdparty claims. We adopted a team-based approach to complex claims, and developed analytical tools. We also refined our approach in the selection of counsel and worked closely with them to improve management practices.

In the property group our claims managers each have at least 14 years' experience and are successful in managing some of the most complex property claims negotiations on behalf of the market. In the marine division, we hired a chief engineer of ships to work closely with us evaluating the claims, finding alternative solutions to mitigating our clients' exposure and our own exposure.

We are confident that the energy invested in this important area will benefit both our clients and shareholders.

# **Informed underwriting decisions**Rating environment

During 2006, trading conditions were robust across all lines of business. The market is proving to be dynamic and responsive, with rate increases across all classes averaging 6% (Figure 10). This is particularly true in our catastrophe accounts: reinsurance, open market property and offshore energy. These were heavily impacted by the 2005 hurricane season. Hurricanes Katrina, Rita and Wilma accounted for estimated worldwide losses of around US\$80bn, of which Beazley's share was originally estimated at £60m net of reinsurance.

We have since adjusted the way we price our risks. For instance, in our reinsurance account our premium rates increased by over 28% in 2006. Likewise, open market property rates increased by 26%, whilst offshore energy rates saw some of the highest increases (over 35%). To ensure our prices were correctly calibrated, we bought and refined a number of risk management products which we use to monitor pricing and our aggregate exposures in certain geographic regions.

Rates across specialty lines, which accounts for around 50% of the premiums we write, maintained their competitive position (small decrease of 1%) despite increasing pressure on rates during the second half of the year. Premiums written by this team increased significantly over the past year to £361.0m (a 33% increase). Through this growth we continued to seek out the most attractive risks while adhering to rigorous management principles.

## Growth

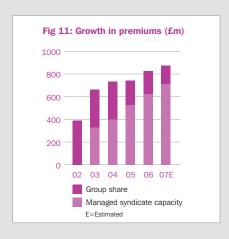
Our managed premium capacity increased to £830m (2005: £742m) in 2006. This increase was driven by the forecast increase in insurance rates following the 2005 hurricane season, together with continued growth in our specialty lines business. In 2007, we plan to write combined premium capacity of £860m, an increase of 4%.

We increased our share of managed premium capacity to 78% (2005: 70%) in 2006 which has risen to 81% for 2007. This increases the amount the group can underwrite at Lloyd's to £697m (2006: £647m). Part of the expansion in capacity (£19m) came from our acquisition of Santam Corporate Limited in December 2006.

Our managed syndicates' (both 2623/623) capacity has grown by 30% since the flotation of Beazley Group in 2002. The group's share of the premiums we manage has increased even more dramatically by 111% from £330m in 2003 to £697m in 2007. The growth in premiums written together with our share of these premiums is highlighted in the Figure 11.

## Outlook

As the US business becomes more established, we are optimistic about realising greater returns in 2007. We have key individuals in place and have seen strong premiums growth in recent months. The addition of the commercial property team in the spring of 2007 will strengthen this further.



We actively monitor the position of our business in relation to the insurance cycle. Figure 12 is an indicative guide to our main opportunities and threats in 2007 and illustrates where our efforts will be focused. It and the statements below represent our current view based on information up to the end of February, and any comparisons at later dates should be viewed in this context.

Across the business, we are expecting 2007 to be a positive year both in terms of premiums written and ratings. Our current projection is that both premiums and ratings will increase up to 5%. Our largest anticipated growth areas are in our political and contingency group within specialty lines and large commercial risks within the property group. Specialty lines will account for over 50% of the business' premiums, and we

expect it to grow despite minor rate decreases. Careful management of the insurance cycle through active price monitoring and claims management holds the key to our long-term success. We believe that underwriting conditions in 2007 will lead to continued profitability for the group.

## 20th anniversary

2006 marked the 20th year of Beazley Furlonge Limited as a managing agency at Lloyd's.

We began trading in 1986 with capacity to underwrite £12m of premiums. Our aim has been to create and build a premier risk-taking business partly through nurturing a working environment that attracts and retains highly skilled individuals. Twenty years later we have the capacity to underwrite £860m with a

team of 419 people around the globe. Our growth has been organic and timed to coincide with positive market conditions. We believe that patience and picking the right people has been core to our success.

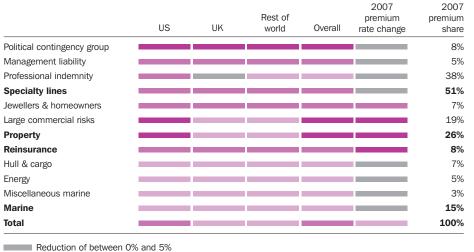
Over the years, numerous world events have tested our skills and ability to both underwrite high quality risks and manage them. The business has never made a loss and we continue to grow confidently and purposefully.

We have recruited and retained talented individuals – underwriters, claims managers and support staff who have made Beazley the professional, well regarded, premier risk-taking business we are today. I'd like to take this opportunity to thank all those who have contributed to making our early vision a reality.

The insurance industry will continue to undergo changes and face challenges brought about by expected and unexpected events. One can be certain that the future holds as much opportunity as we have experienced so far in our journey. The journey is far from over.

Andrew Beazley
Chief executive

Figure 12: Opportunities and threats



No change

Growth of between 0% and 5%

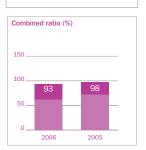
Growth of more than 5%

# Performance by division

# Specialty lines





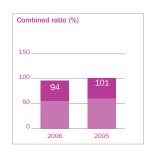


	2006	2005
	£m	£m
Gross premiums written	361.0	270.9
Net premiums written	267.3	207.7
Net earned premiums	234.6	192.2
Net investment income	35.9	19.5
Other income	4.0	2.4
Revenue	274.5	214.1
Net insurance claims	146.3	135.8
Acquisition and administrative expenses	72.6	52.2
Other expenses	7.8	5.9
Expenses	226.7	193.9
Results from operating activities	47.8	20.2
Claims ratio	62%	71%
Expense ratio	31%	27%
Combined ratio	93%	98%
Percentage of lead business	81%	78%
Rate decrease	(1%)	(1%)
Transaction volume	6,478	6,128

# Property





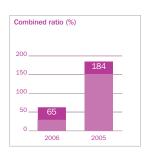


	2006 £m	2005 £m
Gross premiums written	187.8	128.1
Net premiums written	149.9	98.5
Net earned premiums	123.1	81.2
Net investment income	4.2	5.8
Other income	1.3	1.4
Revenue	128.6	88.4
Net insurance claims	66.3	49.1
Acquisition and administrative expenses	49.8	33.6
Other expenses	4.0	3.2
Expenses	120.1	85.9
Results from operating activities	8.5	2.5
Claims ratio	54%	60%
Expense ratio	40%	41%
Combined ratio	94%	101%
Percentage of lead business	70%	66%
Rate increase/(decrease)	<b>13</b> %	(1%)
Transaction volume	2,962	3,014

# Reinsurance





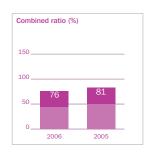


	2006 £m	2005 £m
Gross premiums written	58.4	65.5
Net premiums written	40.5	41.0
Net earned premiums	42.1	37.2
Net investment income	4.1	3.0
Other income	0.7	0.2
Revenue	46.9	40.4
Net insurance claims	13.7	56.0
Acquisition and administrative expenses	13.6	12.4
Other expenses	1.5	1.2
Expenses	28.8	69.6
Results from operating activities	18.1	(29.2)
Claims ratio	33%	151%
Expense ratio	<b>32</b> %	33%
Combined ratio	65%	184%
Percentage of lead business	33%	28%
Rate increase	28%	_
Transaction volume	911	1,018

# Marine

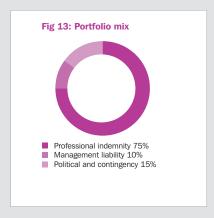


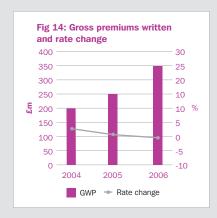




	2006 £m	2005 £m
Gross premiums written	137.9	93.5
Net premiums written	116.6	78.6
Net earned premiums	101.5	64.5
Net investment income	4.1	3.3
Other income	1.1	2.9
Revenue	106.7	70.7
Net insurance claims	44.4	32.1
Acquisition and administrative expenses	32.3	20.0
Other expenses	2.6	2.4
Expenses	79.3	54.5
Results from operating activities	27.4	16.2
Claims ratio	44%	50%
Expense ratio	32%	31%
Combined ratio	<b>76</b> %	81%
Percentage of lead business	50%	52%
Rate increase	9%	2%
Transaction volume	2,807	2,762







# Specialty lines

#### **Profile**

Led by Johnny Rowell since 1992, the specialty lines division is a market leader in most business segments and underwrites around half the group's premium income. The team is organised by major product group – management liability, professional liability, and political and contingency, and by size of risk – small, mid-market and large. This structure was designed to bring together similar disciplines and interests in product line and style of underwriting. These groups do not work in isolation and by sharing experiences team members transfer best practices across portfolios and work together to improve quality.

We have integrated the specialty lines team across the different territories in which we operate. Specialty lines now has a presence in London, Paris, Hong Kong and in eight offices in the US. By establishing experienced, empowered underwriters in local markets we have significantly improved our access to business that we would not otherwise have, and we will continue to pursue this strategy. Our premium income for 2006 was £361.0m (2005: £270.9m).

# Market overview

The rating environment in 2006 was, overall, better than expected. Across the team, rates fell by 1%. There is variation across different portfolios, with rate increases still achievable in some lines and competition intensifying in others. We expect competition to increase slightly in 2007. The team's approach to managing this is multi-tiered, including close monitoring of rate changes and rates achieved, increased segmentation of

individual books of business, robust auditing of internal underwriting teams, delegated authority and treaty business, and targeted reviews of both high performing and underperforming areas.

#### **Current performance**

2006 was the first complete trading year for our US-based operation. Our local presence in the US market has been well received and the growth rate in income achieved to date is very satisfactory.

On both sides of the Atlantic we made significant investment in talent, strengthening our claims service as well as our underwriting capabilities. We see significant opportunities to differentiate ourselves through the calibre of our claims managers and the quality of service they provide. This has not always been an area of focus for insurers in our markets.

Our sources of business remained stable in 2006 with the top five brokers producing 54% of our premium income, against 53% in 2005 and 52% in 2004. Geographically the book remains predominantly US domiciled with 65% of premiums emanating from that region compared with 62% in 2005 and 63% in 2004.

The way we write the business has changed little from previous years. Facultative business accounted for 67% of our premium in 2006 compared with 68% in 2005 and 73% in 2004, while binding authority income was 21% for 2006 against 24% in 2005 and 20% in 2004.

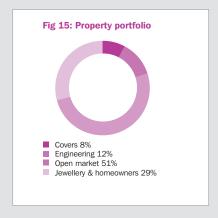
## Outlook

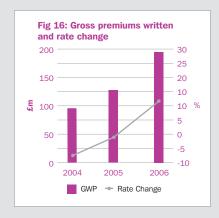
Our goal in 2007 is to ensure that our mix of products and segments (business by size and method of placement) evolves to maximise opportunities in the marketplace. In a changing environment we will need to react quickly to both opportunities and threats.

Overall, we expect premiums to remain stable in 2007, although their distribution may change slightly. Our US, French and Hong Kong operations will grow and we will continue to invest in a number of our London teams. We recognise the value that clients and brokers place on the provision of stable coverage and will work to deliver this, consistent with the demands of profitability.

With a successful year of high-calibre recruitment behind us, our focus in 2007 will be on retaining and developing employees. Responsive service – both in underwriting and claims – will remain at the heart of our business, supported by financial, operations and project management expertise. Our commitment to service excellence, in-depth risk analysis and understanding and delivering products that meet broker and client needs will continue to underpin sustainable long-term profitability.







# **Property**

## **Profile**

Led by Jonathan Gray since 1992, the specialist underwriting teams in the property group lead the programmes of Fortune 1000 clients and insure some of the world's largest construction projects. The division insures large corporate clients, engineering and construction projects, high-value homeowners, jewellers' risks and smaller property clients, representing almost a quarter of the group's gross premiums written.

With expansion in the US, we will also be able to provide medium-sized US clients with property coverage through our admitted insurance company. The diverse nature of our clients and class types and increasingly diverse distribution platform enable us to provide the group with a well-balanced portfolio.

## Market overview

Rates in catastrophe-exposed areas in the US continued to harden during the course of 2006 with hurricane prices reaching an all-time peak during the hurricane season. Earthquake rates in California also increased during the latter part of the year as increased reinsurance costs filtered down to the primary market. However, non-US rating levels were disappointing with competitive conditions a consistent theme throughout the year. There was little or no pricing reaction in the non-US markets to the hurricane losses of 2004 and 2005.

2006 saw a benign hurricane season and the absence of major catastrophes in comparison with recent years. In addition, the underlying trend of claims incidences also showed a decrease.

# **Current performance**

The amount of business led by the property group increased during 2006 from 66% of the business written in 2005 to 70% in 2006 with the biggest increase being in the open market account, where we now lead 53% of the business written.

Rate increases averaged 13% across all lines in the property group during 2006 compared with 2005, with open market experiencing the largest increase at 27%.

Our MGA in Florida had a successful year with premium written increasing from US\$6.2m in 2005 to US\$10.3m in 2006.

The engineering team had another excellent year in 2006, growing its business profitably and consolidating its lead market position in its target areas. To widen the distribution network and access business directly from Asia, we set up an office in Singapore attracting employees already well known to the London team.

The UK homeowner market is experiencing increasing competition. To improve our results, we have completely reviewed and updated our UK homeowners rating tables using the latest peril modelling techniques and postcode data available, which will enhance our risk selection criteria.

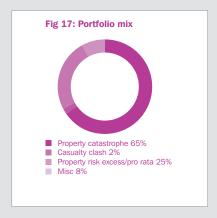
Our reputation as property insurance specialists, combined with a claims performance acknowledged by the market as superior, gave us access to significant reinsurance capacity. However, the cost of this reinsurance was higher than previous years and retention levels increased.

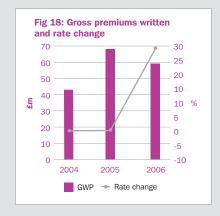
#### Outlook

The US continues to present great opportunity for our business in London though we anticipate that non-US risks will be more of a challenge. Our high-value homeowner operation in Florida will build on its increasing reputation to grow its portfolio and the launch of our admitted market products will provide access to medium-sized commercial property clients thus enhancing the long-term balance of our portfolio.

We believe that high rating levels for catastrophe business will be maintained in the coming year, providing our group with strong business opportunities for US-based risks. Non-catastrophe rates will experience further pressure.







# Reinsurance

#### **Profile**

Led by Neil Maidment since 1996, the reinsurance division is a recognised leader providing capacity to a significant proportion of the world's leading general insurers, some of which have been clients for over 20 years. Specialising in property catastrophe, property risk excess, casualty catastrophe, aggregate excess of loss and pro-rata business, the team's main exposures outside the US are in the UK, Europe, Japan, Canada and Australasia. Results from the reinsurance division represent 8% of the group's 2006 gross premiums written.

# Market overview

Following the losses incurred in the 2005 hurricane season, the reinsurance market hardened considerably in 2006 with rates in the property treaty market increasing 47% on average in the US. Outside the US, the effect was less dramatic but nevertheless rates increased 7% on average.

Despite predictions of another catastrophic hurricane season in the North Atlantic, 2006 proved to be a particularly benign year for hurricane activity. Experts cite two possible exceptional meteorological reasons for this: dust particles blown from the Sahara to the area where hurricanes normally develop, and the El Niño phenomenon in the Pacific. While the insurance market benefited overall, demand also increased at a faster rate than supply in peak zones of exposure. Prices increased and reinsurance capacity decreased.

# **Current performance**

The impact of predicted increases in near term frequency and severity of future losses, and the consequent increase in capital required to manage these exposures, has been felt by both buyers and sellers of reinsurance. The cost of hedging these risks increased to uncommercial levels in the retrocessional market. Therefore, we reduced our gross exposures to fit within our risk appetite which remained unchanged.

We successfully adjusted the portfolio to manage these challenges while improving the risk-reward balance. In addition, we retained our commitment to our long-term clients, while continuing to diversify our portfolio in target markets, such as western Europe.

We benefited directly from the quiet hurricane season, seeing very low claims activity and consequently a greatly reduced loss ratio.

Our estimate for losses incurred as a result of the 2005 hurricane season were well within our reserve limits, hence we are able to release some of the reserves earlier than expected.

#### Outlook

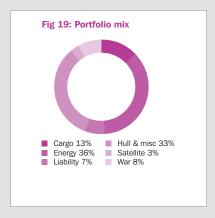
Experts continue to predict Atlantic hurricane activity above the long-term average and because of the trend for the US population to move towards the coast, we expect to see an increase in the cost to the insurance and reinsurance industry.

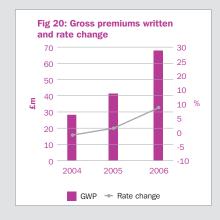
Following from last year's significant price increases in the US, we expect that rates in key catastrophe exposed areas will be maintained at or around their current levels. The recent changes in Florida legislation designed to relieve pressure on buyers in that state are not expected to have a significant direct effect on our portfolio.

Outside the US, we anticipate some pressure on rates, particularly in smaller markets, however they will remain at levels that are capable of substantial profits. It is anticipated that the impact of windstorm Kyrill will encourage greater discipline in the UK and continental European markets.

Our team will continue to advance its longterm objective of developing a well diversified and efficient portfolio focusing on larger nonlife insurance markets.







# Marine

#### **Profile**

Led by Clive Washbourn since 1998, 2006 was a rewarding year for our marine division with record levels of gross premiums (at £137.9m). We are established market leaders in all the major classes we write, which include marine hull, cargo and war. Our energy portfolio has also been expanded to benefit from optimum underwriting conditions in that sector.

We are able to attract the highest quality business through our market leadership position and in-depth knowledge of the segment. As our portfolio has grown, we have continued to strengthen our underwriting and claims team.

## Market overview

Underwriting conditions were favourable for most of our classes during 2006, with healthy premium rates, appropriate levels of deductible and coverage. We saw strong, profitable premium growth, with our marine hull and energy accounts performing particularly well.

Our 2005 hurricane losses have developed in line with projections and compare favourably with our market peers. We are confident that the majority of our gross loss will be collectable from reinsurers.

# **Current performance**

In the wake of a record 2005 hurricane season, underwriting conditions in our energy account were excellent, with rating conditions for Gulf of Mexico risks at the highest levels for many decades. During 2006 the energy class achieved the highest composite rate change of all Beazley classes, which supported the near doubling of gross premium income year on year.

Although there is some indication of competitors expanding their capacity as confidence returns to the sector, we expect rating conditions to be stable.

Our hull account has benefited from a period of relatively benign loss frequency coupled with robust trading conditions for our insureds. In areas such as marine builders' risks, the hull account was able to optimise capacity in a tight market for risks that have natural peril exposure. We continue to be the leader in London for voyage and tow insurances and this class has performed extremely well during the last 12 months.

Our war account, which covers insurance against terrorism and war-like acts on ships and aeroplanes, continues to perform well. Competition for this portfolio has increased although our position as a lead market within London will allow us to respond quickly if rates rise at any stage.

Our cargo portfolio has enjoyed a consistent level of gross premium. Loss frequency reduced during the last 12 months, which has benefited profitability. We continue to develop our modest UK cargo agency underwriting operation. Profitability to date has been excellent, premium levels are projected to double during the next 12 months and there is good long-term opportunity to develop a valuable portfolio and diversify our account.

The group purchased a whole account excess of loss reinsurance programme in 2006, as in previous years, but opted to purchase less low-level specific protection and run this risk against our capital. This decision to purchase less reinsurance proved particularly judicious in the light of the low claims frequency across classes during 2006.

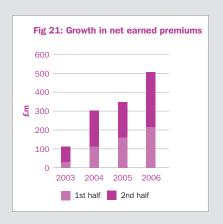
#### Outlook

We look forward to 2007 as a period in which we can further consolidate our position. We are pleased with the quality of our account and anticipate relatively stable underwriting conditions in the majority of our classes. We fully expect to meet our target profitability and to continue to grow income where opportunity allows.

We are delighted that we have reached a long-term agreement to be sole underwriters of the renewal rights for the Charterers Club, which significantly enhances our marine liability portfolio. The marine liability class has historically enjoyed good profitability and since this class typically does not correlate with our other marine classes, it further diversifies our portfolio.

We will continue to focus upon those risks which are well known to the underwriting and claims team. The relationships with the insured often set us apart from our competitors and this, we believe, will help insulate the division from the effects of increased competition in the worldwide market that we believe are likely to develop in future years.

We are pleased to announce record pre-tax profits of £86.8m. These have been achieved through a strong underwriting performance, aligned with robust results from our investment portfolio



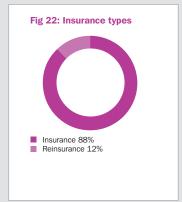
# Financial review - group performance

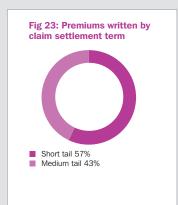
	2006 £m	2005 £m	Movement %
Gross premiums written	745.1	558.0	34
Net premiums written	574.3	425.8	35
Net earned premiums	509.6	372.3	37
Net investment income	48.3	31.6	53
Other income	7.1	6.9	3
Revenue	565.0	410.8	38
Net insurance claims	270.7	273.0	(1)
Acquisition and administrative expenses	168.4	118.5	42
Other expenses	33.5	1.4	2,293
Expenses	472.6	392.9	20
Finance costs	5.6	1.8	211
Profit before tax	86.8	16.1	439
Claims ratio	53%	73%	_
Expense ratio	33%	32%	_
Combined ratio	86%	105%	_
Rate increase	<b>6</b> %	1%	_
Investment return	4.9%	4.2%	_

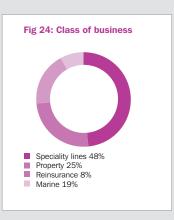


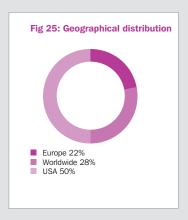
## **Highlights**

- Good overall rating environment: rates are up on average 6% over 2005;
- Premiums growth of 34% to £745.1m;
- 2005 hurricane reserves holding up well: £6.0m released in 2006;
- £31.0m (2005: £12.2m) of prior year reserve releases – £18.0m from our specialty lines team;
- Investment return of 4.9% (2005: 4.2%), generating investment income of £48.3m; and
- A foreign exchange loss on non-monetary items of £9.4m (2005: £8.2m gain).









## **Gross premiums written**

During 2006, our gross premiums written increased by 34% to £745.1m and net earned premiums increased by 37% to £509.6m. Growth came from both the rise in underlying premium capacity for syndicates 623 and 2623 and a higher group share of combined premiums written. In 2006 syndicates 2623 and 623 had capacity to write £830m (2005: £742m) of premiums net of brokerage, and we increased our share of the combined capacity to 78% in 2006 (2005: 70%). The growth in net earned premiums is illustrated in Figure 21.

Our business is derived from a variety of risk types, classes of business and geographical locations. Diversity is one of the key parts of our strategy. Achieving a balanced portfolio enables us to control our risk profile and reduce the capital we are required to hold. It should protect us from the impact of one-off events and balance our results. This was demonstrated in 2005 when our losses from the US hurricanes of around 21% of shareholders funds were amongst the lowest in our sector.

We continued to write approximately 43% of our risks, in medium tail accounts, mainly through our specialty lines team. Medium tail insurance is defined as insurance business where claims are determined and settled three to five years after the period of insurance has expired. We write a significant amount of this type of insurance as we believe it is a source of competitive advantage, based on the correct pricing disciplines and underwriting experience.

Figures 22-25 show how diversified our portfolio was in 2006, across types of insurance, teams and regions.

#### Reinsurance

Reinsurance is purchased for a number of reasons: to mitigate the impact of catastrophes such as those experienced during the 2005 hurricanes; provide lead line capabilities to our underwriters; and as a way of managing the group's capital.

Our reinsurance spend increased by 29% in 2006 to £170.8m. However, as a percentage of gross premiums written, reinsurance spend reduced during the year to 23% of gross premiums written (2005: 24%). The reduction in percentage cover is partly explained by a lack of supply from the reinsurance market, at competitive prices, in the first six months of the year. This was particularly true in our hurricane-impacted classes from 2005. We managed our aggregate exposures carefully and were prepared to reject business if reinsurance cover was not available at the correct prices or if its addition would exceed our risk appetite.

# Combined ratio

The group's combined ratio has reduced from 105% in 2005 to 86% in 2006. The 2005 ratio was heavily impacted by the US hurricane losses of £60m. This alone is estimated to have added 18% to the 2005 ratio. 2006 has been more stable in terms of claims, but has seen increased costs partly through the expansion of the US. The expense ratio increased by 1% as a result of the expansion to 33%.

#### Claims

Our claims ratio decreased to 53% in 2006 (2005: 73%). This has arisen due to two principal factors:

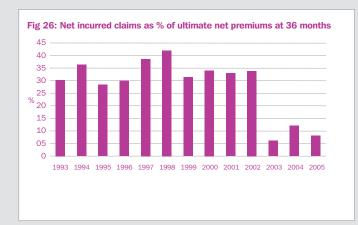
- 2005 was heavily impacted by hurricane losses, which added an estimated 18% to our claims ratio; and
- Increased releases of specialty lines reserves in 2006 reduced the claims ratio by 3.5% (2005: 0.2%).

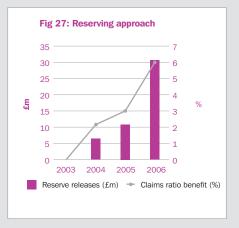
# 2005 hurricane losses - update

At the end of 2005, we set up claims reserves for the 2005 US hurricanes at US\$104m (£60m). During 2006, we saw positive development in terms of these costs, which enabled us to release US\$11m (£6.0m) of our claims reserve.

The table below shows our latest estimate of the total hurricane losses.

	2006 US \$m	2005 US \$m
Gross loss	371	370
Reinsurance recovery	273	260
Sub total	110	98
Reinstatement premiums	21	20
Net loss	119	130
Catastrophe margin released	26	26
Total hurricane losses	104	93





# Financial review – group performance continued

## Specialty lines claims reserve releases

In 2006 we released around £18.0m of prior year specialty lines reserves. This is a reflection of our view that claims for medium tail class of businesses are developing better than initially thought. This is partly attributed to better management of our pricing for these risks at the time of inception, together with strong claims management discipline. This is also due to an improvement in the frequency and severity of claims falling under policies issued during these years.

Figure 26 demonstrates the strength of these reserves. It shows the amount of claims we have incurred by year of account at the same stage (36 months) across the past 10 years of account. It is evident that 2002, 2003, and 2004 show claims which are far lower than in previous years at the end of the third year of development.

# Reserving approach

We have consistently adopted a prudent approach towards our medium tail specialty lines account reserving. The nature of this type of business is that for the majority of classes of business the corridor of uncertainty surrounding potential claims is wide in the first three years of development following the underwriting year. As we gain more certainty in years four and five, we have a better view as to where claims are likely to settle and we can adjust our reserves accordingly. Figure 27 shows, as our business has matured over the past four years, we have gradually been able to increase the levels of reserve releases across all classes of business.

## Expenses

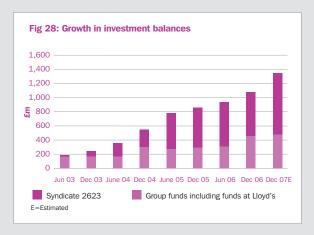
Our expense ratio has increased by 1% to 33% in 2006. This is due to the US, which was in its first full year of operation. This business expanded considerably with employee numbers rising from 44 to 100 by year end. As the business is in a start-up phase it bore one-off costs such as recruitment, marketing and legal fees, incurred in advance of the ultimate premiums potential being delivered.

We also established offices in a number of locations: Paris, Singapore, Hong Kong and throughout the US. Facilitating better access to business is an important part of our strategy.

# **Employee numbers**

During 2006, our permanent employee numbers grew from 282 to 419 as we continued our recruitment in both the UK and in the US. In the UK, we strengthened our specialty lines underwriting, claims teams and support functions – in particular we insourced the accounts processing function during the year. In the US, we recruited additional personnel in all areas of the business as we built up operations in our Florida and Connecticut offices and set up a number of small regional offices. We also set up offices in Hong Kong, Singapore and Paris during the year. Having talented individuals is key to achieving our strategy of becoming a premier risk-taking business.

Employee numbers	2006	2005
Specialty lines	172	101
Property	55	41
Reinsurance	9	7
Marine	28	20
Finance (including actuarial, compliance and internal audit) IT	52 43	31 38
Ceded reinsurance	15	11
Talent management	11	8
General management and other support	34	25
Total	419	282
UK	309	238
US	100	44
Other (Hong Kong, Singapore and Paris)	10	-



## Investment performance

Returns received by currency and by investment type	2006 average £m	2006 annualised % return	2005 average £m	2005 annualised % return
Fixed interest securities				
− £m	383.0	4.5	390.0	4.0
- US\$	425.7	4.4	209.5	3.7
Lloyd's managed and other	56.6	3.9	30.7	3.7
Hedge funds	45.3	11.1	30.1	9.8
Equities	22.5	11.9	3.2	15.5
Cash and money market funds	57.5	3.7	97.0	3.7
Total	990.6	4.9	760.5	4.2

In 2006, despite a difficult environment for fixed income investments, our total investment income grew to £48.3m (2005: £31.6m), providing a return of 4.9% (2005: 4.2%).

During the first half of 2006, the US Federal Reserve continued its programme of raising interest rates in order to slow the rate of growth and contain inflation. The Bank of England also reacted to increasing inflation by raising the base rate twice in the second half of the year. However, for the group, the short duration of our portfolios for most of the year largely insulated our returns from the capital erosion effects of higher interest rates and the portfolios benefited from increasing yields as rates rose.

Our continuing investments in alternative assets and a new stand alone investment in equities added significantly to our investment returns. Our alternative investments achieved a return of 9.0%. These investments represent a mixture of longer-term debt securities, equities, hedge funds, high yield debt and short-term deposits. Meanwhile, our stand-alone equity investment achieved a return of 4.8% since it was initiated in October.

For regulatory and legal reasons, certain trust funds and deposits are required to be managed centrally by Lloyd's on behalf of the syndicates. These funds are invested in high-grade, fixed income securities and their performance is detailed separately in the table above.

The group maintains funds in cash for various operational purposes. The majority of these cash balances are invested in money market funds managed by Scottish Widows Investment Partnership, AIM Global and Bank of America.

Investment income has also increased as a result of larger cash balances being managed by the group. The group's cash and investment balance grew during 2006 mainly due to:

- Additional underwriting of syndicate 2623 in 2006; and
- The receipt of funds raised as part of the debt issue in the final quarter (£150m).

As a large proportion of our insurance liabilities are medium tail, i.e. the claims are paid several years after premiums are

received, we expect the investment balance will increase further into 2007. Figure 28 highlights the growth in investment balances over the past four years and gives an estimate for the end of 2007.

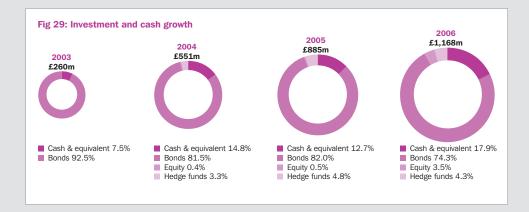
#### Other expenses

Other expenses consist of non-underwriting related group expenses of £6.2m (2005: £9.9m), profit related bonus provisions of £5.0m (2005: £3.3m), and a foreign exchange loss of £22.3m (2005: a credit of £11.8m). The majority of the increase in 2006 is explained by the foreign exchange loss, of which £17.6m (2005: a credit of £11.3m) relates to foreign exchange differences on non-monetary items (refer to note 3).

# Foreign exchange differences arising on non-monetary items

In 2006, the impact of foreign exchange on non-monetary items has added a £9.4m charge (2005: a profit of £8.2m) to our profit before tax. Non-monetary items include unearned premium reserve, reinsurers' share of unearned premium reserve and deferred acquisition costs. Under International Financial Reporting Standards (IFRSs), these balances are carried at historic exchange rates, whilst monetary items are translated at closing rates. This imbalance creates volatility in our accounts which cannot be hedged as the mismatch is not monetary in nature.

Within our 2006 portfolio, around 67% of premiums were generated through US dollar transactions. As the US dollar weakened significantly during 2006, falling from an opening position of £1=US\$1.72 to £1=US\$1.96 (a 12% devaluation) there was a negative effect on our profits and net assets.



# Financial review - balance sheet management

Summary balance sheet	2006 £m	2005 £m	%
<del>- •</del>	24.0		20
Intangible assets	21.9	18.2	20
Investments and cash	1,167.8	884.5	32
Insurance receivables	244.0	158.9	54
Reinsurance assets	345.3	394.5	(12)
Other assets	105.2	87.3	21
Total assets	1,884.2	1,543.4	22
Insurance liabilities	1,225.6	1,096.4	12
Borrowings	154.9	29.1	432
Other creditors	184.2	137.5	34
Total liabilities	1,564.7	1,263.0	24
Net assets	319.5	280.4	14
Net assets per share	88.5p	77.8p	14

# Intangible assets

Intangible assets are made up of two main elements:

- Previously acquired goodwill or purchased capacity; and
- · Capitalised IT projects.

During 2006, we acquired an additional 3% of capacity in syndicate 2623 for £0.5m. Of this 2% was acquired through the purchase of Santam Corporate Limited in December 2006. The remaining 1% was acquired during the Lloyd's auction process where we paid on average 2.7p per £1 of capacity.

We began capitalising IT projects during 2005 (£3.6m), as the company increased its emphasis on building IT systems supporting our non-Lloyd's initiatives such as the US. During 2006, this policy continued and after an annual review we capitalised a further £3.7m, bringing the net book value to £5.0m at 31 December 2006. Our policy is to depreciate these items over their useful economic life (three years).

# Investments and cash

Our portfolio remains mainly invested in high quality, short duration bonds. We invest 11.8% (2005: 7.6%) in alternative investments and equities. To enhance returns and further diversify risks associated with investing solely in bonds, we increased the proportion of equities by 3.7% in October 2006 through a standalone investment in a global equity fund managed by AllianceBernstein. A breakdown of the growth in our portfolio, by asset type is set out in Figure 29.

During the year we diversified the fixed income assets by investing a proportion of our US fixed income portfolios with two new investment managers: Conning Asset Management and Wellington Management. This also gives us access to different investment styles and skill sets.

The performance of the managers and the structure of the investment portfolio are monitored by our chief investment officer who reports to the investment committee, which

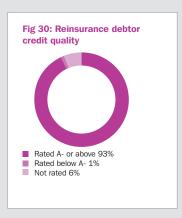
holds delegated responsibility from the board for all investment matters.

# Insurance receivables

Insurance receivables represent broker balances receivable in respect of premiums we have written. During 2006, broker balances increased by 54% to £244.0m, due to increased premiums written by syndicate 2623. We outsource the collection of our premium broker balances to JMD Specialist Insurance Services Limited, which operates within the Lloyd's market as specialist credit controllers.

# Reinsurance assets

Reinsurance assets, which mainly represent recoveries from our reinsurers in respect of claims, form 18% or £345.3m of our total assets at the end of 2006 (2005: 26% or £394.5m). Of this balance, £166.8m represents our estimate of recoveries in respect of claims incurred but not yet reported.



		2006	2006
Manager	Investment type	£m	%
AllianceBernstein	US \$, £, Euro, CAD \$, fixed income, equity	700.9	60.0
Conning Asset Management	US fixed income	125.2	10.7
Wellington Management	US fixed income	86.8	7.4
Union Bancaire Privée	Alternative investments including		
	hedge funds	102.6	8.8
Lloyd's Corporation	Fixed income	73.5	6.3
Scottish Widows Investment			
Partnership	Money market funds	22.3	1.9
AIM Global	Money market funds	7.8	0.7
Bank of America	Money market funds	17.0	1.5
Other cash balances	Current account and deposits	31.7	2.7
Total	·	1,167.8	_

These assets are managed through:

- Minimising risk through selection of reinsurers who meet strict financial criteria (e.g. minimum net assets, minimum 'A' rating by A.M. Best when initially selected). These criteria are varied by type of business (short vs. medium tail);
- Timely calculation and issuance of reinsurance collection notes from our ceded reinsurance team; and
- Regular monitoring of outstanding debtor position by our reinsurance security committee.

In addition we provide against reinsurance recoveries that are impaired. At the end of 2006 we had provided £4.8m (2005: £5.2m) in respect of our reinsurance recoveries. Figure 30 shows the profile (based on A.M. Best rating) of these assets at the end of 2006.

# Insurance liabilities

Insurance liabilities of £1,225.6m consist of two main elements: unearned premiums reserve (UPR), and gross insurance claims.

Our UPR has increased by 34% in 2006 to £359.6m, mainly due to increased premiums written. The bulk of the UPR relates to the 2006 year which has been written at favourable rates. This business will earn through to our income statement in 2007.

Gross insurance claims are made up of claims which have been notified to us but not yet paid and an estimate of incurred but not yet reported claims (IBNR). These are estimated by both the underwriter and the syndicate actuary through the quarterly peer review process, a description of which is included in note 23. Gross insurance claims increased by 4% in 2006 to £866.0m mainly due to the increase in business written.

## **Borrowings**

Historically we have relied on short-term banking facilities to support our underwriting at Lloyd's and the US operation. This was typically issued in the form of letters of credit, although we could draw down physical cash if required to pre-defined limits. As a condition of this type of debt, we also had to comply with certain banking covenants: minimum

levels of net assets, realistic disaster scenario events and profitability. The facility was also renegotiated every two years.

To provide us with greater flexibility over our capital, we issued longer term debt in October 2006. We raised £150m of lower tier 2 long-term subordinated debt through a fixed rate debenture. The proceeds will be used to replace the existing short-term facilities and to support opportunities to grow the business as they arise. The issue is callable on 17 October 2016 and bears an initial interest rate of 7.25% payable in arrears. We retained £50m of the short-term debt in the form of a letter of credit facility, led by Lloyds TSB, to provide additional capital should the requirement arise.

At the time of the issue we entered into a derivative transaction, whereby we better matched our investment and currency risk by swapping the sterling fixed rate loan into the equivalent of:

- · £107m of floating rate sterling loans; and
- US\$80m of floating rate US dollar loans.

These items have been accounted for using hedge accounting for both the floating rate and currency elements of the transaction.

# Currency profit hedging

Our policy is to minimise our largest foreign exchange currency risk-exposure, which is to the US dollar. This is managed by estimating our US dollar profits each year and selling a proportion each month. We also sell our year-end unhedged profits for our second largest currency exposure, Euros, once a year. In 2006, the group sold US\$108.5m at an average exchange rate of 1.88 (2005: 1.87).

# Financial review - capital position

The group has two requirements for capital:

- To support underwriting at Lloyd's through syndicate 2623. This is based on the group's own individual capital adequacy. This may be provided in the form of either the group's cash and investments or debt facilities; and
- 2. To support underwriting in BICI in the US.

Our funding comes from a variety of sources:

- £319.5m comes from our shareholders own funds (i.e. net assets). Of this balance, £81.0m is unavailable to the group at present because it relates to fixed assets or undistributable syndicate profits;
- £150m was raised in 2006 through a tiersubordinated debt issue;
- An undrawn banking facility of £50m (2005: £150m) provided by a syndicate of banks led by Lloyds TSB; and
- The final source of funds comes from our US\$18m subordinated long-term debt with a maturity in 2034.

a matanty in 2004.	2006 £m	2005 £m
Sources of funds		
Shareholders' funds	319.5	280.4
Tier 2 subordinated debt	150.0	_
Long-term subordinated debt (US \$18n	n) <b>9.7</b>	10.5
Bank facility (drawn)	-	70.0
	479.3	360.9
Uses of funds		
Lloyd's underwriting	292.5	301.7
Capital for US insurance company	30.6	32.6
	322.6	334.3
Surplus	156.7	26.6
Unavailable surplus	(81.0)	(19.7)
Available surplus	75.7	6.9

## ICA

Historically our capital requirements were set using Lloyd's risk based capital (RBC) model. The RBC model assessed the risk posed by the proposed business plan based on historical market average data. The capital regime changed in 2005, so that syndicates make their own assessment of risk in their ICA. 2006 was the first full year where our capital requirements were determined by its ICA.

In order to determine its ICA, we made significant investment in both models and process:

- We use sophisticated mathematical models that reflect the key risks in the business allowing for probability of occurrence, impact if they do occur, and interaction between risk types. A key focus of these models is to understand the risk posed by individual teams, and to the business as a whole, of a possible deterioration in the underwriting cycle; and
- The ICA process is embedded so that the teams can see the direct and objective link between underwriting decisions and the capital allocated to that team. This gives a consistent and comprehensive picture of the risk reward profile of the business and allows teams to focus on strategies that improve return on capital.

This robust ICA process demonstrates that the business is well diversified and stable. This is reflected in our capital requirement of 42% of premium capacity, a reduction from 47% of premium capacity in 2006. This equates to a capital requirement of £292m.

# **Andrew Horton**

Finance director



# Investor relations

We place great importance on communication with shareholders. The full report and accounts and the interim report are mailed to all shareholders and, on request, to other parties who have an interest in the group's performance. The company responds to individual letters from shareholders and maintains a separate investor relations centre within the existing www.beazley.com website as a repository for all investor relations matters.

By its very nature, financial reporting for insurance companies is complex. In order to help shareholders and potential investors better understand the key drivers of the business and its prospects, we have endeavoured to provide increasing levels of transparency and explanation in our communications. As a result, in addition to enhancing the information contained in the annual and interim reports, the investor relations centre on the company website contains a substantial amount of relevant information for investors including key corporate data and news, presentations to analysts, information on the names' syndicate 623, analyst estimates and a financial calendar. The website also gives investors the

opportunity to sign up for an alert service as new information becomes available.

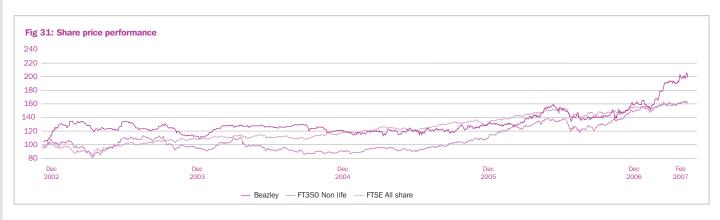
There is a regular dialogue with institutional shareholders as well as general presentations after the preliminary and interim results. The board is advised of any specific comments from institutional investors to enable them to develop an understanding of the views of major shareholders. All shareholders have the opportunity to put questions at the company's annual general meeting.

The company's shares are listed on the London Stock Exchange. Prices are given daily in newspapers including the Financial Times, The Times, the Daily Telegraph, the Daily Mail and the Evening Standard.

There are currently eight analysts publishing research notes on the group. Since the end of 2005, analyst coverage has expanded sharply with coverage being initiated by JPMorgan, UBS, Clear Capital and Fox-Pitt Kelton, in addition to existing research coverage from Numis, the company's corporate broker, ABN Amro, Keefe Bruyette & Woods and KBC Peel Hunt.

## Financial calendar

3 May 2007 10 May 2007 31 July 2007 31 July 2007 Annual general meeting Final dividend payment Interim announcement Interim dividend announcement



We are in the business of evaluating, accepting and managing a wide range of large, complex and often unpredictable risks that occur for our clients in their day-to-day business around the world

# Risk management

We differentiate ourselves by providing our clients with intelligent insurance products and services that add value to the way they conduct their business. Our 20 year trading record of consistent profitability demonstrates the effectiveness of our rigorous risk management practices that are intrinsic to the way we work with our clients and underpin every level of decision-making in the group.

To take full advantage of the opportunities that arise and ensure that we protect our capital we must always accurately assess the expected claims and expenses which may arise from accepting every risk presented to us. More information relating to the risks that are inherent to each business division is detailed in note 2. From a group perspective, to ensure that only the best risk management approaches are applied to all of our activities, we base every action upon three guiding principles:

- · Controlled risk taking;
- · Clear accountability; and
- Open risk culture.

By focusing upon these principles we can manage our diverse risk classes to achieve the ideal balance between risk management control and encouraging our underwriting teams to be professional, innovative, effective and dynamic.

## Enterprise risk management

Enterprise risk management is integral to all our business planning and risk-taking activity. By allocating capital to each underwriting segment and regularly reviewing returns, we manage our portfolio in a way that supports our core markets, and targets growth on the best opportunities as they arise.

To optimise use of the group's capacity for insurance risk, allocation between classes of business is reviewed regularly through stress and scenario analysis. Stochastic modelling techniques are also used to rigorously assess our capital requirements through the ICA process.

# Risk appetite

Insurance risk is our largest risk category, resulting from the blend of complementary catastrophe and non-catastrophe business that we write. To manage these exposures we model and stress test our risks to understand the expected financial impact to the group should extreme events result in claims from our customers.

Following the upward calibration of industry risk models in 2006 to produce a more conservative result, the board has set this appetite as a reflection of the opportunities which exist for catastrophe exposed business. For classes of business where accumulations of losses can result from a single event, such as property, marine energy, terrorism and war, we set insurance risk appetite limits at group level based on our exposure to relevant extreme catastrophe scenarios. For the syndicates this equates to 20% of stamp capacity for a 1 in 250 year modelled US event.



Nicholas Furlonge Director, risk management

We also have market leading portfolios in areas such as professional indemnity and directors' and officers' liability insurance. For these classes the primary risk is charging premium rates that are too low as a result of external factors such as new laws, social trends or regulations which subsequently lead to larger than expected claims. These other types of risk benefit our business by providing healthy diversification from the typical natural catastrophe exposures of London market insurers such as Florida wind or California quake.

We recognise that non-catastrophe exposed classes may cover events which can also create losses. Accordingly, we have set a comprehensive risk appetite framework for these portfolios which is based on their potential impact on our profits.

## Risk assurance framework

Our organisation is structured to ensure clear ownership and accountability for all risk management activities. Therefore our risk assurance framework encourages all our underwriting teams to focus upon achieving the group's strategic objectives.

The board of directors has ultimate responsibility for defining the group's risk tolerance and risk management approach. Nominated individuals and committees are made accountable for day-to-day management of all risks and controls which arise from their activity.

# Risk management team

The purpose of our risk management team is to facilitate and strengthen the risk management framework. Their main goal is to help the business to achieve a consistent approach to the identification, measurement and mitigation of risk across the group. Active participation of this team in all board meetings and senior management committees ensures that risks are monitored and managed as they arise.

This team uses a leading edge system called the BeazleyRiskMatrix to support its work. This online risk management tool allows the emerging risk profile of the group to be captured and analysed in real time using information input directly by risk and control owners across our worldwide locations.

# Internal audit and compliance

Our internal audit and compliance teams reinforce our comprehensive risk management strategies. They work closely with the risk management team to coordinate activity, avoid duplication and deliver a targeted risk-based approach.

The compliance team works closely in partnership with the business to ensure that all relevant regulations are understood and met. Internal audit complement this work by providing independent assurance about the operating efficiency and effectiveness of our controls.

# Key risks

The group has identified six primary categories of risk that arise from its activities:

of fish that arise from its activities.		
RISK	Insurance	Underwriting Reinsurance Claims management Reserving & ultimate reserves
	Credit	Reinsurers Brokers & intermediaries Investments
	Liquidity	Insurance & non-insurance cash calls
	Market	Foreign exchange Interest rate Price
	Operational	People Process Regulation Service provider Business continuity Information security Financial reporting Data integrity Legal
	Group	Strategic Reputation Management stretch

Note 2 on pages 59 to 67 provides further detail about the group's definition, appetite and controls for each of these risk categories.

# Corporate and social responsibility

In continuing to build Beazley as a premier risk-taking business, we take our corporate, social and environmental responsibility seriously. We constantly consider the ethical implications of how we operate in our day-today business and put policies and procedures in place that reflect our commitment. We also recognise the regulatory and reputational risks associated with ethical practice and adhere closely to the Association of British Insurers (ABI) guidelines published in October 2001 on the disclosure of listed companies' social responsibility policies and endeavours.

Intrinsic to our culture is the ethical approach to business conducted by and towards all our stakeholders, including management, staff, clients, suppliers and shareholders. The values that form the essence of our brand and our working culture are professionalism, integrity, effectiveness and being dynamic.

# Corporate responsibility

We are an equal opportunities employer and make it our policy to offer equal treatment to employees and prospective employees, ensuring that all are treated fairly and with dignity and respect. We absolutely do not permit unlawful discrimination of any kind against any person, to include on the grounds of gender, race, nationality or ethnic origin, age, disability, religious beliefs, sexuality, marital status, working patterns or pregnancy.

We are committed to taking positive action to ensure that all employees, whether full-time or part-time, receive equality of opportunity in recruitment, training, development, promotion and remuneration.

We strive to ensure the health, safety and welfare of our employees and anyone else who may be affected by our operations. Employees are expected to take reasonable care for their own health and safety at work as well as those of others, and to co-operate with management to create a safe and healthy working environment. All employees, contractors and visitors are subject to induction, training and supervision in aspects of health & safety and additional training in ergonomics and fire safety awareness is provided to all employees. All health and safety matters are communicated via notice boards, email memos, the intranet and via safety representatives.

We believe that the knowledge and skills of our employees are a key element of organisational success and therefore invest in training and development. We ensure that this is accessible by everyone and recognised as a shared responsibility between individual employees and the organisation.

Employees are kept informed of developments in business through our internal communications including, formal company-wide briefings that occur twice a month, team meetings and an informationrich intranet.

We are proud of our working culture that ensures that we achieve our aim to attract and retain talented staff in competitive markets and supports them as they strive to perform to an excellent standard.

## Social responsibility

We encourage employee involvement in a range of community programmes. Nicholas Furlonge has recently been appointed chairman of the Lloyd's Community Programme Management Board in London, and encourages staff to involve themselves in helping pupils in schools in the Tower Hamlets area, one of the most deprived areas in the country. The largest programme is "Reading Partners", where members of staff volunteer their lunch hour to sit with children and help them with their literacy. There are currently over 20 volunteers, including two executive directors helping with the various partnership schemes. In addition, two directors participated in the police mentoring programme, where a senior business person is paired with a senior police officer, in one of three of East London's most challenging boroughs, in order to help them develop their management skills.

In 2007, we will extend our involvement into broader areas of the community encompassing a sports programme and interview training.

The group made charitable donations during the year ended 31 December 2006 of £25,436 (2005: £31,689). The group's charity budget is managed by a charity committee chaired by Nicholas Furlonge, and consideration is given to a wide range of activities, particularly where members of staff are engaged in fund-raising activities. For example, these activities raised over £7,000 competing in a dragon boat race and over £2,000 in a white-water rafting competition.

Also, our annual Christmas card is distributed electronically to over 10,000 key clients and contacts, giving them the opportunity to indicate the charity that they wish us to support.

In October 2006 we introduced a payroll-giving scheme in the UK in association with the Charities Aid Foundation. By the end of December 2006, 10% of staff had joined the scheme, donating £7,391 annually to 31 different charities.

No political donations were made by the group in either the current or prior reporting period.

# Environmental responsibility

We are committed to achieving best practice in all the areas of the business where there may be an impact on the environment. From our head office in Plantation Place in London we encourage environmentally aware behaviour including:

- A policy for minimising waste by scanning risks and claims, which enables employees worldwide to view documents electronically rather than on paper;
- Recycling facilities for plastics, glass, paper, cardboard and used toner cartridges at several points throughout the building;
- Glass refillable bottles are used in lieu of disposable ones;
- Recycling bins for old mobile telephones for charity;
- Multi-functional scanner, printing, copying and faxing facilities exist and double-sided printing is encouraged;

- In the head office building, motion detectors are fitted to lighting systems to ensure electricity usage is kept to a minimum; and
- We also actively encourage the use of public transport and provide ample cycle racks, shower facilities and locker storage for those employees who cycle into work.

We are also currently undertaking an environmental impact assessment of all our UK operations, including an assessment of their carbon emissions.

# Board of directors

# **Executive directors**



Andrew Beazley
(aged 53) is the chief
executive of the
company. Andrew is a
co-founder of Beazley
Furlonge and the active
underwriter for the
managed syndicates
2623 and 623. He has
31 years' experience at
Lloyd's and is chairman
of Lloyd's of Japan.



(aged 44) is the group finance director and joined the board in June 2003. Andrew was previously UK chief financial officer at ING and, prior to January 2001, was deputy global chief financial officer and global head of finance for the equity markets division of ING Barings, having held various financial positions with ING Barings since January 1997. He qualified as a chartered

accountant with

in 1987.

Coopers and Lybrand

Andrew Horton



Nicholas Furlonge (aged 56) is responsible for the risk management of the Beazley Group. Nicholas is a cofounder of Beazley Furlonge, and has 35 years' experience at Lloyd's. He is also chairman of the Lloyd's Community Programme Management Board and a director of the LMA. He is also responsible for brand and communications and the ceded reinsurance department.



Jonathan Gray (aged 53) is head of the group's property division. Jonathan has 33 years of experience at Lloyd's, joining Beazley in 1992. He is an active underwriter in his area of expertise, open market commercial property risks.



Neil Maidment (aged 44) is head of the group's reinsurance division. Neil has 22 years of Lloyd's experience. He joined Beazley in 1990 and remains an active underwriter on the account.



Johnny Rowell (aged 45) is head of the group's specialty lines division. Johnny has 22 years' experience, joining the market as a broker. He joined Beazley in 1992 and continues as an active underwriter with a principal focus on professional liability.



Clive Washbourn (aged 46) is the head of the group's marine division. Clive has 24 years' experience in the marine insurance industry and actively underwrites marine hull, marine liability and marine war risks. He is a member of the LMA Marine Committee, the LMA Underwriting and the Claims Committee and is the chairman of the Joint War Committee.

# Non-executive directors



Jonathan Agnew (aged 65) is the chairman of the company. Jonathan was formerly a managing director of Morgan Stanley and subsequently chief executive of Kleinwort Benson (now Dresdner Kleinwort). He has been chairman of Limit plc and Gerrard Group plc. He is currently chairman of Nationwide Building Society, The Cayenne Trust plc, LMS Capital plc and senior independent director of Rightmove plc. He was a member of the Council of Lloyd's from 1995 to 1998.



Dudley Fishburn (aged 60) is chairman of HFC Bank Limited and a non-executive director of HSBC Bank plc. He is a nonexecutive director of Altria Inc. in the US.



Andy Pomfret (aged 46) was appointed chief executive of Rathbone Brothers Plc in 2004 having held the position of finance director since 1999. Prior to that, he held positions at Peat, Marwick, Mitchell & Co (now KPMG) and Kleinwort Benson (now Dresdner Kleinwort).



Marty Becker (aged 54) is currently chairman and CEO of Max Re Capital, Ltd. (Nasdaq - MXRE) and LaSalle Re, Ltd. He was formerly chairman and CEO of Orion Capital Corporation, president and CEO of McDonough Caperton Insurance Group, and interim chairman and CEO of Trenwick Group, Ltd. He is currently a director of Selective Insurance Group, Inc. (Nasdaq -SIGI).



Gordon Hamilton (aged 61) recently retired as a senior audit partner in Deloitte & Touche LLP after more than 30 years, principally involved with listed multi-national company audits and major forensic assignments. He is currently the director of the listed South African group, Barloworld Ltd.



Dan Jones (aged 55) retired in 2003 as vicechairman for Marsh, Inc., responsible for non-North American operations, strategic planning, and mergers/acquisitions, based in London. In 2006 he re-entered the broking business as chief executive for the broking operations of Fred A. Moreton & Co., a Salt Lake City-based regional financial services concern focusing on the western United States.

# Application of principles of good corporate governance

There is, and historically there has been, throughout the company and the group, a commitment to high standards of corporate governance. The directors continue to develop procedures which ensure that, where the board considers it appropriate, the Beazley Group will comply with the Combined Code on corporate governance.

#### Compliance with code provisions

The board confirms that the company and the group have complied with the provisions set out in the Combined Code for the year ended 31 December 2006.

The board is accountable to the company's shareholders for good governance and the statements set out below describe how the principles identified in the revised Combined Code have been applied by the group.

#### The board

The board consists of a non-executive chairman, Jonathan Agnew, together with five independent non-executive directors, of which Andy Pomfret is the senior non-executive director, and seven executive directors, of which Andrew Beazley is chief executive. All five of the non-executive directors, who have been appointed for specified terms, are considered by the board to be independent of management and free of any relationship which could materially interfere with the exercise of their independent judgement.

Joe Sargent and Tom Sullivan both retired on 31 October 2006 and during the year three further non-executive directors were appointed, Marty Becker, Dan Jones and Gordon Hamilton. In December 2006 Clive Washbourn joined the board as an executive director and the appointment of a further non-executive director will be considered now the company is included in the FTSE 250 index.

Biographies of board members appear on pages 32 and 33 of this report. These indicate the high levels and range of business experience that are essential to manage a business of this size and complexity. A well defined operational and management structure is in place, and terms of reference exist for all board committees. The roles and responsibilities of senior executives and key members of staff are clearly defined.

The full board meets at least four times each year and more frequently where business needs require. The board has a schedule of matters reserved for its decision including, inter alia: statutory matters; approval of financial statements and dividends; appointments and terminations of directors, officers and auditors; appointments of committees and setting of terms of reference; review of group performance against budgets; approving of risk management strategy and material contracts; and the determining of authority levels within which management is required to operate.

There is an agreed principle that directors may take independent professional advice if necessary at the company's expense, on the basis that the expense is reasonable. This is in addition to the access which every director has to the company secretary. The secretary is charged by the board with ensuring that board procedures are followed.

To enable the board to function effectively and directors to discharge their responsibilities, full and timely access is given to all relevant information. In the case of board meetings, this consists of a comprehensive set of papers, including regular business progress reports and discussion documents regarding specific matters.

Appointments to the board of both executive and non-executive directors are considered by the nomination committee. The recommendations of the nomination committee are ultimately made to the full board, which considers them before any appointment is made. The remuneration committee considers any remuneration package of executive directors before it is offered to a potential appointee. The members of the audit, remuneration, nomination and investment committees are set out below.

Any director appointed during the year is required, under the provisions of the company's articles of association, to retire and seek re-election by shareholders at the next annual general meeting. The articles also require that one third of the directors retire by rotation each year and seek re-election at the annual general meeting, and the directors required to retire are those in office longest since their previous re-election. In addition, each director is required to retire at least once in any three year period.

Full details of directors' remuneration and a statement of the company's remuneration policy are set out in the directors' remuneration report on pages 37 to 45. The members of the remuneration committee and the principal terms of reference of the committee appear on page 36.

# Meetings with non-executive directors

The chairman holds meetings as required with the non-executive directors without the executive directors being present.

## Board performance evaluation

In accordance with the requirements of the Combined Code, the board undertook a formal and rigorous evaluation of its own performance and that of its committees and individual directors in 2005 and a further evaluation will be carried out during 2007.

### Individual attendance by directors\* at regular meetings of the board and of committees

		Board	,	Audit	Rem	uneration	Nor	nination	Inve	estment
	No. of		No. of	_	No. of		No. of		No. of	
Director	meetings	No. attended								
J G W Agnew	5	5	_	-	-	-	4	4	5	5
A F Beazley	5	5	-	_	-	_	-	_	-	_
M Becker										
(appointed 8 May 2006)	3	3	3	3	_	_	_	_	3	3
J D Fishburn	5	4	8	6	7	6	4	3	-	_
N H Furlonge	5	5	-	_	-	_	-	_	-	_
J G Gray	5	4	_	_	-	_	_	_	_	_
A G K Hamilton										
(appointed 8 September 2006	5) 1	1	1	1	3	3	-	_	-	_
D A Horton	5	5	_	_	-	_	_	_	5	5
D Jones (appointed 1 July 200	06) 2	2	_	_	4	4	2	2	_	_
N P Maidment	5	5	_	_	_	_	_	_	5	5
A D Pomfret	5	5	8	8	7	5	4	2	_	_
J G B Rowell	5	5	_	_	-	_	_	_	_	_
J D Sargent										
(resigned 31 October 2006)	4	4	4	4	3	3	3	3	4	4
T F Sullivan										
(resigned 31 October 2006)	4	4	4	4	3	3	_	_	_	_
C A Washbourn										
(appointed 4 December 2006)	_	-	-	_	-	-	-	_	-	-

<sup>\*</sup> Whilst a director and excludes directors attending by invitation

### Board committees

The company has established properly constituted audit, remuneration, nomination and investment committees of the board.

### Audit committee

The audit committee currently comprises Andy Pomfret (committee chairman), Dudley Fishburn, Marty Becker and Gordon Hamilton. Tom Sullivan and Joe Sargent resigned during the year. The committee regularly meets without any executive management being present and the committee holds regular meetings with the head of internal audit, and with the external auditor.

The committee's main objectives are, inter alia: to monitor the integrity of the company's financial statements and any other formal announcements relating to the company's financial performance; review significant financial reporting judgements contained in them, before submission to, and approval by, the board, and before clearance by the external auditors; review the company's internal financial controls and the company's internal control and risk management systems; approve the appointment, or termination of appointment, of the head of internal audit and monitor and review the effectiveness of the company's internal audit function; and review the arrangements by which employees of the company may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters.

The committee also reviews any matters raised by the auditors and internal audit. The chief executive, the finance director, and the risk management director are invited to attend part of each meeting of this committee. The external auditors are invited to attend meetings regularly. The auditors have unrestricted access to the members of the audit committee, and the committee ensures that meetings are used as an open avenue of communication between compliance, internal audit, the external auditors and the board. The committee receives regular updates and monitors the status of actions taken by management to address issues raised by both external and internal audit. Risk management provides reports to the audit committee on the risk assessment and the self-certification from risk owners of the operating effectiveness of internal controls.

In respect of any firm of external auditors and consulting actuaries which may be appointed by any group company, the audit committee is also responsible for recommending their appointment and termination; recommending their terms of reference; receiving regular reports, independently of management where necessary; determining their independence; monitoring their performance; and approving their fees.

Following a recommendation from the audit committee, the board has adopted a policy in relation to the provision of non-audit services by the auditors. The objective is to ensure that the provision of such services does not impair the external auditor's objectivity. The policy specifically disallows certain activities to be provided by the auditor such as bookkeeping and accounting services, internal actuarial service, internal audit outsourcing services and executive remuneration services. The policy requires pre-approval for all material other services such as due diligence assistance, tax services and advice on accounting and audit matters.

The aim is to limit the total spend on non-audit services to a maximum of the annual audit fee unless it is deemed to be in the shareholders' interest from an efficiency and effectiveness point of view.

The split between audit and non-audit fees for the year under review is disclosed on page 70. All of these are considered by the audit committee not to affect the auditors' independence or objectivity.

Following publication of the Combined Code on corporate governance, the terms of reference of the audit committee have been expanded. These are published on the company's website.

### Remuneration committee

The remuneration committee comprises Dudley Fishburn as chairman, together with Andy Pomfret, Dan Jones and Gordon Hamilton. Joe Sargent and Tom Sullivan both resigned during the year. The work of the remuneration committee is covered further in the directors' remuneration report on pages 37 to 45.

Copies of executive directors' service contracts and the terms and conditions of appointment of the non-executive directors are available for inspection at the company's office during normal business hours.

The terms of reference of the remuneration committee are published on the company's website.

### Nomination committee

The nomination committee consists of Jonathan Agnew as chairman, together with Dudley Fishburn, Andy Pomfret and Dan Jones. Joe Sargent resigned during the year. It meets as required and makes recommendations to the board on all board appointments, including the selection of non-executive directors.

The terms of reference of the nomination committee are published on the company's website.

### Investment committee

The investment committee consists of Jonathan Agnew as chairman, together with Andrew Horton, Marty Becker, Neil Maidment, Peter Glynne-Percy and Arthur Manners. Joe Sargent resigned during the year. The committee makes recommendations to the board regarding the investment policy of the Beazley Group and the syndicates, including the establishment of investment guidelines and monitoring of performance and compliance with those guidelines.

The terms of reference of the investment committee are published on the company's website.

### Shareholder communication

The company places great importance on communication with shareholders. The full report and accounts and the interim report are mailed to all shareholders and, on request, to other parties who have an interest in the group's performance. The company responds to individual letters from shareholders and maintains a separate investor relations centre within the existing www.beazley.com website as a repository for all investor relations matters.

There is a regular dialogue with institutional shareholders as well as general presentations after the preliminary and interim results. The board is advised of any specific comments from institutional investors to enable them to develop an understanding of the views of major shareholders. All shareholders have the opportunity to put forward questions at the company's annual general meeting.

A resolution is being proposed at the annual general meeting to allow the company to communicate with its shareholders using electronic and website communication and to allow for electronic proxy voting.

## Audit and internal control

The respective responsibilities of the directors and the auditors in connection with the accounts are explained on pages 46 to 47, and the statement of directors on going concern on page 48.

The board confirms that there is a continuous process for identifying, evaluating and managing any compliance issues and significant risks faced by the group. The internal capital assessment process maps risks to capital requirements through review and challenge and sign-off by the board.

The directors are responsible for the group's system of internal control and for reviewing its effectiveness. However, such a system can only provide reasonable, but not absolute, assurance against material misstatement or loss. The system is designed to manage rather than eliminate the risk of failure to achieve business objectives within parameters set by the board.

The key procedures that the directors have established to ensure that internal controls are effective and commensurate with a group of this size include the day-to-day supervision of the business by the executive directors. Other internal control procedures and reviews for effectiveness by the board include the:

- Preparation of standard monthly, quarterly and periodic reporting as prescribed by the board for review by the various group committees;
- · Review of financial, operational and compliance reports from management; and
- Review of any significant issues arising from the external audits.

Further information on the role of the audit committee is set out above. The committee, on behalf of the board, approves the internal audit project plan and any subsequent changes. Internal audit reports directly to the audit committee, whose terms of reference include approving the appointment or termination of appointment, of the head of internal audit and monitoring and reviewing the effectiveness of the company's internal audit function.

### Consideration of matters relating to directors' remuneration

The remuneration policy is set by the board and is described below. Individual remuneration packages of executive directors and the chairman are determined by the remuneration committee within the framework of this policy. The remuneration committee consists of the non-executive directors and during the year the members included Dudley Fishburn as chairman, Andy Pomfret, Joe Sargent, Tom Sullivan, Dan Jones and Gordon Hamilton. Details of the changes to the membership of the committee during the year are set out below. The company views each of these directors as independent. The committee met eight times during the year.

The committee receives advice from a variety of sources on issues where it considers it appropriate. New Bridge Street Consultants LLP advised the committee on ongoing issues. The committee also calls on specialist advice from a variety of additional sources including Capita Hartshead Ltd for pensions advice, Watson Wyatt publications for salary data, The Share Option Centre, and internal advisers including the chief executive and the company secretary who present to the committee on specific issues.

## Remuneration policy statement

The directors believe that performance-related remuneration is an essential motivation to management and staff, and this policy will form the basis for determining executive directors' remuneration for the current and forthcoming financial years. The general philosophy underlying the reward strategy for executive directors is the same as that applied to all other employees. Pay and employment conditions elsewhere in the company and data on comparable positions in other similar organisations are taken into consideration when determining executive directors' remuneration.

The company's policy is to remunerate the executive directors and other management fairly in such a manner as to facilitate the recruitment, retention and motivation of suitably qualified personnel. The measurement of the executive directors' performance and the determination of their annual remuneration package is undertaken by the remuneration committee. The main elements of the remuneration package payable under the service agreement of each executive director comprise basic salary, short-term incentive payments, pension contributions, sharebased incentives and other benefits. Other benefits include private medical insurance for the director and his immediate family, permanent health insurance, death in service benefit at four times annual salary, accident and travel insurance, healthclub membership, season ticket, car parking and the provision of either a company car or a monthly car allowance.

In line with Lloyd's market practice there are no upper limits on the amounts payable to individuals under short-term incentives. The committee has considered whether it is appropriate to set an upper limit and has recently agreed that such a limit would adversely affect the company's competitive position and would not be in the interests of shareholders. The incentive payments, which comprise short-term incentive payments and share incentive plans, are awarded on a discretionary basis, and are determined by the committee in respect of performance of both the individual and the company. As the profitability of the group has improved significantly during the year, the committee was able to reflect this improved performance in the incentive awards made to directors. The policy is to ensure that a material proportion of each executive director's overall remuneration is performance based to align executive directors' interests with those of shareholders.

The board, on a bi-annual basis, determines the remuneration of the non-executive directors with details set out below. No director plays a part in any discussion about his own remuneration.

The directors believe that a key element of the remuneration strategy is the share incentive plans that further align the interests of participants in the plans with shareholders' interests. Entitlements under certain plans are subject to the achievement of performance conditions as described below under share incentive plans.

Section headings marked § indicate the information in that section that has been audited.

## § Service contracts

The company has service contracts with executive directors. It is company policy that such contracts contain notice periods of not more than 12 months. Details of the contracts currently in place for executive directors who have served during the year and their basic salary for 2007 are as follows:

	Annual salary £	Date of contract	Unexpired term*	Notice period	Provision for compensation
A F Beazley	450,000	6 Nov 2002	n/a	12 months	Nil
N H Furlonge	225,000	6 Nov 2002	n/a	12 months	Nil
J G Gray	285,000	6 Nov 2002	n/a	12 months	Nil
D A Horton	280,000	1 Jun 2003	n/a	12 months	Nil
N P Maidment	260,000	6 Nov 2002	n/a	12 months	Nil
J G B Rowell	400,000	6 Nov 2002	n/a	12 months	Nil
C A Washbourn**	260,000	6 Dec 2006	n/a	12 months	Nil

<sup>\*</sup> The unexpired term is not applicable as each of the executive director's contracts is on a rolling basis.

<sup>\*\*</sup> C A Washbourn was appointed on 4 December 2006.

# Directors' remuneration report continued

Subject to the notice requirements described on page 37, there is no provision in the service agreements for compensation to be payable on early termination of the contract. The company will normally phase any payments of compensation which will also be subject to negotiation and mitigation.

### Non-executive directors

The fees of non-executive directors, other than the chairman, are determined by the board. When setting fee levels consideration is given to levels in comparable companies for comparable services.

No non-executive director participates in the company's incentive arrangements or pension plan.

Non-executive directors are appointed for fixed terms, normally for three years, and may be reappointed for future terms. Non-executive directors are typically appointed through a selection process that includes the candidate bringing the desired competence and skills to the group.

The board has identified several key competencies for non-executive directors to complement the existing skill-set of the executive directors. These competencies are as follows:

- Insurance sector expertise;
- · Asset management skills;
- · Public company and corporate governance experience;
- · Risk management skills; and
- Finance skills.

During the year the following non-executive directors resigned and were appointed to ensure that the board comprises sufficient non-executive directors to provide all these key competencies. Following both the inclusion of the company within the FTSE 250 index in September 2006 and the appointment of Clive Washbourn as an executive director, the appointment of a further non-executive director will be considered.

		Date of resignation or appointment
J D Sargent	Resignation	31 Oct 2006
T F Sullivan	Resignation	31 Oct 2006
D L Jones	Appointment	1 Jul 2006
W M Becker	Appointment	8 May 2006
A G K Hamilton	Appointment	8 Sep 2006

A bi-annual review of the fees and other income payable was carried out by the board in December 2006. Details of the non-executive directors' terms of appointment and their fees for 2007 are set out below:

	Current annual fees £	Term of appointment	Expires	Other income*
J G W Agnew	75,000	3 years	31 Dec 2008	_
J D Fishburn	42,000	3 years	31 Dec 2008	7,000
A D Pomfret	42,000	3 years	31 Dec 2008	14,000
D L Jones	42,000	3 years	30 Jun 2009	_
W M Becker	42,000	3 years	7 May 2009	_
A G K Hamilton	42,000	3 years	7 Sep 2009	_

<sup>\*</sup> Other income relates to the additional fee payable to A D Pomfret in respect of his chairmanship of the audit committee and as senior non-executive director and to J D Fishburn in respect of his chairmanship of the remuneration committee.

### Individual aspects of remuneration

## § Details of individual emoluments and compensation

The emoluments in respect of qualifying services and compensation of each person who served as a director during the year were as follows:

	Salary & fees¹ £	Enterprise bonus pool £	Staff underwriting distribution £	Staff underwriting deferred bonus £	Benefits² £	Salary supplements in lieu of of pension contributions £	Total for 12 months to 31 December 2006 £	Personal pension contributions	Total for 12 month to 31 December 2005 £
J G W Agnew	68,000	_	_	_	_	_	68,000	_	68,000
A F Beazley	377,573	881,975	_	118,025	17,573	107,712	1,502,858	_	876,890
J D Fishburn	43,000	_	_	_	_	_	43,000	_	43,000
N H Furlonge	262,756	302,800	18,525	47,200	16,006	90,234	737,521	_	527,141
J G Gray	283,859	450,000	18,525	-	17,109	_	769,493	23,620	652,138
D A Horton	278,507	400,000	18,525	_	13,507	_	710,539	13,481	580,623
N P Maidment	269,188	500,000	18,525	_	19,813	_	807,526	19,059	522,870
A D Pomfret	46,000	_	_	_	_	_	46,000	_	46,000
J G B Rowell	320,057	1,021,317	_	78,683	15,557	_	1,435,614	19,548	774,031
J D Sargent	31,667	_	_	_	_	_	31,667	_	44,000
T F Sullivan	31,667	_	_	_	_	_	31,667	_	38,000
C A Washbourn <sup>3</sup>	17,097	648,143	13,200	51,857	797	_	731,094	1,892	_
D L Jones	19,000	_	_	_	_	_	19,000	_	_
W M Becker	24,846	_	_	_	_	_	24,846	_	_
A G K Hamilton	11,838	_	-	_	_	_	11,838	_	_
Total :	2,085,055	4,204,235	87,300	295,765	100,362	197,946	6,970,663	77,600	4,172,693

- 1 Other than for the chairman, fees include fees paid for membership of board committees (investment, audit, remuneration and nomination committees). During the year non-executive directors were entitled to between £5,000 and £8,000 per annum in respect of the chairmanship of a committee.
- <sup>2</sup> The benefits comprise those detailed in the service contracts of the executive directors and relate to the standard benefits such as private medical insurance, car allowance, etc.
- 3 Salary, benefits and pension contributions have been disclosed from 4 December 2006, Clive Washbourn's date of appointment to the board.
- <sup>4</sup> The directors have deferred bonus entitlements to support their underwriting through Beazley Staff Underwriting Limited.

### Salary

The remuneration committee reviews salaries annually taking into account levels in comparable positions in other similar financial companies. It also considers the performance of the group, individual and average salary increases for employees across the whole group. The salaries of Messrs Beazley and Rowell have been increased significantly during the year as the committee believes that increasing competitive pressures make it necessary and that it is in the best interests of shareholders for the salaries of these individuals to be in line with the top quartile of the salaries of directors of comparable companies at the current time.

## § Short-term incentives

## Enterprise bonus pool

Since listing, the total pool available for distribution to participants under the enterprise pool equals 5.83% of the profits of the syndicates as reported on an annual accounting basis. So, for 2006 the pool contains profits from the 2004, 2005 and 2006 years of account.

During the year the committee reviewed the operation of the short-term incentive scheme to improve its efficiency and effectiveness. It concluded that a scheme based on achieving stretching target returns on group equity with minimum hurdles to be met better aligned the interests of directors and staff with shareholders.

A proportion of this pool is allocated among executive directors at the discretion of the committee. In determining the award levels, the committee had regard to both methods of establishing the enterprise pool and as both the group's return on equity and syndicate profitability has improved, the level of awards made were increased.

In addition, a proportion of any award can be paid in deferred shares that will vest after three years dependent only on continued employment.

### Retention plan

In addition to the 5.83% of syndicate profits that make up the enterprise bonus pool, senior executives will be eligible to receive conditional awards of ordinary shares under the retention plan.

The retention plan is operated on a discretionary basis based on performance to ensure key individuals have an adequate retention package and the first grant of awards was made in April 2005. The remuneration committee has concluded that the award of retention shares should be targeted at key staff where retention is essential to the business and that executive directors who already have significant shareholdings are unlikely to be awarded retention shares in the future as additional awards of ordinary shares are unlikely to further align their interests with shareholders. The total number of shares awarded to date has been 5,530,937 of which 5,015,426 ordinary shares are held by the employee benefit trust.

### Special award of retention shares to Clive Washbourn

On 4 December 2006 the committee awarded 1 million retention shares to Clive Washbourn at the time of his appointment to the board, which was in excess of the grants allowed under the existing scheme. The committee felt it was necessary to provide this meaningful incentive to retain his services in the longer term in the current climate. 15% of the shares awarded shall become transferable to Clive Washbourn on or following the announcement of results for the financial year of the company ending 31 December 2008. Thereafter, 15% of the total outstanding shares held under the scheme shall become transferable on or following the announcement of the company's results for each subsequent financial year, subject to Clive remaining a director or employee within the company's group. Dividends on shares still subject to retention will be rolled up and paid from the announcement of the results for the year ending 31 December 2008 and thereafter whenever dividends are paid to shareholders.

The award will be forfeited if Clive Washbourn ceases to be an employee or director of the company's group unless he ceases by reason of injury, ill-health or permanent disability, retirement, redundancy, the sale or transfer of his employing company or business out of the company's group, or any other reason permitted by the remuneration committee. In these circumstances, the award will vest early to the extent and on such terms determined by the remuneration committee.

In the event of a takeover (not being an internal corporate reorganisation) or the voluntary winding-up of the company, the award will vest early. In the event of an internal corporate reorganisation, awards may be replaced by equivalent new awards over shares in a new holding company. No payment is required on the grant of the award. The award is not transferable, except on death. The award is not pensionable. The award is over shares held by the company's employee benefit trust and does not confer any shareholder rights until shares are transferred. In the event of any variation of the company's share capital, the remuneration committee may make such adjustment as it considers fair and reasonable to the number of shares subject to the award. The remuneration committee may, at any time, amend this special award in any respect, provided that the prior approval of shareholders is obtained for any amendments that are to the advantage of Clive Washbourn in respect of the terms applying to the size of his award and the basis for determining his entitlement to, and the terms of, the shares and the adjustment of his award. This prior approval will not, however, apply to any minor alteration made to benefit the administration of the award, to take account of a change in legislation or to obtain or maintain favourable tax, exchange control or regulatory treatment.

### § Pensions

All executive directors, except D A Horton, participated in the Beazley Furlonge Limited final salary pension scheme up to 31 March 2006. This was a non-contributory final salary scheme subject to applicable Inland Revenue restrictions. All executive directors, except A F Beazley and N H Furlonge, are subject to the Inland Revenue earnings cap on pension entitlements. This scheme provided significant contractual entitlements to pensions for employees (including executive directors) which left the company exposed to potentially very high and unpredictable liabilities. Consequently, a decision was taken to close the scheme to new members with effect from 31 December 2002 and accruals for future service for all members of the scheme ceased from 31 March 2006. The arrangements adopted on 1 April 2006 were devised to be on a cost-neutral basis to the company as well as reducing the longer term risk to the group.

Details of the entitlements for service accruals up to 31 March 2006 of those directors who participated in the final salary scheme during the year are as follows:

	Accrued benefit at 31 Dec 2006 £	Increase in accrued benefits excluding inflation (A) £	Increase in accrued benefits including inflation	Transfer value of (A) less directors' contributions	Transfer value of accrued benefits at 31 Dec 2006 £	Increase in transfer value less directors' contributions £
A F Beazley	222,321	2,143	46,607	37,986	3,940,543	847,977
N H Furlonge	139,243	1,623	6,128	33,406	2,865,212	199,584
J G Gray	25,491	440	2,024	7,303	423,412	37,263
N P Maidment	29,401	440	2,268	5,004	334,085	26,098
J G B Rowell	25,961	440	1,908	3,462	306,023	22,991
C A Washbourn	13,762	440	1,295	5,415	169,496	16,364

The increase in the transfer value for the past service entitlement of A F Beazley and N H Furlonge reflects the increase in pensionable salary, as an additional quarter year's service has been accrued and as the discount rate and mortality assumptions used in the transfer value calculations have changed.

The company and the trustees of the scheme have agreed to accelerate the funding of the deficit of the scheme and the final tranche of an additional £3m will be paid to fund the deficit shortly.

From 1 April 2006 pension benefits for all staff have been by way of a defined contribution scheme arranged through Fidelity, which is non-contributory. The salary supplements for the active final salary scheme members were based on the age of the individual and on the principle that there is no overall additional cost to the company.

No other pension provisions are made. The normal retirement age for pension calculation purposes is 60 years. A spouse's pension is the equivalent of two-thirds of the member's pension (before any commutation) payable on the member's death after retirement.

### Share incentive plans

The company operates a variety of long-term, share-based incentives including a pre-IPO plan (now closed), tax-approved and unapproved option plans, a long-term incentive plan (LTIP) and a save-as-you-earn (SAYE) scheme, which are detailed below.

In 2005 it was agreed that in the future share option grants (other than those under the Beazley SAYE scheme which have substantial tax advantages for participants) are to be made only in exceptional circumstances, e.g. recruitment, when the terms of those share options will reflect best practice prevailing at that time. In particular, there will be no retesting of performance conditions on those grants. Existing options will be honoured and allowed to run their full course.

### § The LTIP

Participation in the LTIP is restricted to employees and full-time executive directors of the Beazley Group. Participants are selected on a discretionary basis, and receive awards of free shares in the form of a nil-cost option, thus, no exercise price is payable. The options will normally be exercisable (subject to meeting the performance conditions set out below and provided that the participant continues in the employment of the company at that date) between the third and tenth anniversaries of grant.

The LTIP awards that were granted in May 2003 did not meet the performance criteria established and have therefore lapsed. It is expected that the performance conditions in respect of the awards made in March 2004 will be met in part and therefore a proportion of the awards will vest.

The maximum normal levels of grants that may be made under the LTIP to one individual is one times salary in any financial year, measured by the value of ordinary shares put under award at the time of the award. Dividends are not currently accrued on ordinary shares prior to vesting and the number of shares awarded is not therefore adjusted. The committee will keep this issue under review for future awards.

Awards are measured by TSR and net asset value (NAV) performance. The company decided upon these measures as TSR aligns the interests of directors with shareholders by requiring superior TSR performance and NAV is a key measure of the company's financial performance.

The LTIP performance conditions were originally set when the scheme was established by board resolution on 6 November 2002. The performance conditions were amended at an extraordinary general meeting on 14 March 2005 for grants made after that date.

2005	and
future	awards

Shares worth up to 50% of salary ("Basic Shares")

50% of the Basic Shares will be received if NAV growth equals or is greater than the risk-free rate of return plus 5% per year.

### AND/OR

25% of the Basic Shares will be received for median TSR performance and 50% of the Basic Shares will be received for upper quartile performance. For performance between median and upper quartile the number of shares which can be received is determined on a straight-line basis.

Shares worth more than 50% of salary ("Additional Shares")

No Additional Shares will be received if NAV growth is less than the risk-free rate of return plus 5% per year.

50% of the Additional Shares will be received for a rate of outperformance of the risk-free rate of return plus 10% or more per year. For out-performance of the risk-free rate of return of between plus 5% and plus 10%, the number of shares which will be received is determined on a straight-line basis.

## AND/OR

No Additional Shares will be received if less than the upper quartile TSR performance is achieved.

50% of the Additional Shares will be received if top decile performance

For performance between upper quartile and top decile performance. the number of shares which will be received is determined on a straight-line basis.

### Awards up to 2004

Shares can only be received if two conditions are met:

(a) if NAV growth is greater than the risk-free rate of return plus 5% per year

### AND

(b) if TSR is at least median in the comparator group.

If both conditions are met, 50% of the award vests at median TSR performance, with full vesting at upper quartile performance. For performance between median and upper quartile the number of shares which can be received is determined on a straight-line basis.

## Directors' remuneration report continued

The company's TSR growth is compared with that of members of a comparator group comprising 11 companies from the insurance sector (the "comparator group") over a three-year period starting with the year in which the award is made. The comparator group is defined as the Lloyd's vehicles listed on the London Stock Exchange and includes the following companies for the 2006 awards:

Alea Brit Insurance Hardy Kiln
Amlin Catlin Group Highway Novae Group
Atrium Chaucer Hiscox

The comparator group changed from last year as Cox, Goshawk and Wellington are either no longer listed or not trading, SVB changed its name to Novae Group and Catlin and Alea have been introduced as these companies are now listed on the London Stock Exchange.

Details of entitlements under this plan, which are all subject to the above performance conditions, for directors who served during the period, are set out in the table on the next page. No awards were exercised during the period as none has vested unconditionally since the first grant was made under this plan.

### § The pre-IPO plan

Participation in the pre-IPO plan is restricted to employees and full-time executive directors of the Beazley Group. Participants were selected on a discretionary basis. No payment is required for the grant of an option.

All options under the pre-IPO plan were granted on 6 November 2002 and no further grants are anticipated. The exercise price per ordinary share for this grant is 71.44p (as adjusted for the 2004 rights issue), and options will normally be exercisable (subject to meeting the performance conditions set out below) between the third and the tenth anniversaries of grant.

The initial performance condition was not met during the three years following the grant of the options, being TSR growth of at least 100%. As the performance target was not achieved within this period, the TSR target was increased by 10% per annum and only 75% of the options can vest if the target is achieved within the first year of the additional period. This enhanced performance condition was met on 22 January 2007 and 75% of the awards have vested.

The above performance conditions were set when the scheme was established by board resolution on 6 November 2002. These conditions were considered appropriate because a target TSR growth of 100%, while imposing a demanding requirement on the participants, would, if achieved, ensure that shareholders also receive attractive returns.

### § The unapproved share option plan

Participation in the unapproved plan is restricted to employees and full-time executive directors of the Beazley Group, although it is the committee's intention to only make awards under this plan in exceptional circumstances. Participants are selected on a discretionary basis. No payment is required for the grant of an option and the limit on grants when aggregated with awards under the LTIP is shares with a face value of one times salary or twice salary in exceptional circumstances.

Under both the approved and unapproved share option plans, options are subject to performance conditions and typically vest on the third anniversary of the date of grant, provided that the participant has remained in employment up to that date. The performance conditions require the company's NAV plus dividends per share growth to increase as follows over a three-year period:

- An option may be exercised over all ordinary shares under option if the cumulative growth in NAV plus dividends per share is equal to or
  exceeds the risk-free rate of return (this being defined as the average yield of UK gilts with maturity dates within the next five years) in the
  relevant period plus 10% per annum;
- An option may be exercised over half the ordinary shares under option if the cumulative growth in NAV plus dividends per share is equal to the risk-free rate of return plus 5% per annum;
- For performance where the cumulative growth in NAV plus dividends per share equals a number between the risk-free rate of return plus 5% and 10% per annum, the number of ordinary shares over which an option can be exercised will be calculated on a straight-line basis between these two points;
- If the option is not fully exercisable at the end of the three-year period, it will be re-tested once, on the fourth anniversary of the date of grant, from a fixed base. The option is exercisable over whichever is the higher number of options vesting; and
- The option will lapse if NAV plus dividends per share performance is below the risk-free rate of return plus 5% per annum in both periods.

The performance conditions above were set when these plans were established by board resolution on 6 November 2002. These performance conditions were considered to be appropriate as they impose demanding performance requirements, while ensuring that shareholders also receive attractive returns over the performance period. It is expected that a proportion of the unapproved (and approved) options granted in 2003 and 2004 will vest following the announcement of the results for the year ended 31 December 2006 while the options awarded in 2002 have not met the performance criteria and have lapsed.

### § The approved share option plan

Participation in the approved plan is restricted to employees and full-time executive directors of the Beazley Group. The terms and conditions are consistent with the unapproved plan, except that the plan has been approved by HMRC (formerly known as the Inland Revenue).

### SAYE scheme

A SAYE scheme, administered by Yorkshire Bank plc, was launched in May 2003 for the benefit of staff. The scheme rules were approved by HMRC.

The scheme offered a three-year savings contract period with options being offered at a price of 73p (as adjusted for the 2004 rights issue) for grants in 2003, 74p (as adjusted for the 2004 rights issue) for grants in 2004, 74p for grants in 2005 and 93p for grants in 2006, representing the maximum allowed discount of 20%. Monthly contributions are made through payroll deduction directly to individual Yorkshire Bank accounts on behalf of participating employees.

All employees who had completed their probationary period prior to the closure of the invitation period were considered eligible to participate in the scheme.

### Savings-related share option plan for US employees

The Beazley Group plc savings-related share option plan for US employees (the Plan) permits all eligible US-based employees to purchase shares of Beazley Group at a discount of up to 15% to the shares' fair market value. The Plan is designed to comply with the terms of Section 423 of the US Internal Revenue Code. A similar arrangement (SAYE scheme) is in place for UK-based Beazley Group employees. Approval is being sought from shareholders for the adoption of this Plan.

Participants elect to participate by entering into a savings contract under which the participant agrees to have a portion of his or her compensation withheld in a savings plan for the purpose of exercising options granted under the Plan. The maximum amount of compensation that may be withheld each month under all savings contracts for any participant may not exceed £250.

After a two-year period, participants may exercise their options to purchase Beazley shares at the exercise price. The shares purchased are non-transferable for at least 12 months following exercise. Unexercised options lapse 27 months after the date on which the options were granted.

Options may be exercised early in the event of an employee's death or retirement, certain other cessations of employment and certain Beazley Group change in control events. The Plan, by its terms, will terminate on 5 May 2016, which is the tenth anniversary of its adoption.

The share plans permit 10% of the company's share capital to be issued pursuant to options/LTIP awards in a 10-year period. Since November 2002, 30% of this allowance (3.0%) has been allocated for option and LTIP awards.

### § Directors' share scheme interests

Details of share options of those directors who served during the period are as follows:

	Scheme	At 31 Dec 2005	Awarded	Exercised	Lapsed	At 31 Dec 2006	Ex. price in pence	Earliest date of exercise	Expiry date
A F Beazley	Pre-IPO plan	996,584	_			996,584	71.44	06/11/2005	06/11/2012
A i beaziey	Unapproved plan	244,086			_	244,086	71.44	06/11/2005	06/11/2012
	Unapproved plan	153,265	_	_	_	153,265	90.04	15/05/2006	15/05/2013
	Unapproved plan	84,300	_	_	_	84,300	93.95	29/03/2007	29/03/2014
	LTIP	51,092	_	_	51,092	04,500	Nil	N/A	N/A
	LTIP	28,101	_	_	51,052	28,101	Nil	29/03/2007	29/03/2014
	LTIP	140,449	_	_	_	140,449	Nil	21/03/2008	21/03/2015
	LTIP	140,445	133,698	_	_	133,698	Nil	21/03/2009	21/03/2016
	SAYE 2006	_	10,083	_	_	10,083	92.73	01/07/2006	01/01/2010
	SAYE 2003	12,945	-	12,945	_		Nil	N/A	N/A
	Retention plan	112,359	_	-	_	112,359	Nil	21/03/2008	-
	Retention plan	-	222,831	_	_	222,831	Nil	21/03/2009	_
N H Furlonge	Pre-IPO plan	410,358	_	_	_	410,358	71.44	06/11/2005	06/11/2012
	Approved plan	31,931	_	_	_	31,931	93.95	29/03/2007	29/03/2014
	Unapproved plan	92,385	_	_	_	92,385	71.44	06/11/2005	06/11/2012
	Unapproved plan	72,512	_	_	_	72,512	71.44	15/05/2006	15/05/2013
	Unapproved plan	25,545	_	_	_	25,545	93.95	29/03/2007	29/03/2014
	LTIP	24,173	_	_	24,173	_	Nil	N/A	N/A
	LTIP	19,159	_	_	, –	19,159	Nil	29/03/2007	29/03/2014
	LTIP	184,831	_	_	_	184,831	Nil	21/03/2008	21/03/2015
	LTIP	_	70,781	_	_	70,781	Nil	21/03/2009	21/03/2016
	SAYE 2004	12,736	_	_	_	12,736	74.00	01/06/2007	01/12/2007
	Retention plan	28,089	_	_	_	28,089	Nil	21/03/2008	
	Retention plan		70,781	_	-	70,781	Nil	21/03/2009	_

	Scheme	At 31 Dec 2005	Awarded	Exercised	Lapsed	At 31 Dec 2006	Ex. price in pence	Earliest date of exercise	Expiry date
J G Gray	Pre-IPO plan	820,716	_	_	_	820,716	71.44	06/11/2005	06/11/2012
<i>y</i> a.a.a.	Approved plan	31,931	_	_	_	31,931	93.95	29/03/2007	29/03/2014
	Unapproved plan	118,105	_	_	_	118,105	71.44	06/11/2005	06/11/2012
	Unapproved plan	92,700	_	_	_	92,700	90.04	15/05/2006	15/05/2013
	Unapproved plan	33,209	_	_	_	33,209	93.95	29/03/2007	29/03/2014
	LTIP	30,902	_	_	30,902	_	Nil	N/A	N/A
	LTIP	21,714	_	_	_	21,714	Nil	29/03/2007	29/03/2014
	LTIP	190,730	_	_	_	190,730	Nil	21/03/2008	21/03/2015
	LTIP	_	101,506	_	_	101,506	Nil	21/03/2009	21/03/2016
	SAYE 2003	12,945	,	12,945	_	´ _	Nil	N/A	N/A
	Retention plan	84,269	_	,	_	84,269	Nil	21/03/2008	_
	Retention plan	,	135,341	_	_	135,341	Nil	21/03/2009	-
D A Horton	Pre-IPO plan	_	-	_	-	-	_	_	_
	Approved plan	30,351	_	_	_	30,351	98.84	13/06/2006	13/06/2013
	Approved plan	1	_	-	-	1	93.95	29/03/2007	29/03/2014
	Unapproved plan	159,348	_	_	-	159,348	98.84	13/06/2006	13/06/2013
	Unapproved plan	65,140	_	_	_	65,140	93.95	29/03/2007	29/03/2014
	LTIP	63,233	_	-	63,233		Nil	N/A	N/A
	LTIP	21,714	_	_	-	21,714	Nil	29/03/2007	29/03/2014
	LTIP	189,606	-	_	_	189,606	Nil	21/03/2008	21/03/2015
	LTIP	-	88,476	_	_	88,476	Nil	21/03/2009	21/03/2016
	SAYE 2004	10,083	_	_	_	10,083	74.00	01/06/2007	01/12/2007
	Retention plan Retention plan	95,505 –	- 117,968	_	_	95,505 117,968	Nil Nil	21/03/2008 21/03/2009	_
N P Maidment	Pre-IPO plan	879,339			_	879,339	71.44	06/11/2005	06/11/2012
IN F IVIAIUITIETIL	Approved plan	31,931	_	_	_	31,931	93.95	29/03/2007	29/03/2014
	Unapproved plan	115,481	_		_	115,481	71.44	06/11/2005	06/11/2012
	Unapproved plan	90,641			_	90,641	90.04	15/05/2006	15/05/2013
	Unapproved plan	33,209			_	33,209	93.95	29/03/2007	29/03/2014
	LTIP	-	_	_	30,216	-	Nil	N/A	N/A
	LTIP	21,714			50,210	21,714	Nil	29/03/2007	29/03/2014
	LTIP	186,404			_	186,404	Nil	21/03/2008	21/03/2015
	LTIP	100,404	68,487			68,487	Nil	21/03/2009	21/03/2019
	SAYE 2003	12,945	-	12,945		-	Nil	N/A	N/A
	SAYE 2006	12,545	10,083	12,545	_	10,083	92.73	01/07/2009	01/01/2010
	Retention plan	84,269	10,005	_	_	84,269	Nil	21/03/2008	01/01/2010
	Retention plan	-	91,317	_	_	91,317	Nil	21/03/2009	_
J G B Rowell	Pre-IPO plan	586,226	_	_		586,226	71.44	06/11/2005	06/11/2012
	Approved plan	31,931	_	-	-	31,931	93.95	29/03/2007	29/03/2014
	Unapproved plan	120,731	_	_	-	120,731	71.44	06/11/2005	06/11/2012
	Unapproved plan	94,760	_	-	-	94,760	90.04	15/05/2006	15/05/2013
	Unapproved plan	33,209	_	_	_	33,209	93.95	29/03/2007	29/03/2014
	LTIP	_	_	_	31,589	_	Nil	N/A	N/A
	LTIP	21,714	_	-	-	21,714	Nil	29/03/2007	29/03/2014
	LTIP	210,112	_	-	-	210,112	Nil	21/03/2008	21/03/2015
	LTIP	_	121,639	_	-	121,639	Nil	21/03/2009	21/03/2016
	SAYE 2003	12,945	_	12,945	-	_	Nil	N/A	N/A
	Retention plan	84,269	-	_	_	84,269	Nil	21/03/2008	_
	Retention plan	_	162,186		_	162,186	Nil	21/03/2009	
C A Washbourn	Pre-IPO plan	476,170	_	_	_	476,170	73.00	06/11/2005	06/11/2012 13/11/2012
	Approved plan	38,461 59,076	_	_	_	38,461	78.00	13/11/2005	
	Unapproved plan	59,076 5.440	_	_	_	59,076 5 449	73.00	06/11/2005	06/11/2012
	Unapproved plan	5,449	_	_	_	5,449	78.00	13/11/2005	13/11/2012
	Unapproved plan Unapproved plan	62,903 63,750	_	_	_	62,903 63,750	92.00 96.00	15/05/2006	15/05/2013 29/03/2014
	Unapproved plan		_	_	21,697	63,750	96.00 Nil	29/03/2007	
	LTIP	21,697 21,250	_	_	21,697	21,250	Nil	N/A 29/03/2007	N/A 29/03/2014
		21,250 169,101	_	_	_	169,101	Nil	29/03/2007	29/03/2014 21/03/2015
	ITIP		_	_		,	Nil		
	LTIP ITIP		QQ 101						
	LTIP	_	90,181	_	_	90,181		21/03/2009	21/03/2016
	LTIP SAYE 2004	12,736	-	_	_	12,736	74.00	01/06/2007	01/12/2007
	LTIP SAYE 2004 Retention plan	12,736 95,505	-	- - -		12,736 95,505	74.00 Nil	01/06/2007 21/03/2008	
	LTIP SAYE 2004	12,736	-	- - -		12,736	74.00	01/06/2007	

Other than the pre-IPO plan options, all the share incentive awards that have performance conditions relating to TSR or growth in NAV have not yet met performance targets established.

LTIP awards mid-market price at 26 March 2004 was 94p (Source: Bloomberg)

LTIP awards mid-market price at 18 March 2005 was 89p (Source: Bloomberg)

LTIP awards mid-market price at 21 March 2006 was 116p (Source: Bloomberg)

### § Directors' interests in shares

Details of the ordinary shareholdings of the directors who held office during the year are as follows:

	Number of ordinary shares held as at 1 January 2006 or at date of appointment if later	Acquired or exercised options during year	Number of ordinary shares held as at 31 December 2006	Shareholding as a percentage of the total issued ordinary share capital as at 31 December 2006
J G W Agnew	114,263	_	114,263	0.03
A F Beazley	7,009,905	107,945	7,117,850	1.97
J D Fishburn	15,714	_	15,714	0.00
N H Furlonge	2,510,831	_	2,510,831	0.70
J G Gray	3,368,805	12,945	3,381,749	0.94
D A Horton	36,461	_	36,461	0.01
N P Maidment	2,945,307	_	2,958,251	0.82
A D Pomfret	16,500	_	16,500	0.00
J G B Rowell	4,120,663	662,945	4,783,608	1.32
J D Sargent *	1,292,193	_	N/A	_
T F Sullivan *	10,000	_	N/A	_
C A Washbourn	_	_	_	_
W M Becker	_	20,000	20,000	0.01
A G K Hamilton	_	10,000	10,000	0.00
D L Jones	_	-	_	_

<sup>\*</sup> Resigned on 31 October 2006

With a total of 361,028,809 issued shares at 31 December 2006, the directors held 5.81%.

## § Underwriting interests on syndicate 623

The following directors participated in syndicate 623 either directly through NameCos or indirectly through Beazley Staff Underwriting Limited:

	2006 year of account capacity £	2007 year of account capacity £
J G W Agnew	78,253	
A F Beazley	1,395,953	2,124,477
N H Furlonge	211,819	232,558
J G Gray	111,841	122,791
D A Horton	111,841	232,558
N P Maidment	111,841	122,791
J G B Rowell	1,600,000	2,048,954
C A Washbourn	109,843	120,598

The directors believe that it is important that the incentive arrangements include an element of downside risk to align further with the interests of capital providers. The directors participate in the underwriting and have exposure to underwriting results either through direct involvements in NameCos or through participation in Beazley Staff Underwriting Limited that provides an indirect involvement in the results of the syndicate. The majority of underwriters has an interest through this company and has agreed to defer future bonuses that will be at risk if the syndicate declares losses.

### Annual general meeting

A resolution will be proposed at the forthcoming annual general meeting to be held on 3 May 2007 to approve this directors' remuneration report. By order of the board

# **Dudley Fishburn**

Chairman of the remuneration committee Plantation Place South 60 Great Tower Street London EC3R 5AD

7 March 2007

The directors have pleasure in presenting their report and the audited financial statements of the group for the year ended 31 December 2006.

### Principal activity

The company is the ultimate holding company for the Beazley Group, a global specialist risk insurance and reinsurance business operating through Lloyd's syndicates 2623 and 623 in the UK and BICI, a US-admitted carrier in the US.

### Review of business

A more detailed review of the business for the year and a summary of future developments are included in the chairman's statement on page 4 and 5 and the business review on pages 6 to 9.

### Results and dividends

The consolidated profit after taxation for the year ended 31 December 2006 amounted to £59.9m (2005: £11.1m).

The directors recommend a final dividend of 3.2p (2005: 2.5p) per share. This, when taken with the interim dividend of 1.6p (2005: 1.5p) per share, gives a total dividend of 4.8p per share for the year ended 31 December 2006 (2005: 4.0p).

### Directors

The directors of the company at 31 December 2006, who served during the year and to the date of this report, were as follows:

Jonathan Geoffrey William Agnew (non-executive chairman)
Andrew Frederick Beazley (chief executive)

David Andrew Horton (group finance director)

Nicholas Hill Furlonge (director)
Jonathan George Gray (director)
Neil Patrick Maidment (director)
Jonathan George Benton Rowell (director)

Clive Andrew Washbourn (director – appointed on 4 December 2006)

John Dudley Fishburn (non-executive director)
Andrew David Pomfret (non-executive director)

Joseph Denny Sargent (non-executive director – resigned 31 October 2006)
Thomas Francis Sullivan (non-executive director – resigned 31 October 2006)
Daniel Lawrence Jones (non-executive director – appointed 1 July 2006)
William Marston Becker (non-executive director – appointed 8 May 2006)
Alexander Gordon Kelso Hamilton (non-executive director – appointed 8 September 2006)

In accordance with the articles of association, Clive Washbourn, Dan Jones, Marty Becker and Gordon Hamilton offer themselves for reelection as they were appointed directors during the year and Johnny Rowell, Andrew Horton, Jonathan Gray and Andy Pomfret retire by rotation and, being eligible, offer themselves for re-election at the forthcoming annual general meeting.

Details of directors' service contracts and beneficial interests in the company's share capital are given in the directors' remuneration report on pages 37 to 45. Biographies of directors seeking re-election are set out on pages 32 and 33.

## Corporate governance

The company's compliance with corporate governance is disclosed in the corporate governance statement on pages 34 to 36.

### Going concern

The directors have prepared these accounts on a going concern basis, as they are of the opinion that the company and group will be able to pay its debts as and when they fall due.

After reviewing the group's budgets and medium-term plans, the directors have a reasonable expectation that the group has adequate resources to continue in operational existence for the foreseeable future.

### Supplier payment policy

The company and group's policy for the year ending 31 December 2006, for all suppliers, is to fix terms of payment when agreeing the terms of each business transaction, to ensure the supplier is aware of those terms and to abide by the agreed terms of payment. The group had an average 46 days' purchases included in trade creditors at 31 December 2006 (2005: 38 days).

## Corporate, social and environmental responsibility

The company's corporate, social and environmental policy is disclosed on pages 30 to 31.

No political donations were made by the group in either of the current or prior reporting period.

### Financial instruments and risk management

The board agrees and reviews policies and financial instruments for risk management.

Further information on reinsurance, borrowings and financial instruments is contained in notes 18, 23, 24 and 25 to the financial statements.

### Substantial shareholdings

As at 26 February 2007, the board had been notified of, or was otherwise aware of, the following shareholdings of 3% or more of the company's issued ordinary share capital:

	Number of ordinary shares	%
Amvescap plc and subsidiaries	71,514,051	19.81
Jupiter Asset Management Limited	30,334,806	8.40
Abeforth Partners	19,048,743	5.28
Legal & General Group plc	19,020,864	5.26
Scottish Widows	18,140,066	5.02
Baillie Gifford	15,291,696	4.24
AXA Framlington Investment Managers	11,296,428	3.13

### Annual general meeting

The notice of the annual general meeting to be held at 4pm on Thursday, 3 May 2007 at Plantation Place South is set out in the circular to shareholders regarding the annual general meeting.

Resolutions will be proposed at the forthcoming annual general meeting, inter alia:

- Renew the directors' general authority to allot the company's ordinary shares up to an aggregate nominal amount of £4.500.000. This authority shall expire on whichever is the earlier of the conclusion of the annual general meeting of the company to be held in 2008 or the date falling 15 months from the passing of this resolution. The directors have no present intention of exercising this authority, which represents 24.93% of the present issued share capital;
- Approve a limited disapplication of pre-emption rights on allotments for cash up to an aggregate nominal amount of £900,000, representing 4.99% of the present issued share capital;
- Authorise the directors to make purchases of the company's ordinary shares in the market for cancellation or to be held in treasury when the directors consider that it would be in the best interests of the company to do so, up to an aggregate nominal amount of £1,805,000, representing 10% of the present issued share capital.

Following the introduction of The Companies (Acquisitions of Own Shares) (Treasury Shares) Regulations 2003, companies are now able to hold shares acquired by way of market purchase in treasury, rather than cancelling them. The company may consider holding any of its own shares which it purchases pursuant to the authority conferred by the relevant resolution as treasury shares. This would allow the company to sell shares out of treasury, providing the company with the ability to replenish its distributable reserves. No dividends will be paid on any shares held in treasury and no voting rights will attach to such shares. It will also be possible for the company to transfer shares out of treasury, pursuant to an employee share scheme.

At 7 March 2007 the company held no shares in treasury.

This is a renewal of the authority granted by shareholders at the 2004 annual general meeting, since when no shares have been re-purchased;

- A resolution to approve the savings-related share option plan for US employees as described on page 43 and in appendix one of the circular;
- A resolution to approve changes to the company's LTIP regarding the eligibility of employees to participate in the plan and the ability of participants to exercise options early upon ceasing employment by reason of retirement with the agreement of the company as described in appendix two of the circular; and
- A resolution to adopt new articles of association to allow the company to communicate with its shareholders using electronic and website communication and to allow for electronic proxy voting.

At 7 March 2007 there are outstanding options to subscribe for 10.0m ordinary shares pursuant to employee share schemes, representing 2.9% of the issued share capital. If the authority to purchase shares were exercised in full, these options would represent 2.7% of the enlarged issued share capital.

A resolution to re-appoint KPMG Audit plc as auditors will be proposed at the forthcoming annual general meeting.

# Disclosure of information to auditors

The directors who held office at the date of approval of this directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the company's auditors are unaware; and each director has taken all the steps that he ought to have taken as a director to make himself aware of any relevant audit information and to establish that the company's auditors are aware of that information.

### By order of the board

# A R Manners

Company secretary Plantation Place South 60 Great Tower Street London EC3R 5AD

7 March 2007

# Statement of directors' responsibilities in respect of the financial statements

The directors are responsible for preparing the directors' report and the group and parent company financial statements, in accordance with applicable law and regulations.

Company law requires the directors to prepare group and parent company financial statements for each financial year. Under that law the directors have elected to prepare the group financial statements in accordance with IFRSs as adopted by the EU and have elected to prepare the parent company financial statements on the same basis.

The group and parent company financial statements are required by law and IFRSs as adopted by the EU to present fairly the financial position and the performance of the group and the parent company. The Companies Act 1985 provides in relation to such financial statements that references in the relevant part of that Act to financial statements giving a true and fair view are references to their achieving a fair presentation.

In preparing each of the group and parent company financial statements, the directors are required to:

- Select suitable accounting policies and then apply them consistently;
- Make judgements and estimates that are reasonable and prudent;
- · State whether they have been prepared in accordance with IFRSs as adopted by the EU; and
- Prepare the financial statements on the going concern basis unless it is inappropriate to presume that the group and the parent company will continue in business.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the parent company and enable them to ensure that its financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the group and to prevent and detect fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the company's website. Legislation in the UK governing preparation and dissemination of financial statements may differ from legislations in other jurisdictions.

# Independent auditors' report to the members of Beazley Group plc

We have audited the group and parent company financial statements (the "financial statements") of Beazley Group plc for the year ended 31 December 2006 which comprise the consolidated income statement, the group and parent company balance sheets, the group and parent cash flow statements, the group and parent company statement of movements in equity and the related notes. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the directors' remuneration report that is described as having been audited.

This report is made solely to the company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

### Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the financial statements in accordance with applicable law and IFRSs as adopted by the EU are set out in the statement of directors' responsibilities on page 48.

Our responsibility is to audit the financial statements and the part of the directors' remuneration report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985 and, as regards the group financial statements, Article 4 of the IAS Regulation. We also report to you whether in our opinion the information given in the directors' report is consistent with the financial statements.

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 review whether the corporate governance statement reflects the company's compliance with the nine provisions of the 2003 Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the group's corporate governance procedures or its risk and control procedures.

We read the other information contained in the financial statements and consider whether it is consistent with the audited financial statements. 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 and the part of the directors' remuneration report to be audited. 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 group's and 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 and the part of the directors' remuneration report to be audited 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 and the part of the directors' remuneration report to be audited.

## Opinion

In our opinion:

- The group financial statements give a true and fair view, in accordance with IFRSs as adopted by the EU, of the state of the group's affairs as at 31 December 2006 and of its profit for the year then ended;
- The parent company financial statements give a true and fair view, in accordance with IFRSs as adopted by the EU, of the state of the parent company's affairs as at 31 December 2006;
- The financial statements and the part of the directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation; and
- The information given in the directors' report is consistent with the financial statements.

### **KPMG Audit Plc**

Chartered accountants Registered auditor

8 Salisbury Square London EC4Y 8BB United Kingdom

7 March 2007

	Notes	2006 £m	2005 £m
Gross premiums written Written premiums ceded to reinsurers	3	745.1 (170.8)	558.0 (132.2)
Net premiums written	3	574.3	425.8
Change in gross provision for unearned premiums Reinsurer's share of change in the provision for unearned premiums		(84.9) 20.2	(73.7) 20.2
Change in net provision for unearned premiums		(64.7)	(53.5)
Net earned premiums	3	509.6	372.3
Net investment income Other income	4 5	48.3 7.1	31.6 6.9
		55.4	38.5
Revenue		565.0	410.8
Insurance claims Insurance claims recoverable from reinsurers		357.0 (86.3)	463.7 (190.7)
Net insurance claims	3	270.7	273.0
Expenses for the acquisition of insurance contracts Administrative expenses Other expenses	3 6 6	129.6 38.8 33.5	95.5 23.0 1.4
Operating expenses		201.9	119.9
Expenses	3	472.6	392.9
Results of operating activities		92.4	17.9
Finance costs	8	(5.6)	(1.8)
Profit before tax		86.8	16.1
Comprises: Profit before tax and foreign exchange adjustments on non-monetary items Foreign exchange on non-monetary items		96.2 (9.4)	7.9 8.2
Income tax expense	9	(26.9)	(5.0)
Profit after tax		59.9	11.1
Earnings per share (pence per share): Basic Diluted	10 10	16.8 16.7	3.1 3.1

		2006		2005	
		Group	Company	Group	Company
	Notes	£m	£m	£m	£m
Assets					
Intangible assets	12	21.9	_	18.2	_
Plant and equipment	13	7.0	_	2.5	_
Investment in subsidiaries		_	65.1	_	31.7
Investment in associates	14	1.3	_	1.3	_
Deferred acquisition costs	15	78.9	_	52.7	_
Financial investments	16	958.4	340.0	771.9	221.9
Insurance receivables	17	244.0	_	158.9	_
Deferred income tax	26	3.5	_	2.4	_
Reinsurance assets	18, 23	345.3	_	394.5	_
Current income tax		_	0.7	_	_
Other receivables		14.5	25.4	28.4	48.4
Cash and cash equivalents	19	209.4	29.8	112.6	6.7
Total assets		1,884.2	461.0	1,543.4	308.7
Fauite					
Equity Share conital	20	18.1	18.1	18.0	18.0
Share capital Reserves	21, 22	225.8	230.9	232.1	229.4
Retained earnings	21, 22	75.6	230.9 14.9	30.3	229.4 16.1
Retained earnings		75.0	14.9	30.3	10.1
Total equity		319.5	263.9	280.4	263.5
Liabilities					
Insurance liabilities	23	1,225.6	_	1,096.4	_
Borrowings	24	154.9	157.0	29.1	10.5
Derivative financial instrument	25	2.4	2.4		
Deferred income tax	26	11.6		6.0	_
Current income tax liabilities		15.6	_	4.5	1.3
Other payables	27	152.7	37.7	124.1	33.4
Retirement benefit obligations	28	1.9	_	2.9	-
Total liabilities		1,564.7	197.1	1,263.0	45.2
Total equity and liabilities		1,884.2	461.0	1,543.4	308.7

The financial statements were approved by the board of directors on 7 March 2007 and were signed on its behalf by:

J G W Agnew, Chairman A F Beazley, Chief executive D A Horton, Finance director

Group	Notes	Share capital £m	Reserves £m	Retained earnings £m	Total £m
Balance at 1 January 2005		18.0	232.5	27.1	277.6
Retained profits for the year		_	_	11.1	11.1
Foreign exchange translation differences		_	0.8	_	0.8
Dividends paid	11	_	_	(7.9)	(7.9)
Increase in employee share options	21	_	0.4	_	0.4
Acquisition of own shares in trust	21	_	(1.6)	_	(1.6)
Balance at 31 December 2005		18.0	232.1	30.3	280.4
Retained profits for the year		_	_	59.9	59.9
Change in net investment hedge		_	(0.6)	_	(0.6)
Foreign exchange translation differences			(2.8)	_	(2.8)
Dividends paid	11	_	_	(14.6)	(14.6)
Issue of shares	20	0.1	0.3		0.4
Increase in employee share options	21	_	0.8	_	0.8
Acquisition of own shares in trust	21	-	(4.0)	_	(4.0)
Balance at 31 December 2006		18.1	225.8	75.6	319.5
Company	Notes	Share capital £m	Reserves £m	Retained earnings £m	Total £m
Balance at 1 January 2005		18.0	230.5	2.1	250.6
Retained profits for the year		_	_	21.9	21.9
Foreign exchange translation differences		_	(1.1)	_	(1.1)
Dividends paid	11	_	_	(7.9)	(7.9)
Balance at 31 December 2005		18.0	229.4	16.1	263.5
Retained profits for the year		_	_	13.4	13.4
Foreign exchange translation differences		_	1.3	_	1.3
Dividends paid	11	_	_	(14.6)	(14.6)
Issue of shares	20, 21	0.1	0.2	-	0.3
Balance at 31 December 2006		18.1	230.9	14.9	263.9

Cash flow from operating activities   Profit before tax   Profit			2	006	2	005
Cash flow from operating activities   Robin before tax		Notes				
Profit before tax	Cash flow from operating activities					
Manoritisation of intangibles			86.8	14.4	16.1	23.6
Manoritisation of intangibles	Adjustments for non-cash items					
Common   C			1.4	_	0.3	_
Net fair value losses/(gains) on financial assets   8,8   0.8   3.0   0.7	Equity settled share based compensation		0.8	_	0.4	_
Depreciation of plant and equipment   1.2			, ,	_		_
Changes in operating assets and liabilities         129.2         -         635.9         -           Increase in insurance liabilities         (85.1)         -         69.9)         -           Increase in insurance receivables         (85.1)         2.9         (30.0)         (21.8)           Decrease/Increase) in other receivables         (26.2)         -         (14.4)         -           Decrease/Increase) in deferred acquisition costs         49.2         -         (296.2)         -           Increase in other payables         37.6         6.5         69.0         32.7           Increase in other payables         (10.0)         -         -         -				0.8	(3.0)	0.7
Increase in insurance   Insurance   Insurance   Insurance   Insurance   Insurance   Insurance receivables   (85.1)   - (69.9)   -	Depreciation of plant and equipment		1.2	_	_	_
Decrease in insurance receivables   18.51   -   669.9   -     Decrease/(Increase) in other receivables   13.9   22.9   (3.0)   (21.8)     Decrease/(Increase) in deferred acquisition costs   26.2   -   (14.4)   -     Decrease/(Increase) in reinsurance assets   49.2   -   (296.2)   -     Decrease/(Increase) in reinsurance assets   49.2   -   (296.2)   -     Decrease/(Increase) in reinsurance assets   49.2   -   (296.2)   -     Increase in other payables   37.6   6.5   69.0   32.7     Increase in other payables   (11.5)   (3.1)   (5.8)   (1.1)     Contribution to pension fund   (10.0)   -   (1.0)   -     Acquisition of own shares in trust   21   (4.0)   -   (1.6)   -     Net cash from operating activities   178.9   41.5   328.7   34.1     Durchase of plant and equipment   13   (5.7)   -   (2.5)   -     Purchase of syndicate capacity   12   (2.0)   -   (1.6)   -     Purchase of syndicate capacity   12   (2.0)   -   (1.6)   -     Purchase of investments   12   -   (3.6)   -     Purchase of investments   (2.12)   -   (5.1)   (1.0)   -     Purchase of investments   (2.12)   (41.2)   (1.19.3)   211.1     Purchase of software development   12   (3.1)   -   (3.6)   -     Proceeds from sale of investments   1947.2   293.5   (1.20.2)   (205.7)     Capital injection in subsidiary   -   (3.6)   -   (2.6)     Net cash used in investing activities   (189.1)   (182.3)   (311.9)   (21.2)     Proceeds from issue of shares   0.4   0.4   -   -     Proceeds from issue of shares   0.4   0.4   -   -     Proceeds from issue of shares   0.4   0.4   -   -     Proceeds from issue of shares   0.4   0.4   -   -     Proceeds from issue of shares   0.4   0.4   -   -     Proceeds from issue of shares   0.4   0.4   -   -     Proceeds from issue of shares   0.4   0.4   -   -     Proceeds from issue of shares   0.4   0.4   -   -     Proceeds from issue of shares   0.4   0.4   -   -     Proceeds from issue of shares   0.5   0.5   0.5     Proceeds from issue of shares   0.5   0.5   0.5     Proceeds from issue of shares   0.5   0.5   0.5     Proce						
Decrease/(Increase) in other receivables   13.9   22.9   3.0   (21.8)   Increase in deferred acquisition costs   (26.2)   - (14.4)   - (296.2)   - (	Increase in insurance liabilities			_		_
Increase in deferred acquisition costs   1,26,2   - (14,4)   - 1,25,2   - (296,2)   - (2						_
Decrease/(Increase) in reinsurance assets					, ,	(21.8)
Note as a in other payables   37.6   6.5   69.0   32.7     Income tax paid   (11.5   (3.1)   (5.8)   (1.1)     Contribution to pension fund   (1.0)   - (1.0)   - (1.0)     Acquisition of own shares in trust   21   (4.0)   - (1.6)   - (1.6)     Net cash from operating activities   178.9   41.5   328.7     Salar	•				, ,	_
Contribution to pension fund						32 7
Contribution to pension fund Acquisition of own shares in trust         (1.0)         -         (1.0)         -           Acquisition of own shares in trust         21         (4.0)         -         (1.6)         -           Net cash from operating activities         178.9         41.5         328.7         34.1           Cash flow from investing activities         8         8         8         9         41.5         328.7         34.1           Purchase of plant and equipment         13         (5.7)         -         (2.5)         -         -           Purchase of syndicate capacity         12         (0.2)         -         (1.6)         -         -           Acquisition of subsidiary (net of cash acquired)         (2.22)         -         -         -         -         -           Purchase of investments         12         (2.125.1)         (412.4)         (1.410.3)         211.1         -						
Net cash from operating activities         178.9         41.5         328.7         34.1           Cash flow from investing activities	Contribution to pension fund				(1.0)	
Cash flow from investing activities           Purchase of plant and equipment         13         (5.7)         -         (2.5)         -           Purchase of syndicate capacity         12         (0.2)         -         (1.6)         -           Acquisition of subsidiary (net of cash acquired)         (2.22)         -         -         -           Purchase of licences         12         -         -         (5.1)         -           Purchase of investments         (2,125.1)         (412.4)         (1,419.3)         211.1           Purchase of investments         1,947.2         293.5         1,120.2         (205.7)           Capital injection in subsidiary         -         (33.4)         -         (26.6)           Net cash used in investing activities         (189.1)         (152.3)         (311.9)         (21.2)           Cash flow from financing activities         (189.1)         (152.3)         (311.9)         (21.2)           Cash flow from financing activities         189.1)         (152.3)         (311.9)         (21.2)           Cash flow from financing activities         189.1)         (152.3)         (311.9)         (21.2)           Proceeds from Tier 2 subordinated debt         148.1         148.1         148.1	Acquisition of own shares in trust	21	(4.0)	-	(1.6)	_
Purchase of plant and equipment         13         (5.7)         — (2.5)         —           Purchase of syndicate capacity         12         (0.2)         — (1.6)         —           Acquisition of subsidiary (net of cash acquired)         (2.2)         — — — (5.1)         —           Purchase of licences         12         — — — (5.1)         —           Purchase of investments         (2,125.1)         (412.4)         (1,419.3)         211.1           Purchase of software development         12         (3.1)         — — (3.6)         —           Proceeds from sale of investments         1,947.2         293.5         1,120.2         (205.7)           Capital injection in subsidiary         — — (33.4)         — — (26.6)           Net cash used in investing activities         (189.1)         (152.3)         (311.9)         (21.2)           Cash flow from financing activities         — — — — — — — — — — — — — — — — — — —	Net cash from operating activities		178.9	41.5	328.7	34.1
Purchase of syndicate capacity   12   (0.2)   - (1.6)   - Acquisition of subsidiary (net of cash acquired)   (2.2)   -   -   -   -   -   -   -   -   -	Cash flow from investing activities					
Acquisition of subsidiary (net of cash acquired)  Purchase of licences  12				_		_
Purchase of licences         12         -         -         (5.1)         -           Purchase of investments         (2,125.1)         (412.4)         (1,419.3)         211.1           Purchase of software development         12         (3.1)         -         (3.6)         -           Proceeds from sale of investments         1,947.2         293.5         1,120.2         (205.7)           Capital injection in subsidiary         -         (33.4)         -         (26.6)           Net cash used in investing activities         (189.1)         (152.3)         (311.9)         (21.2)           Cash flow from financing activities         0.4         0.4         -         -         -           Proceeds from issue of shares         0.4         0.4         -         -         -         -           Repayment of syndicated loan         (18.6)         - </td <td>·</td> <td>12</td> <td></td> <td>_</td> <td></td> <td>_</td>	·	12		_		_
Purchase of investments         (2,125.1)         (412.4)         (1,419.3)         211.1           Purchase of software development         12         (3.1)         -         (3.6)         -           Proceeds from sale of investments         1,947.2         293.5         1,120.2         (205.7)           Capital injection in subsidiary         -         (33.4)         -         (26.6)           Net cash used in investing activities         (189.1)         (152.3)         (311.9)         (21.2)           Cash flow from financing activities         0.4         0.4         -         -         -           Proceeds from issue of shares         0.4         0.4         -         -         -         -           Repayment of syndicated loan         (18.6)         -		40	(2.2)	_		_
Purchase of software development         12         (3.1)         —         (3.6)         —           Proceeds from sale of investments         1,947.2         293.5         1,120.2         (205.7)           Capital injection in subsidiary         —         (33.4)         —         (26.6)           Net cash used in investing activities         (189.1)         (152.3)         (311.9)         (21.2)           Cash flow from financing activities         0.4         0.4         —         —         —           Proceeds from issue of shares         0.4         0.4         —         —         —         —           Repayment of syndicated loan         (18.6)         — <td< td=""><td></td><td>12</td><td>(2 125 1)</td><td>(412 4)</td><td>, ,</td><td>- 211 1</td></td<>		12	(2 125 1)	(412 4)	, ,	- 211 1
Proceeds from sale of investments         1,947.2         293.5         1,120.2         (205.7)           Capital injection in subsidiary         -         (33.4)         -         (26.6)           Net cash used in investing activities         (189.1)         (152.3)         (311.9)         (21.2)           Cash flow from financing activities         0.4         0.4         -         -         -           Proceeds from issue of shares         0.4         0.4         -         -         -         -           Repayment of syndicated loan         (18.6)         -		12	. ,	(412.4)		
Capital injection in subsidiary         -         (33.4)         -         (26.6)           Net cash used in investing activities         (189.1)         (152.3)         (311.9)         (21.2)           Cash flow from financing activities         Proceeds from issue of shares         0.4         0.4         -         -         -           Repayment of syndicated loan         (18.6)         -         <		12		293.5		(205.7)
Cash flow from financing activities Proceeds from issue of shares Repayment of syndicated loan Proceeds from Tier 2 subordinated debt 148.1 148.1 18.6 - Dividends paid 11 (14.6) (14.6) (7.9) (7.9)  Net cash used in financing activities 115.3 133.9 10.7  Net increase in cash and cash equivalents 105.1 23.1 27.5 5.0  Cash and cash equivalents at beginning of year Effect of exchange rate changes on cash and cash equivalents (8.3) - 3.6 -	Capital injection in subsidiary		_		_	. ,
Proceeds from issue of shares Repayment of syndicated loan Repayment of sy	Net cash used in investing activities		(189.1)	(152.3)	(311.9)	(21.2)
Proceeds from issue of shares Repayment of syndicated loan Repayment of sy	Cash flow from financing activities					
Proceeds from Tier 2 subordinated debt Dividends paid  11 (14.6) (14.6) (7.9) (7.9)  Net cash used in financing activities  115.3 133.9 10.7 (7.9)  Net increase in cash and cash equivalents  105.1 23.1 27.5 5.0  Cash and cash equivalents at beginning of year  Effect of exchange rate changes on cash and cash equivalents  (8.3) - 3.6 -	•		0.4	0.4	_	_
Dividends paid         11         (14.6)         (14.6)         (7.9)         (7.9)           Net cash used in financing activities         115.3         133.9         10.7         (7.9)           Net increase in cash and cash equivalents         105.1         23.1         27.5         5.0           Cash and cash equivalents at beginning of year         112.6         6.7         81.5         1.7           Effect of exchange rate changes on cash and cash equivalents         (8.3)         -         3.6         -	Repayment of syndicated loan		(18.6)	_	_	_
Net cash used in financing activities115.3133.910.7(7.9)Net increase in cash and cash equivalents105.123.127.55.0Cash and cash equivalents at beginning of year112.66.781.51.7Effect of exchange rate changes on cash and cash equivalents(8.3)-3.6-						_
Net increase in cash and cash equivalents  105.1  23.1  27.5  5.0  Cash and cash equivalents at beginning of year  Effect of exchange rate changes on cash and cash equivalents  (8.3)  -  3.6  -	Dividends paid	11	(14.6)	(14.6)	(7.9)	(7.9)
Cash and cash equivalents at beginning of year  Effect of exchange rate changes on cash and cash equivalents  112.6 (8.3)  - 3.6  -	Net cash used in financing activities		115.3	133.9	10.7	(7.9)
Effect of exchange rate changes on cash and cash equivalents (8.3) – 3.6 –	Net increase in cash and cash equivalents		105.1	23.1	27.5	5.0
Effect of exchange rate changes on cash and cash equivalents (8.3) – 3.6 –	Cash and cash equivalents at beginning of year		112.6	6.7	81.5	1.7
Cash and cash equivalents at end of year 19 209.4 29.8 112.6 6.7						
	Cash and cash equivalents at end of year	19	209.4	29.8	112.6	6.7

## 1 Statement of accounting policies

Beazley Group plc is a group domiciled in England and Wales. The consolidated financial statements of the group for the year ended 31 December 2006 comprise the parent company and its subsidiaries and the group's interest in associates.

Both the parent company financial statements and the group financial statements have been prepared and approved by the directors in accordance with IFRSs as adopted by the EU ("adopted IFRSs"). On publishing the parent company financial statements here together with the group financial statements, the company is taking advantage of the exemption in \$230 of the Companies Act 1985 not to present its individual income statement and related notes that form a part of these approved financial statements.

These consolidated financial statements have been prepared on the basis of adopted IFRSs in issue that are effective or available for early adoption at 31 December 2006. Based on these adopted IFRSs, the directors have applied the accounting policies, as set out below.

In preparing these consolidated financial statements, the group and the parent company have adopted IFRS 7 "Financial Instruments: Disclosures" and IAS 1 "Presentation of Financial Statements – Capital Disclosures" prior to their required application date of 1 January 2007. The group and the parent company have also adopted the amendments to IAS 19 "Employee Benefits", in relation to defined benefit plans and the amendment to IAS 39 "The Fair Value Option".

The adoption of IFRS 7 and the amendments to IAS 1 and IAS 19 impacted the type and amount of disclosures made in these financial statements, but had no impact on the reported profits or financial position of the group or the parent company. In accordance with the transitional requirements of the standards, the group and the parent company have provided full comparative information.

The fair value option in IAS 39 has been used to eliminate measurement or recognition inconsistency that would result from measuring assets or liabilities or recognising gains or losses on them on different bases.

The principal accounting policies applied in the preparation of these financial statements are set out below. The policies have been consistently applied to all periods presented unless otherwise stated.

### Basis of presentation

These financial statements are prepared using the historical cost convention except that financial instruments are stated at their fair value. All amounts presented are stated in sterling and millions, unless noted otherwise.

### Use of estimates

The preparation of the financial statements in conformity with IFRSs requires the group to make certain critical estimates and assumptions. Although these estimates are based on management's best knowledge of current facts, circumstances and to some extent future events and actions, actual results ultimately may differ from those estimates, possibly significantly.

## Consolidation

### Subsidiary undertakings

Subsidiary undertakings, which are those entities in which the group, directly or indirectly, has the power to exercise control over financial and operating policies, have been consolidated. They are consolidated from the date on which control is transferred to the group and cease to be consolidated from the date on which control ceases.

The group has used the purchase method of accounting for the acquisition of subsidiaries. Under purchase accounting, the cost of acquisition is measured as the fair value of assets given, shares issued or liabilities undertaken at the date of acquisition plus costs directly attributable to the acquisition. The excess of the cost of an acquisition over the fair value of the net assets of the subsidiary acquired is recorded as goodwill.

Certain group subsidiaries underwrite as corporate members of Lloyd's on a syndicate managed by Beazley Furlonge Limited. In view of the several liability of underwriting members at Lloyd's for the transactions of syndicates in which they participate, only attributable share of transactions, assets and liabilities of that syndicate has been included in the financial statements.

### Associates

Associates are those entities in which the group has power to exert significant influence, which it does not control. Significant influence is generally presumed if the group has between 20% and 50% of voting rights.

Investments in associates are accounted for using the equity method of accounting. Under this method, the group's share of post-acquisition profits or losses is recognised in the income statement and its share of post-acquisition movements are recognised in reserves. The cumulative post-acquisition movements are adjusted against the cost of the investment.

When the group's share of loss equals or exceeds the carrying amount of the associate, the carrying amount is reduced to nil and recognition for the loss is discontinued except to the extent that the group has incurred obligations in respect of the associate.

Equity accounting is discontinued when the group no longer has significant influence over the investment.

### Intercompany balances and transactions

All intercompany transactions, balances and unrealised gains or losses on transactions between group companies have been eliminated.

All accounting policies have been consistently applied throughout the group.

### Foreign currency translation

### Functional and presentation currency

Items included in the financial statements of the parent and the subsidiaries are measured using the currency of the primary economic environment in which it operates (the "functional currency"). The consolidated financial statements are presented in sterling, which is the group's presentation currency.

### Transactions and balances

Foreign currency transactions are translated into the functional currency using average exchange rates applicable to this period and which the group considers to be a reasonable approximation of the historic rate. Foreign exchange gains and losses resulting from the settlement of such transactions and from translation at the period end of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement. Non-monetary items recorded at historical cost in foreign currencies are translated using the exchange rate on the date of the initial transaction.

### Group companies

The results and financial position of the group companies that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- Assets and liabilities are translated at the closing rate ruling at the balance sheet date;
- Income and expenses for each income statement are translated at average exchange rates for the reporting period; and
- All resulting exchange differences are recognised as a separate component of equity.

The exchange differences on disposal of foreign entities are recognised in the income statement as part of the gain or loss on disposal.

Insurance contracts (including inwards reinsurance contracts) are defined as those containing significant insurance risk. Insurance risk is considered significant if, and only if, an insured event could cause an insurer to pay significant additional benefits in any scenario, excluding scenarios that lack commercial substance.

Such contracts remain insurance contracts until all rights and obligations are extinguished or expire.

### Net earned premiums

### Premiums

Gross premiums written represent premiums on business commencing in the financial year together with adjustments to premiums written in previous accounting periods and estimates for premiums from contracts entered into during the course of the year. Gross premiums written are stated before deduction of brokerage, taxes, duties levied on premiums and other deductions.

A provision for unearned premiums (gross of reinsurance) represents that part of the gross premiums written that is estimated will be earned in the following financial periods. It is calculated using the daily pro-rata method where the premium is apportioned over the period of risk.

## Deferred acquisition costs (DAC)

Acquisition costs comprise brokerage, premium levy and staff-related costs of the underwriters acquiring new business and renewing existing contracts. The proportion of acquisition costs in respect of unearned premiums is deferred at balance sheet date and recognised in later periods when the related premiums are earned.

These include the cost of claims and claims handling expenses paid during the period, together with the movements in provisions for outstanding claims, claims incurred but not reported (IBNR) and claims handling provisions. The provision for claims comprises amounts set aside for claims advised and IBNR.

The IBNR amount is based on estimates calculated using widely accepted actuarial techniques which are reviewed quarterly by the group actuary and annually by Beazley's independent syndicate reporting actuary. The techniques generally use projections, based on past experience of the development of claims over time, to form a view on the likely ultimate claims to be experienced. For more recent underwriting years, regard is given to the variations in the business portfolio accepted and the underlying terms and conditions. Thus, the critical assumptions used when estimating provisions are that past experience is a reasonable predictor of likely future claims development and that the rating and business portfolio assumptions are a fair reflection of the likely level of ultimate claims to be incurred for the more recent years.

### Liability adequacy testing

At each balance sheet date, liability adequacy tests are performed to ensure the adequacy of the claims liabilities net of DAC. In performing these tests, current best estimates of future contractual cash flows, claims handling and administration expenses as well as investment income from the assets backing such liabilities are used. Any deficiency is immediately charged to the income statement initially by writing off DAC and by subsequently establishing a provision for losses arising from liability adequacy test ("unexpired risk provision").

### Reinsurance

These are contracts entered into by the group with reinsurers under which the group is compensated for losses on contracts issued by the group and that meet the definition of an insurance contract. Insurance contracts entered into by the group under which the contract holder is another insurer (inwards reinsurance) are included with insurance contracts.

Any benefits to which the group is entitled under its reinsurance contracts held are recognised as reinsurance assets. These assets consist of balances due from reinsurers and include reinsurers' share of provisions for claims. These balances are based on calculated 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 period and the current security rating of the reinsurer involved. Reinsurance liabilities are primarily premiums payable for reinsurance contracts and are recognised as an expense when due.

The group assesses its reinsurance assets for impairment. If there is objective evidence of impairment, then the carrying amount is reduced to its recoverable amount and the impairment loss is recognised in the income statement.

### Revenue

Revenue consists of net earned premium, net investment income, profit commissions earned and managing agent's fees.

Profit commissions and managing agent's fees are recognised as the services are provided.

### Dividends paid

Dividend distribution to the shareholders of the group is recognised in the period in which the dividends are approved by the shareholders in the group's annual general meeting. Interim dividends are recognised in the period in which they are paid and approved by the board of directors.

### Plant and equipment

All fixed assets are recorded at cost less accumulated depreciation. Depreciation is calculated using the straight-line method to allocate the cost of the assets to their residual values over their estimated useful lives as follows:

Fixtures and fittings Three to five years Computer equipment Three years.

These assets' residual value and useful lives are reviewed at each balance sheet date and adjusted if appropriate.

## Intangible assets

### Goodwil

Goodwill represents the excess of the cost of an acquisition over the fair value of the group's share of the net assets of the acquired subsidiary/associate at the date of acquisition. Goodwill is carried at cost less accumulated impairment losses.

Goodwill has an indefinite life and is annually tested for impairment. Goodwill is allocated to each cash generating unit for the purpose of impairment testing. Goodwill is impaired when the net present value of the forecast future cash flows is insufficient to support its carrying value.

## Licences

Licences are shown at historical cost. They have an indefinite useful life and are carried at cost less accumulated impairment. Licences are annually tested for impairment and provision is made for any impairment when the net present value of future cash flows is less than the carrying value.

### Syndicate capacity

The syndicate capacity represents the cost of purchasing the group's participation in syndicate 2623. The capacity is capitalised at cost in the balance sheet. It has an indefinite useful life and is carried at cost less accumulated impairment. It is annually tested for impairment and provision is made for any impairment.

### Computer software

Costs that are directly associated with the development of identifiable and unique software products and that will probably generate economic benefits exceeding costs beyond one year, are recognised as intangible assets. Costs include external consultants' fees, certain qualifying internal staff costs and other costs incurred to develop software programs. These costs are amortised over their estimated useful life (three years). Other non-qualifying costs have been expensed as incurred.

### Financial instruments

Financial instruments are recognised in the balance sheet at such time that the group becomes a party to the contractual provisions of the financial instrument. A financial asset is derecognised when the contractual rights to receive cash flows from the financial assets expire, or where the financial assets have been transferred, together with substantially all the risks and rewards of ownership. Financial liabilities are derecognised if the group's obligations specified in the contract expire, are discharged or cancelled.

Purchases and sales of financial assets are recognised on the trade date, which is the date the group commits to purchase or sell the asset.

### Financial assets

On acquisition of a financial asset, the group is required to classify the asset into the following categories: financial assets at fair value through profit or loss, loans and receivables, held to maturity and available for sale. The group does not make use of the held to maturity and available for sale classifications.

### Financial assets at fair value through profit or loss

This category has two sub-categories: financial assets held for trading and those designated at fair value through profit or loss at inception.

Trading assets are those assets which are acquired principally for the purpose of selling in the short term, or which are held as part of a portfolio in which there is evidence of short-term profit taking or if it is designated so by management. Derivatives are classified as held for trading unless they are designated as hedges.

A financial asset is designated as fair value through profit or loss upon initial recognition if it is managed and its performance is evaluated on a fair value basis. Information about these financial assets is provided internally on a fair value basis to the group's key management. The group's investment strategy is to invest and evaluate their performance with reference to their fair values.

Upon initial recognition, attributable transaction costs are recognised in the income statement when incurred. Financial assets at fair value through profit or loss are measured at fair value, and changes therein are recognised in profit or loss. Net changes in the fair value of financial assets at fair value through profit or loss exclude interest and dividend income.

The fair values of these assets are based on quoted bid price.

## Insurance receivables and payables

Insurance receivables and payables are recognised when due. These include amounts due to and from agents, brokers and insurance contract holders. These are classified as "loans and receivables" as they are non-derivative financial assets with fixed or determinable payments that are not quoted on an active market. Insurance receivables are measured at amortised cost less any provision for impairments.

### Other receivables

Other receivables principally consist of prepayments, accrued income and sundry debtors and are carried at amortised cost.

### Investment income

Investment income consists of dividends, interest, realised and unrealised gains and losses on financial assets at fair value through profit or loss. Dividends on equity securities are recorded as revenue on the ex-dividend date. Interest is recognised on an accruals basis for financial assets at fair value through profit or loss. Realised gain or loss on disposal of an investment is the difference between the proceeds and the carrying value of the investment. Unrealised investment gains and losses represent the difference between the carrying value at the balance sheet date, and the carrying value at the previous period end or purchase value during the period.

### Borrowings

Borrowings are initially recorded at fair value less transaction costs incurred. Subsequently borrowings are stated at amortised cost and interest is recognised in the income statement over the period of the borrowings using the effective interest method.

Finance costs comprise interest payable, fees paid for the arrangement of debt and letter of credit facility and commissions charged for the utilisation of letters of credit. These costs are incurred on borrowings on initial recognition and they are recognised in the income statements using an effective interest method.

## Other payables

Other payables are stated at amortised cost.

### Hedge accounting and derivative financial instruments

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at their fair value. The method of recognising the resulting fair value gains or losses depends on whether the derivative is designated as a hedging instrument and, if so, the nature of the item being hedged. Fair values are obtained from quoted market prices in active markets, recent market transactions, and valuation techniques which include discounted cash flow models. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

The best evidence of fair value of a derivative at initial recognition is the transaction price.

The group designates certain derivatives as cash flow hedges or net investment hedges.

The group documents at the inception of the transaction the relationship between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedging transactions. The group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are being used in hedging transactions are expected to be and have been highly effective in offsetting changes in fair values or cash flows of hedged items.

### Cash flow hedges

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in equity. The gain or loss relating to any ineffective portion is recognised immediately in the income statement within "net fair value gains/(losses) on derivative financial instruments".

If the derivative expires or is sold, terminated, exercised, or no longer meets the criteria for cash flow hedge accounting, or the designation is revoked, then hedge accounting is discontinued and the amount recognised in equity remains in equity until the forecast transaction affects profit or loss. If the forecast transaction is no longer expected to occur, then the hedge accounting is discontinued and the balance in equity is recognised immediately in the income statement.

### Fair value hedges

When a derivative is designated as a hedge of the change in fair value of a recognised asset or liability or a firm commitment, changes in the fair value of the derivative are recognised immediately in the income statement together with the changes in the fair value of the hedged item that are attributable to the hedged risk.

If the derivative expires or is sold, terminated, exercised, or no longer meets the criteria for fair value hedge accounting, or the designation is revoked, hedge accounting is discontinued. Any adjustment up to that point, to a hedged item for which the effective interest method is used, is amortised to profit or loss as part of the recalculated effective interest rate of the item over its remaining life.

### Net investment hedges

Hedges of net investments in foreign operations are accounted for similarly to cash flow hedges. Any gain or loss on the hedging instrument relating to the effective portion of the hedge is recognised in equity; the gain or loss relating to the ineffective portion is recognised immediately in the income statement within "net fair value gains/(losses) on financial investments" through profit or loss.

Gains and losses accumulated in equity are included in the income statement on disposal of the foreign operation.

### Impairment of assets

The group assesses at each balance sheet date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the assets and that event has an impact on the estimated cash flows of the financial asset or group of financial assets that can be reliably estimated.

If there is objective evidence that impairment exists, the amount of the loss is measured as the difference between the asset's carrying amount and the value of the estimated future cash flows. The amount of the loss is recognised in the income statement.

## Cash and cash equivalents

Cash and cash equivalents consist of cash at bank and in hand, deposits held at call with banks, bank overdrafts and other short-term highly liquid investments with maturities of three months or less from the date of acquisition.

### Operating leases

Leases where a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made for operating leases are charged to the income statement on a straight-line basis over the period of the lease.

# Employee benefits

### Annual leave and long service leave

Employee entitlements to annual leave and long service leave are recognised when they accrue to employees.

### Pension obligations

The group operates a defined benefit pension plan that is now closed to future service accruals. The scheme is generally funded by payments from the group taking account of the recommendations of an independent qualified actuary. All employees now participate in a defined contribution pension plan funded by the group.

A defined benefit plan is a pension plan that defines an amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors like age, years of service and compensation. The pension costs are assessed using the projected unit credit method. Under this method the costs of providing pensions are charged to the income statement so as to spread the regular costs over the service lives of employees in accordance with the advice of the qualified actuary, who values the plans annually. The pension obligation is measured at present value of the estimated future cash flows. The actuarial gains or losses are recognised in the profit or loss using the corridor approach over the average remaining service lives of employees.

The corridor approach is defined as the excess of net cumulative unrecognised gains and losses at the end of the previous reporting period and the greater of:

- 10% of present value of the defined benefit obligation at that date; and
- 10% of fair value of plan assets at that date.

For the defined contribution plan, the group pays contributions to a privately administered pension plan. Once the contributions have been paid, the group has no further obligations. The group's contributions are charged to the income statement in the period to which they relate.

### Share-hased compensation

The group offers option plans over the group's ordinary shares to certain employees, including the SAYE scheme, details of which are included in the directors' remuneration report.

The group accounts for share compensation plans that were granted after 7 November 2002. The cost of providing share-based compensation is based on the fair value of the share options at grant date, which is recognised in the income statement over the expected service period of the related employees and a corresponding entry in reserves. The fair value of the share options is determined using the Black Scholes method.

When the options are exercised, the proceeds received, net of any transaction costs, are credited to share capital (nominal value) and share premium.

### Income taxes

Income tax on the profit or loss for the period presented comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the year using tax rates enacted or substantively enacted at balance sheet date and any adjustments to tax payable in respect of prior periods.

Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liability and their carrying amounts in the financial statements. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of the assets and liabilities, using tax rates enacted or substantively enacted at balance sheet date.

Deferred tax assets are recognised in the balance sheet to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

## Earnings per share

Basic earnings per share are calculated by dividing profit after tax available to shareholders by the weighted average number of ordinary shares in issue during the period.

For diluted earnings per share, the weighted average number of ordinary shares in issue is adjusted to assume conversion of all dilutive potential ordinary shares such as share options granted to employees.

The shares held in the employee share options plan (ESOP) have been excluded from both the calculations until such time as they vest unconditionally with the employees.

## Provisions and contingencies

Provisions are recognised when the group has a present legal or constructive obligation as a result of a past event, it is probable that an outflow of resources of economic benefits will be required to settle the obligation and a reliable estimate of the obligation can be made. Where the group expects a provision to be reimbursed, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain.

Contingent liabilities are present obligations that are not recognised because it is not probable that an outflow of resources will be required to meet the liabilities or if the amount of the obligation cannot be measured with sufficient reliability.

### 2 Risk management

The group has identified the risks arising from its activities and has established policies and procedures to manage these items in accordance with its risk appetite. The group categorises its risks into six areas: insurance, credit, liquidity, market, operational and group risk. The sections below outline the group's risk appetite and explain how it defines and manages each category of risk.

### Insurance risk

The group's insurance business assumes the risk of loss from persons or organisations that are directly exposed to an underlying loss. Insurance risk arises from this risk transfer due to inherent uncertainties about the occurrence, amount and timing of insurance liabilities. The four key components of insurance risk are underwriting, reinsurance, claims management, reserving and ultimate reserves. Each element is considered below.

## Underwriting risk

Underwriting risk comprises four elements that apply to all insurance products offered by the group:

- Event risk the risk that individual risk losses or catastrophes lead to claims that are higher than anticipated in plans and pricing;
- Pricing risk the risk that the level of expected loss is understated in the pricing process;
- Cycle risk the risk that business is written in a soft market without full knowledge as to the (in)adequacy of rates, terms and conditions;
- Expense risk the risk that the allowance for expenses and inflation in pricing is inadequate.

The group's underwriting strategy is to seek a diverse and balanced portfolio of risks in order to limit the variability of outcomes. This is achieved by accepting a spread of business over time, segmented between different classes of business.

The annual business plans for each underwriting team reflect the group's underwriting strategy, and set out the classes of business, the territories in which business is to be written and the industry sectors to which the group is prepared to expose itself. These plans are approved by the board and monitored by the monthly underwriting committee.

Our underwriters calculate premiums for risks written based on a range of criteria tailored specifically to each individual risk. These factors include but are not limited to the financial exposure, loss history, risk characteristics, limits, deductibles, terms and conditions and acquisition expenses.

The group also recognises that insurance events are, by their nature, random, and the actual number and size of events during any one year may vary from those estimated using established statistical techniques.

To address this, the group sets out the exposure that it is prepared to accept in certain territories to a range of events such as natural catastrophes and specific scenarios which may result in large industry losses. This is monitored through regular calculation of realistic disaster scenarios (RDS). The aggregate position is monitored at the time of underwriting a risk, and reports are regularly produced to highlight the key aggregations to which the group is exposed.

The group uses a number of modelling tools to monitor aggregation and to simulate catastrophe losses in order to measure the effectiveness of its reinsurance programmes. Stress and scenario tests are also run using these models. The range of scenarios considered include natural catastrophes, marine, liability, political, terrorism and war events.

The greatest likelihood of significant losses to the group arises from natural catastrophe events, such as flood damage, windstorm or earthquake. Where possible the group measures geographic accumulations and uses its knowledge of the business, historical loss behaviour and commercial catastrophe modelling software to assess the probable maximum loss (PML). Upon application of the reinsurance coverage purchased, the key gross and net exposures are calculated on the basis of a 1 in 250 year event.

The group's high level catastrophe risk appetite is set by the board and the business plans of each team are determined within these parameters. The board may adjust these limits during the course of the year as conditions change. Currently, the group operates to catastrophe risk appetite for a 1 in 250 modelled event of 20% of underwriting capacity.

Lloyd's has defined its own specific set of RDS events for which all syndicates with relevant exposures must report. The group's three largest Lloyd's specified natural catastrophe 1 in 250 year stress events are:

	2006		2005	
	Modelled PML	Modelled PML	Modelled PML	Modelled PML
	(before	(after	(before	(after
	reinsurance)	reinsurance)	reinsurance)	reinsurance)
LLoyd's prescribed natural catastrophe event	US \$m	US \$m	US \$m	US \$m
San Francisco quake (US \$65bn, 2005: US \$54bn)	384.4	161.4	361.7	133.6
Gulf of Mexico windstorm (US \$100bn, 2005: US \$60bn)	336.3	149.9	306.5	102.3
Florida Pinellas windstorm (US \$100bn, 2005: US \$70bn)	331.8	190.1	324.7	175.6

The group has developed limits of authority and business plans which are binding upon all staff authorised to underwrite and are specific to underwriters, classes of business and industry. In 2006, the normal maximum gross PML line that any one underwriter could commit the managed syndicate to was US \$50m. In most cases, maximum lines for classes of business were much lower than this.

These authority limits are enforced through a comprehensive sign-off process for underwriting transactions including dual sign-off for all line underwriters. Exception reports are also run regularly to monitor compliance.

All underwriters also have a right to refuse renewal or change the terms and conditions of insurance contracts upon renewal. Rate monitoring details, including limits, deductibles, exposures, terms and conditions and risk characteristics are also captured and the results are combined to monitor the rating environment for each class of business.

A proportion of the group's insurance risks is written by third parties under delegated underwriting authorities. Each third party is thoroughly vetted by our coverholder approval group before we transact with them, and is subject to rigorous monitoring to maintain underwriting quality and ensure ongoing compliance with contractual guidelines.

### Terms and conditions of insurance risks

The group's business is structured as a confederation of four independent business segments utilising the same capital base and central services. The group has recognised risk features specific to the main insurance products offered by the group, and these are explained below.

### Specialty lines

This segment mainly underwrites professional lines, employment practices liability, specialty liability, political risk, directors' and officers' liability, healthcare, stand-alone terrorism and contingency. Whilst most of this business is domiciled in the US, the team also has a presence in the UK, continental Europe and the Far East.

The liability insurance which is written on a worldwide basis is considered medium tail because claims in this class typically take three to nine years before they are fully assessed and paid by the group for a given accident year. The speed of claim reporting and claim settlement is a function of the specific coverage provided, the jurisdiction and any policy provisions applied such as self-insured retentions. Other inherent uncertainties encountered through this class include:

- Whether the "event" triggering coverage is confined to only one time period or is spread over multiple time periods;
- The potential financial costs arising from individual claim actions;
- Whether such claims were reasonably foreseeable and intended to be covered at the time the contracts were written; and
- The potential for mass claim actions.

### Property

Our property segment underwrites commercial, high-value homeowners and engineering property insurance on a worldwide basis. Property insurance indemnifies, subject to any limits or excesses, the policyholder against loss or damage to their own material property and business interruption arising from this damage. The event giving rise to a claim for damage to buildings or contents usually occurs suddenly (as for fire and burglary) and the cause is easily determinable. The claim will thus be notified promptly and can be settled without delay (an exception to this is subsidence claims).

Significant geographical concentrations of risk can exist within property portfolios meaning that natural perils such as adverse windstorms or earthquakes may expose large segments of the group's property risks. In the event of an earthquake, the property portfolio expects to receive claims for both structural damage and business interruption.

### Reinsurance

This division specialises in writing property catastrophe, property per risk, aggregate excess of loss and pro-rata business.

The two primary risks in this business are:

- The risk that a catastrophe event does or does not occur; and
- That future catastrophe experience may turn out to be inconsistent with the assumptions used in the industry-wide pricing models, causing claims experience to be higher than expected.

### Marine

This segment underwrites a broad spectrum of marine classes. Specialist cover includes hull, energy, cargo & specie and war risks, and the majority of these risks are exposed to catastrophes. For example, a significant portion of the energy business is exposed to the Gulf of Mexico and thus has substantial hurricane exposure.

Some areas of the marine business overlap with other segments which can result in loss accumulations. These accumulations, including exposures to catastrophes, are regularly monitored and managed by our reinsurance programmes.

### Reinsurance risk

Reinsurance risk to the group arises where reinsurance contracts put in place to reduce gross insurance risk do not perform as anticipated, result in coverage disputes or prove inadequate in terms of the vertical or horizontal limits purchased. Failure of a reinsurer to pay a valid claim is considered a credit risk which is detailed separately below.

The group's reinsurance programmes are determined from the underwriting team business plans and seek to protect group capital from an adverse volume or volatility of claims on both per risk and per event basis. In some cases the group deems it more economic to hold capital than purchase reinsurance. This is regularly reviewed as an integral part of the business planning and performance monitoring process.

In 2006, the group bought a combination of proportional and non-proportional reinsurance treaties and facultative reinsurance to reduce the maximum net exposure on any one risk for the managed syndicates to US \$25m. In most classes of business the maximum net exposure is much lower than this. The group aims to establish appropriate retention levels and limits of protection to achieve the target rate of return and remain within the board's risk tolerance limits. The efficacy of protection sought is assessed against the cost of reinsurance, taking into consideration current and expected market conditions.

The reinsurance security committee (RSC) examines and approves all reinsurers to ensure that they possess suitable security. The RSC also establishes limits for the reinsurance programme regarding quality and quantity. The group's ceded reinsurance team maintains the list of these approved reinsurers and no reinsurance is placed without prior referral from this team. This team also monitors erosion of the reinsurance programme and its ongoing adequacy.

### Claims management risk

Claims management risk may arise within the group in the event of inaccurate or incomplete case reserves and claims settlements, poor service quality or excessive claims handling costs. These risks may damage the group brand and undermine its ability to win and retain business or incur punitive damages. These risks can occur at any stage of the claims life-cycle.

The group's claims teams are focused on delivering quality, reliability and speed of service to both internal and external clients. Their aim is to adjust and process claims in a fair, efficient and timely manner, in accordance with the policy's terms and conditions, the regulatory environment, and the business' broader interests. Prompt and accurate case reserves are set for all known claims liabilities, including provisions for expenses.

### Reserving and ultimate reserves risk

Reserving and ultimate reserves risk occurs within the group where established insurance liabilities are insufficient through inaccurate forecasting, or where there is inadequate allowance for expenses and reinsurance bad debts in provisions.

To manage reserving and ultimate reserves risk, our experienced actuarial team uses a range of recognised techniques to project gross premiums written, monitor claims development patterns and stress test ultimate insurance liability balances. An external independent actuary also performs an annual review to produce a statement of actuarial opinion for reporting entities within the group.

The objective of the group's reserving policy is to produce accurate and reliable estimates that are consistent over time and across classes of business. The estimates of gross premiums written and claims prepared by the actuarial department are used through a formal quarterly peer review process to independently check the integrity of the estimates produced by the underwriting teams for each class of business. These meetings are attended by senior management, senior underwriters, actuarial, claims, and finance representatives.

### Credit risk

Credit risk arises where counterparties fail to meet their financial obligations in full as they fall due. The primary sources of credit risk for the group are:

- Reinsurers whereby reinsurers may fail to pay valid claims against a reinsurance contract held by the group;
- Brokers and intermediaries whereby counterparties fail to pass on premiums or claims collected or paid on behalf of the group; and
- Investments whereby issuer default results in the group losing all or part of the value of a financial instrument.

The group's core business is to accept significant insurance risk and the appetite for other risks is low. This protects the group's capital from erosion so that it can meet its insurance liabilities.

To assist in the understanding of credit risks, A.M. Best, Moody's and Standard & Poor's (S&P) ratings are used. These ratings have been categorised below as used for Lloyd's reporting:

	A.M. Best	Moody's	S&P
Tier 1	A++ to A-	Aaa to A3	AAA to A-
Tier 2	B++ to $B-$	Baa1 to Ba3	BBB+ to BB-
Tier 3	C++ to $C-$	B1 to Caa	B+ to CCC
Tier 4	D,E,F,S	Ca to C	R,(U,S) 3

The following tables summarise the group's significant concentrations of credit risk:

2006	Tier 1 £m	Tier 2 £m	Tier 3 £m	Unrated £m	Total £m
Financial investments	788.7	64.6	5.2	99.9	958.4
Insurance receivables	_	_	_	244.0	244.0
Reinsurance assets	319.9	5.0	_	20.4	345.3
Cash and cash equivalents	209.4	_	_	_	209.4
Total	1,318.0	69.6	5.2	364.3	1,757.1

	Tier 1	Tier 2	Tier 3	Unrated	Total
2005	£m	£m	£m	£m	£m
Financial investments	684.9	38.4	2.8	45.8	771.9
Insurance receivables	17.3	_	_	141.6	158.9
Reinsurance assets	347.3	1.9	_	45.3	394.5
Cash and cash equivalents	106.8	_	_	5.8	112.6
Total	1,156.3	40.3	2.8	238.5	1,437.9

The carrying amount of financial assets at the balance sheet date represents the maximum credit exposure.

The group has insurance receivables that are past due but not impaired at the reporting date. The group believes that impairment of these receivables is not appropriate on the basis of stage of collection of amounts owed. An aged analysis of insurance receivables that are past due but not impaired is presented below:

				Greater than		
Overdue debtors	Up to 30 days	30 - 60 days	60 - 90 days	90 days	Total	
2006	67%	15%	6%	12%	100%	
2005	77%	8%	3%	12%	100%	

This analysis excludes binder and treaty reinsurance receivables.

An analysis of the overall credit risk exposure indicates that the group has reinsurance assets, insurance receivables and other debtors that are impaired at the reporting date. Some reinsurance assets that are individually impaired at 31 December 2006 total £4.8m (2005; £5.2m).

These assets have been individually impaired after considering information such as the occurrence of significant changes in the counterparty's financial position, pattern of historical payment information and disputes with counterparties.

The group has developed processes to formally examine all reinsurers before entering into new business arrangements. New reinsurers are approved by the RSC, which also reviews arrangements with all existing reinsurers at least annually. Vulnerable or slow-paying reinsurers are examined more frequently.

An approval system also exists for all new brokers, and broker performance is regularly reviewed. Regular exception reports highlight trading with non-approved brokers, and the group's outsourced credit control function frequently monitors the ageing and collectibility of debtor balances. Any large, aged items are prioritised and the outsourced credit controllers have incentives for collecting these debts.

The investments committee has established guidelines for the group's investment managers regarding the type, duration and quality of investments acceptable to the group. The performance of investment managers is regularly reviewed to confirm adherence to these guidelines.

## Liquidity risk

Liquidity risk arises where cash may not be available to pay obligations when due at a reasonable cost. The group is exposed to daily calls on its available cash resources, principally from claims arising from its insurance business. In the majority of the cases, these claims are settled from the premiums received.

The group's approach is to manage its liquidity position so that it can reasonably survive a significant individual or market loss event. This means that the group maintains sufficient liquid assets, or assets that can be translated into liquid assets at short notice and without any significant capital loss, to meet expected cash flow requirements. These liquid funds are regularly monitored using cash flow forecasting to ensure that surplus funds are invested to achieve a higher rate of return.

The following is an analysis by business segment of the estimated timing of the net cash flows based on the claims liabilities balance held at 31 December 2006.

						weighted	
					average term		
	Within			Greater than		to settlement	
2006	1 year	2-3 years	4-5 years	5 years	Total	(years)	
Specialty lines	20%	40%	27%	13%	100%	2.7	
Property	<b>53</b> %	38%	<b>7</b> %	2%	100%	1.4	
Reinsurance	48%	40%	<b>12</b> %	_	100%	1.5	
Marine	41%	43%	<b>15</b> %	1%	100%	1.6	

	Within			Greater than		Weighted average term to settlement
2005	1 year	2-3 years	4-5 years	5 years	Total	(years)
Specialty lines	17%	38%	30%	15%	100%	3.0
Property	46%	45%	6%	3%	100%	1.4
Reinsurance	41%	43%	14%	2%	100%	1.6
Marine	41%	43%	15%	1%	100%	1.7

### Market risk

Market risk arises where the value of assets and liabilities changes as a result of movements in foreign exchange rates, interest rates and market prices.

### Foreign exchange risk

The group is exposed to changes in the value of assets and liabilities due to movements in foreign exchange rates. The group deals in four main currencies, US dollars, UK sterling, Canadian dollars and Euros. Transactions in all other currencies are converted to UK sterling on initial recognition.

The group manages foreign exchange exposure by projecting forward its US dollar profits for each calendar year and selling one-twelfth of the expected amount each month. The amounts sold are periodically validated against actual exposure and additional "top-up" trades of US dollars are made if required. The foreign exchange exposure to Canadian dollars and Euros are closely monitored by the group and a similar approach will be taken to manage the risk as our exposure grows in the future.

The group also has investment in foreign subsidiaries with functional currencies that are different from the presentational currency. This gives rise to an exposure to US dollars, Hong Kong dollars and Singapore dollars, although the exposures to Hong Kong dollars and Singapore dollars are minimal. The US dollar exposure is managed by borrowing funds denominated in the same currency.

The following table summarises the carrying value of total assets and total liabilities categorised by currency:

2006	US \$	CAD \$	Euro € £m	Subtotal £m	UK £ £m	Total £m
Total assets Total liabilities	1,035.8 (985.0)	49.1 (36.0)	85.8 (68.3)	1,170.7 (1,089.3)	713.5 (475.4)	1,884.2 (1,564.7)
Total	50.8	13.1	17.5	81.4	238.1	319.5
2005	US \$ £m	CAD \$	Euro € £m	Subtotal £m	UK £ £m	Total £m
Total assets Total liabilities	940.0 (928.3)	38.4 (32.8)	54.3 (46.0)	1,032.7 (1,007.1)	510.7 (255.9)	1,543.4 (1,263.0)
Total	11.7	5.6	8.3	25.6	254.8	280.4

The net assets have been stated net of the cross-currency swap as explained in note 25.

### Sensitivity analysis

If the US dollar, Canadian dollar and Euro weakened against UK sterling by 10%, with all other variables constant, pre-tax profit would have been lower by an estimated £12.4m (2005: £5.5m) and net assets would have decreased by an estimated £10.8m (2005: £5.0m). The analysis is based on the current information available and our assumptions in performing this analysis are:

- The closing year end spot rates and the average rates throughout the year were 10% higher;
- · No hedging of currency during the period;
- · The analysis includes an estimate of the impact on our foreign borrowings and cross currency swaps; and
- The impact of foreign exchange on non-monetary items will be nil.

### Interest rate risk

Some of the group's financial instruments, including financial investments, cash and cash equivalents and borrowings, are exposed to movements in market interest rates.

The group manages interest rate risk by investing in short duration financial investments and cash and cash equivalents. The investment committee monitors the duration of these assets on a regular basis.

The following table shows the average duration of the financial instruments. Duration is a commonly used measure of volatility and we believe gives a better indication than maturity of the likely sensitivity of our portfolio to changes in interest rates.

Duration	<1 yr	1-2 yrs	2-3 yrs	3-4 yrs	4-5 yrs	5-10 yrs	>10 yrs	Total
2006	£m	£m	£m	£m	£m	£m	£m	£m
Debt securities	568.0	190.8	69.1	26.2	12.6	0.7	_	867.4
Cash and cash equivalents	209.4	_	_	_	_	_	_	209.4
Derivative financial instruments	_	_	_	_	_	(2.4)	_	(2.4)
Borrowings	_	-	-	-	_	(145.7)	(9.2)	(154.9)
Total	777.4	190.8	69.1	26.2	12.6	(147.4)	(9.2)	919.5
Duration	<1 yr	1-2 yrs	2-3 yrs	3-4 yrs	4-5 yrs	5-10 yrs	>10 yrs	Total
2005	£m	£m	£m	£m	£m	£m	£m	£m
Debt securities	505.4	188.3	15.1	12.5	2.7	0.9	_	724.9
Cash and cash equivalents	112.6	_	_	_	_	_	_	112.6
Borrowings	_	_	(18.6)	_	_	_	(10.5)	(29.1)
Total	618.0	188.3	(3.5)	12.5	2.7	0.9	(10.5)	808.4

The next two tables summarise the carrying amount of financial instruments exposed to interest rate risk by maturity at balance sheet date.

Maturity	<1 yr	1-2 yrs	2-3 yrs	3-4 yrs	4-5 yrs	5-10 yrs	>10 yrs	Total
2006	£m	£m	£m	£m	£m	£m	£m	£m
Debt securities	522.1	229.3	61.8	27.1	23.4	1.1	2.6	867.4
Cash and cash equivalents	209.4	_	_	_	_	_	_	209.4
Derivative financial instruments	_	_	_	_	_	(2.4)	_	(2.4)
Borrowings	_	-	_	-	_	(145.7)	(9.2)	(154.9)
Total	731.5	229.3	61.8	27.1	23.4	(147.0)	(6.6)	919.5
Maturity	<1 yr	1-2 yrs	2-3 yrs	3-4 yrs	4-5 yrs	5-10 yrs	>10 yrs	Total
2005	£m	£m	£m	£m	£m	£m	£m	£m
Debt securities	319.7	284.6	11.6	50.1	17.8	40.5	0.6	724.9
Cash and cash equivalents	112.6	_	_	_	_	_	_	112.6
Borrowings	-	_	(18.6)	-	_	_	(10.5)	(29.1)
Total	432.3	284.6	(7.0)	50.1	17.8	40.5	(9.9)	808.4

The group makes annual interest payments for derivative financial instruments and borrowings. Further details are provided in notes 24 and 25.

### Sensitivity analysis

The group holds financial assets and liabilities that are exposed to interest rate risk. An increase in 100 basis points in interest yields, with all other variables constant, would result in a loss of capital on debt securities and a change in value of borrowings and derivative financial instruments. This will decrease pre-tax profits for the period by an estimated £10.7m (2005: £4.2m) and net assets would have decreased by an estimated £7.5m (2005: £2.5m).

## Price risk

The equity securities and hedge funds that are recognised on the balance sheet at their fair value are susceptible to losses due to adverse changes in prices. This is referred to as price risk.

Investments are made in equity and hedge funds depending on the group's appetite for risk. These investments are well diversified with high quality, liquid securities. The investment committee has established guidelines with investment managers setting out maximum investment limits, diversification across industries and concentrations in any one industry or company.

Listed investments are recognised on the balance sheet at quoted bid price. If the market for the investment is not considered to be active, then the group has established fair value using valuation techniques. This includes using recent arm's length market transactions, reference to current fair value of other investments that are substantially the same, discounted cash flow models and other valuation techniques that are commonly used by market participants. The total change in fair value using these valuation techniques that was recognised in the income statement during the year is £1.8m (2005: £4.1m).

### Sensitivity analysis

At 31 December 2006, the fair value of hedge funds recognised on the balance sheet was £50.3m (2005: £42.5m). If the fair value of the group's hedge fund portfolio were to fall by 10%, then the overall pre-tax impact on net assets would be a decline of £5.0m (2005: £4.3m).

At 31 December 2006, the fair value of equities recognised on the balance sheet was £40.7m (2005: £4.5m). These equities are listed on various global stock exchanges and a 10% fall in the global equity market will result in a pre-tax impact on net assets of £4.1m (2005: £0.5m).

### Operational risk

Operational risk arises from the risk of losses resulting from inadequate or failed internal processes, people and systems or from external events.

The group actively manages these risks and minimises them where appropriate. This is achieved by implementing and communicating guidelines to staff and other third parties. The group also regularly monitors the performance of its controls and adherence to these guidelines through the risk management reporting process.

Key components of the group control environment include:

- ICA modelling of operational risk exposure and scenario testing;
- · Management review of activities;
- · Documentation of policies and procedures;
- · Contingency planning; and
- · Other systems controls.

### Group risk

Group risk occurs where business units fail to consider the impact of their activities on other parts of the group, as well as the risks arising from these activities. There are three main components of group risk which are explained below.

### Strategic

This is the risk that the group's strategy is inappropriate or that the group is unable to implement its strategy. There is no tolerance for any breach of guidance issued by the board, and where events supersede the group strategic plan this is escalated at the earliest opportunity through the group's monitoring tools and governance structure.

### Reputation

Reputation risk is the risk of negative publicity as a result of the group's contractual arrangements, customers, products and services. Key sources of reputation risk include operation of a Lloyd's franchise, interaction with capital markets since the group's IPO during 2002, and reliance upon the Beazley brand in the US, Europe and Asia. The group's preference is to minimise reputation risks. Where it is not possible to avoid all events which can result in reputation risks, the group seeks to minimise their frequency and severity by managing these topics through public relations and communication channels.

### Management stretch

Management stretch is the risk that business growth might cause the group's matrix management structure to become overly complex, and undermine accountability and control within the group. As the group expands its worldwide business in the US, Europe and Asia, management stretch may make the identification, analysis and control of group risks more complex.

On a day-to-day basis, operation of the matrix management structure encourages organisational flexibility and adaptability, while ensuring that activities are appropriately coordinated and controlled. By focusing on the needs of their customers and demonstrating both progressive and responsive abilities, staff, management and outsourced service providers are expected to excel in service and quality. Individuals and teams are also expected to transact their activities in an open and transparent way. These behavioural expectations reaffirm low group risk tolerance by aligning interests to ensure that routine activities, projects and other initiatives are implemented to benefit and protect both local and group resources.

### Capital management

The group has two requirements for capital that it complied with during the year:

- · To support underwriting at Lloyd's through syndicate 2623. This is based on the group's own individual capital adequacy (ICA); and
- To support its underwriting in BICI in the US.

	2006 £m	2005 £m
Underwriting at Lloyd's through syndicate 2623 (ICA)	292.0	301.7
Underwriting in US through BICI	30.6	32.6
Total	322.6	334.3

BICI holds adequate capital to meet US regulatory and credit rating requirements.

### ICA

We use stochastic modelling techniques to regularly assess our ICA for our Lloyd's underwriting operations. Through detailed measurement of risk exposures, we allocate capital to support business activities according to risk profile. Stress and scenario analysis is performed and the results are documented and reconciled to the board's risk appetite.

Prudential risk type	Importance to group	Comment
Insurance	Dominant	This is the largest risk we face as our primary business is to accept insurance and reinsurance risk by means of appropriate premiums to cover claims and operational costs, and to maximise the expected return on regulatory capital.
Credit	Material	Both brokers and reinsurers are of good quality.
Liquidity	Low	This risk is low because the group's assets are liquid and short-term.
Market	Material	Group assets are high quality, well diversified and short-term.
Operational	Low	Our allocation of capital to these risks is cautious and is based on a set of worst case defined scenarios.
Group	Low	This risk is low, but may increase with growth of the US operation.

Insurance risk is our biggest risk, and includes both catastrophe and non-catastrophe exposures. To manage these exposures we model aggregate risks and the likely financial impact to the group for defined events.

To manage our underwriting, we assign maximum gross and net line sizes for all underwriters. This limit is adjusted according to the nature of the business being underwritten and the experience of the underwriter and cannot be exceeded unless appropriately authorised. To ensure that our decisions are robust, there is a comprehensive sign-off process for underwriting transactions including dual sign-off for all line underwriters.

Reserving activities are rigorously controlled to ensure adequate reserves are set. A quarterly peer review process exists for the underwriting teams and group actuary to independently determine required movements.

### 3 Segmental analysis

Segment information is presented in respect of business segments (primary) and Lloyd's/non-Lloyd's (secondary) segments. This is based on the group's management and internal reporting structures.

Segment results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis.

All inter-segment transactions are determined on an arm's length basis.

## Primary reporting segment – business segments

The group is organised into four business segments: specialty lines, property, reinsurance and marine. A description of the business undertaken by each segment is given in note 2.

All foreign exchange differences on non-monetary items have been left unallocated. This has been separately disclosed as it provides a fairer representation of the loss ratios, which would otherwise be distorted by the mismatch arising under IFRSs whereby unearned premium reserve, reinsurers' share of unearned premium reserve and DAC are treated as non-monetary items and claims reserves are treated as monetary items.

	Specialty lines	Property	Reinsurance	Marine	Unallocated	Tota
2006	£m	£m	£m	£m	£m	£m
Segment results						
Gross premiums written	361.0	187.8	58.4	137.9	_	745.1
Net premiums written	267.3	149.9	40.5	116.6	_	574.3
Net earned premiums	234.6	123.1	42.1	101.5	8.3	509.6
Net investment income	35.9	4.2	4.1	4.1	_	48.3
Other income	4.0	1.3	0.7	1.1	_	7.1
Revenue	274.5	128.6	46.9	106.7	8.3	565.0
Net insurance claims	146.3	66.3	13.7	44.4	_	270.7
Expenses for the acquisition of insurance contracts	50.8	39.9	10.3	28.5	0.1	129.6
Administrative expenses	21.8	9.9	3.3	3.8	_	38.8
Other expenses	7.8	4.0	1.5	2.6	17.6	33.5
Expenses	226.7	120.1	28.8	79.3	17.7	472.6
Results from operating activities Finance costs	47.8	8.5	18.1	27.4	(9.4)	92.4 (5.6
Profit before tax						86.8
Tax expense						(26.9
Profit after tax						59.9
Claims ratio	<b>62</b> %	54%	33%	44%	_	53%
Expense ratio	<b>31</b> %	40%	<b>32</b> %	<b>32</b> %	_	33%
Combined ratio	93%	94%	<b>65</b> %	<b>76</b> %	-	86%
Segment assets and liabilities						
Segment assets	1,120.6	367.9	150.2	245.4	0.1	1,884.2
Segment liabilities	(925.4)	(266.7)	(149.3)	(216.5)	(6.8)	(1,564.7
Net assets	195.2	101.2	0.9	28.9	(6.7)	319.5
Additional information						
Capital expenditure	5.7	3.0	1.0	2.3	_	12.0
Depreciation	0.7	0.3	0.1	0.3	_	1.4
Net cash flow	64.7	17.0	8.9	14.5	_	105.1

2005	Specialty lines £m	Property £m	Reinsurance £m	Marine £m	Unallocated £m	Tota £n
Segment results						
Gross premiums written	270.9	128.1	65.5	93.5	_	558.0
Net premiums written	207.7	98.5	41.0	78.6	_	425.8
Net earned premiums	192.2	81.2	37.2	64.5	(2.8)	372.3
Net investment income	19.5	5.8	3.0	3.3	_	31.6
Other income	2.4	1.4	0.2	2.9		6.9
Revenue	214.1	88.4	40.4	70.7	(2.8)	410.8
Net insurance claims	135.8	49.1	56.0	32.1	_	273.0
Expenses for the acquisition of insurance contracts	39.4	27.9	10.1	17.8	0.3	95.5
Administrative expenses	12.8	5.7	2.3	2.2	_	23.0
Other expenses	5.9	3.2	1.2	2.4	(11.3)	1.4
Expenses	193.9	85.9	69.6	54.5	(11.0)	392.9
Results from operating activities	20.2	2.5	(29.2)	16.2	8.2	17.9
Finance costs			,			(1.8
Profit before tax						16.1
Tax expense						(5.0
Profit after tax						11.1
Claims ratio	71%	60%	151%	50%		73%
Expense ratio	71% 27%	41%	33%	31%	_	32%
Combined ratio	98%	101%	184%	81%	_	105%
Combined ratio	9870	101/0	10470	81/0	_	103/0
Segment assets and liabilities						
Segment assets	895.8	282.9	186.6	178.1	_	1,543.4
Segment liabilities	(722.2)	(185.3)	(193.9)	(161.6)		(1,263.0
Net assets	173.6	97.6	(7.3)	16.5	-	280.4
Additional information						
Capital expenditure	3.8	1.8	0.9	1.3	5.2	13.0
Depreciation	0.1	0.1	0.9	0.1	5.2	0.3
Net cash flow	15.4	7.8	0.6	3.7	_	27.5
THE GUSTI HOW	10.7	7.0	0.0	0.1		21.0
Secondary reporting segment – geographical segment The group's four business segments are managed go		lacement of rig	skia Hovd's an	d non-l lovd's		
The group's rour business segments are managed ge	sograpriidally by p	iacement of fit	sn, i.e. Liuyu S ali	iu Horr-Lioyu S.		
					2006	2005

	2006	2005 £m
	£m	
Net earned premiums		
Lloyd's	507.1	372.3
Non-Lloyd's	2.5	-
	509.6	372.3
	2006	2005
	£m	£m
Segment assets		
Lloyd's	1,810.9	1,494.2
Non-Lloyd's	73.7	49.2
	1,884.2	1,543.4

Secondary reporting segment – geographical segments continued		
Segment assets are allocated based on where the assets are located.		
	2006	2005
	£m	£m
Capital expenditure	10.0	7.5
Lloyd's Non-Lloyd's	10.6 1.4	7.5 5.4
Tion Loya o	12.0	
	12.0	12.9
Capital expenditure is allocated based on where the assets are located.		
ouplian orponantare to announce success on misro are access are recated.		
4 Net investment income	2000	2005
	2006 £m	2005 £m
Investment income at fair value through profit or loss		
- Dividend income	_	_
- Interest income	28.0	31.3
Realised gains/(losses) on financial investments at fair value through profit or loss		
- Realised gains  - Realised gains	22.9	1.8
- Realised losses	(9.9)	(3.6)
Not fair value gains/(lesses) on financial investments through profit or less		
Net fair value gains/(losses) on financial investments through profit or loss  – Fair value gains	24.4	5.7
- Fair value losses	(15.6)	(2.7)
Net fair value daire (/leases) on fair value hadde		
Net fair value gains/(losses) on fair value hedge  - Change in interest rate swap	(3.0)	_
- Change in borrowings	3.0	_
Investment management expenses	(1.5)	(0.9)
Net investment income	48.3	31.6
5 Other income	2006	2005
	£m	£m
Profit commissions	5.5	4.9
Agency fees	1.1	1.3
Other income	0.5	0.7
	7.1	6.9
6 Operating expenses	2006	2005
	£m	£m
Fees payable to the company's auditor for the audit of the company's annual accounts	0.2	0.2
Fees payable to the company's auditor and its associates for other services:		
<ul> <li>Audit of the company's subsidiaries</li> </ul>	0.1	0.1
<ul><li>Tax services</li><li>Other services</li></ul>	0.1 0.1	0.1
Operating leases	1.7	0.7
Profit commission related bonus payments		
- 2003 year of account	- 4.2	2.0 1.3
<ul><li>2004 year of account</li><li>2006 year of account</li></ul>	0.8	
Foreign exchange loss/(gain)	22.3	(11.7)

7 Employee benefit expenses	2	2006	2	005
	Group £m	Company £m	Group £m	Company
Wages and salaries	22.2	0.3	15.4	0.2
Short-term incentive payments	8.1	_	5.8	_
Social security	2.8	_	2.4	-
Share-based remunerations	1.3	_	0.8	-
Pension costs	3.7	_	2.9	-
	38.1	0.3	27.3	0.2
Recharged to syndicate 623	(7.8)	-	(7.8)	_
	30.3	0.3	19.5	0.2
8 Finance costs				
			2006	2005
			£m	£m
Interest expense			5.5	1.2
Arrangement fees			0.1	0.6
			5.6	1.8
9 Income tax expense			2006	2005
			£m	£m
Current tax expense				
Current year			21.4	6.2
Prior year adjustments			1.4	0.8
Deferred tax expense			22.8	7.0
Origination and reversal of temporary differences			5.6	(1.0
Prior year adjustments			(1.5)	(1.0
			4.1	(2.0
Income tax expense			26.9	5.0
				10.1
Profit before tax Tax calculated at domestic tax rates			86.8 26.0	<b>16.1</b> 4.8
ומא כמוכטומנכט מג טטוווכטנוכ נמא ומנכט			20.0	4.0
Effects of:				
<ul> <li>Tax rates in foreign jurisdictions</li> </ul>			0.6	0.3
<ul> <li>Non-deductible expenses</li> </ul>			0.2	0.1
<ul> <li>Under/(over) provided in prior years</li> </ul>			0.1	(0.2
Tax charge for the period			26.9	5.0

The weighted average applicable tax rate was 30% (2005: 30%).

10 Earnings per share	2006	2005
	£m	£m
Basic	<b>16.8</b> p	3.1p
Diluted	16.7p	3.1p

#### Basic

Basic earnings per share are calculated by dividing profit after tax of £59.9m (2005: £11.1m) by the weighted average number of issued shares during the year of 355.8m (2005: 358.8m). The shares held in the ESOP have been excluded from the calculation until such time as they vest unconditionally with the employees.

#### Diluted

Diluted earnings per share are calculated by dividing profit after tax of £59.9m (2005: £11.1m) by the adjusted weighted average number of shares of 359.3m (2005: 362.1m). The adjusted weighted average number of shares assumes conversion of dilutive potential ordinary shares, being shares from the SAYE, retention and deferred share schemes. The shares held in the ESOP have been excluded from the calculation until such time as they vest unconditionally with the employees.

#### 11 Dividends per share

A final dividend of 3.2p (2005: 2.5p) per ordinary share is payable on 10 May 2007 to shareholders registered on 13 April 2007 in respect of the year ended 31 December 2006. Together with the interim dividend of 1.6p (2005: 1.5p) this brings the total to 4.8p (2005: 4.0p). These financial statements do not provide for the final dividend as a liability.

#### 12 Intangible assets

		Syndicate		IT development	
	Goodwill	capacity	Licences	costs	Total
	£m	£m	£m	£m	£m
Cost					
Balance at 1 January 2005	6.0	2.1	_	-	8.1
Acquisition of subsidiary	_	_	5.1	_	5.1
Additions	_	1.6	_	3.6	5.2
Disposals Foreign exchange	_	_	0.1	_	0.1
Balance at 31 December 2005	6.0	3.7	5.2	3.6	18.5
Balance at 1 January 2006	6.0	3.7	5.2	3.6	18.5
Acquisition of subsidiary	1.9	0.7	_	-	2.6
Additions	_	_	_	3.7	3.7
Disposals	_	_	_	(8.0)	(0.8)
Foreign exchange	_	-	(0.6)	_	(0.6)
Balance at 31 December 2006	7.9	4.4	4.6	6.5	23.4
Amortisation					
Balance at 1 January 2005				_	_
Amortisation for the year				0.3	0.3
Balance at 31 December 2005				0.3	0.3
Balance at 1 January 2006				0.3	0.3
Disposals for the year				(0.2)	(0.2)
Amortisation for the year				1.4	1.4
Balance at 31 December 2006				1.5	1.5
Carrying amount					
31 December 2006	7.9	4.4	4.6	5.0	21.9
31 December 2005	6.0	3.7	5.2	3.3	18.2

# 12 Intangible assets continued

## Impairment tests

Goodwill, syndicate capacity and licences are deemed to have indefinite life. Consequently, they are not amortised but annually tested for impairment. They are allocated to the group's cash generating units (CGUs) as follows:

		2006		2005	
	Lloyd's	Non-Lloyd's	Lloyd's £m	Lloyd's Non-Llo	Non-Lloyd's
	£m	£m		£m	
Goodwill	7.9	_	6.0	_	
Syndicate capacity	4.4	_	3.7	_	
Licences	_	4.6	_	5.2	

When testing for impairment, the recoverable amount of a CGU is determined based on value in use. Value in use is calculated using projected cash flows based on financial budgets approved by management covering a three-year period. Cash flows beyond a three-year period are extrapolated using an estimated growth rate of 2% (2005: 2%). This growth rate is consistent with the long-term average growth rate for the industry. A pre-tax discount rate of 8% (2005: 8%) has been used to discount the projected cash flows.

# 13 Plant and equipment

	Fixtures & fittings £m	Computer equipment £m	Total £m
Cost			
Balance at 1 January 2005 Additions Disposals	_ 2.4 _	0.1	2.5 -
Balance at 31 December 2005	2.4	0.1	2.5
Balance at 1 January 2006 Additions Disposals	2.4 4.9 -	0.1 0.8 -	2.5 5.7
Balance at 31 December 2006	7.3	0.9	8.2
Accumulated depreciation Balance at 1 January 2005 Depreciation charge for the year Disposals	- - -	- - -	- - -
Balance at 31 December 2005	-	-	_
Balance at 1 January 2006 Depreciation charge for the year Disposals	(1.0) -	(0.2) -	(1.2) -
Balance at 31 December 2006	(1.0)	(0.2)	(1.2)
Carrying amounts			
<b>31 December 2006</b> 31 December 2005	<b>6.3</b> 2.4	<b>0.7</b> 0.1	<b>7.0</b> 2.5

#### 14 Investment in associates

The group has the following interests in associates:

		Ownership		
	Country	2006	2005	
Beazley Finance Limited	UK	22.7%	22.7%	
Beazley Dedicated Limited	UK	22.7%	22.7%	

Summary financial information on associates - 100%:

2006	Assets £m	Liabilities £m	Equity £m	Profit £m
Beazley Finance Limited	0.2	(0.2)	_	0.1
Beazley Dedicated Limited	2.6		2.6	_
Total	2.8	(0.2)	2.6	0.1
2005				
Beazley Finance Limited	0.4	(0.5)	(0.1)	_
Beazley Dedicated Limited	4.2	(1.6)	2.6	_
Total	4.6	(2.1)	2.5	_

On 26 January 2006, the group increased its shareholding in Asia Pacific Underwriting Agency Limited to 100% from 79.8% at 31 December 2005. The company has been renamed Beazley Limited.

Beazley Furlonge Holdings Limited owns 5,000,000 ordinary shares in Beazley Finance Limited, the holding company of Beazley Dedicated Limited, a dedicated corporate member of syndicate 623. This share represents 22.7% of the entire share capital of Beazley Finance Limited. Beazley Furlonge Holdings Limited has guaranteed a letter of credit of £2m to support underwriting of Beazley Dedicated Limited on syndicate 623. The proportion of profits receivable by the group is determined by agreement between AON (the majority shareholder in Beazley Finance Limited) and the group and varies by year of account.

Beazley Dedicated Limited participated in syndicate 623 for all years of account up to 2002. Reflected in these accounts are the results for the 2002 year of account together with the results of Beazley Finance Limited to 31 December 2006.

#### 15 Deferred acquisition costs

	2006	2005
	£m	£m
Balance at 1 January	52.7	38.3
Additions	155.8	109.9
Amortisation charge	(129.6)	(95.5)
Balance at 31 December	78.9	52.7

#### 16 Financial investments 2006 2005 Group Company Financial investments at fair value through profit or loss Equity securities-listed 40.7 4.5 Hedge funds 50.3 42.5 Debt securities 672.3 396.2 - Fixed interest 287.2 111.6 - Floating interest 195.1 52.8 328.7 110.3 Total financial investments at fair value through profit or loss 958.4 340.0 771.9 221.9 538.8 297.0 366.7 151.5 Current Non-current 419.6 43.0 405.2 70.4 **Total** 958.4 340.0 771.9 221.9

The group has given a fixed and floating charge over its investments and other assets to secure obligations to Lloyd's in respect of its corporate member subsidiary. Further details are provided in note 33.

## 17 Insurance receivables

	2006	2005
	£m	£m
Insurance receivables	244.0	158.9

These are receivable within one year and relate to business transacted with brokers and intermediaries. All insurance receivables are designated as loans and receivables.

## 18 Reinsurance assets

	2006 £m	2005 £m
Reinsurers' share of claims	274.7	344.5
Impairment provision	(4.8)	(5.2)
	269.9	339.3
Reinsurers' share of unearned premium reserve	75.4	55.2
	345.3	394.5

# 19 Cash and cash equivalents

		2006		2005	
	Group	Company	Group £m	Company £m	
	£m	£m			
Cash at bank and in hand	16.3	0.6	6.2	0.7	
Short-term deposits	131.7	29.2	51.8	6.0	
Overseas deposits	61.4	_	54.6	_	
Cash and cash equivalents	209.4	29.8	112.6	6.7	

20 Share capital				2006	:	2005
			No. of shares (m)	£m	No. of shares (m)	£m
Authorised, issued and fully paid 450,000,000	ordinary shares of §	5p each	361.0	18.1	360.6	18.0
Balance at 1 January			360.6	18.0	360.6	18.0
Issue of shares			0.4	0.1	_	
Balance at 31 December			361.0	18.1	360.6	18.0
21 Reserves			Foreign currency	Employee	Employee	
	Share	Merger	translation	share	share	
	premium	reserve	reserve	options reserve	trust reserve	Total
Group	£m	£m	£m	£m	£m	£m
Balance at 1 January 2005	230.5	1.6	_	0.4	_	232.5
Increase in employee share options	_	_	_	0.4	-	0.4
Acquisition of own shares held in trust	_	_	_	_	(1.6)	(1.6)
Foreign exchange translation differences			0.8		_	0.8
Balance at 31 December 2005	230.5	1.6	0.8	8.0	(1.6)	232.1
Issue of shares	0.3	_	_	_	_	0.3
Increase in employee share options	-	_	-	0.8	_	0.8
Acquisition of own shares held in trust	_	_	(0.6)	_	(4.0)	(4.0)
Change in net investment hedge Foreign exchange translation differences		_	(0.6) (2.8)			(0.6) (2.8)
Balance at 31 December 2006	230.8	1.6	(2.6)	1.6	(5.6)	225.8
			Fausida aumanau	Frantsuss	Employee	
	Share	Merger	Foreign currency translation	Employee share	Employee share	
	premium	reserve	reserve	options reserve	trust reserve	Total
Company	£m	£m	£m	£m	£m	£m
Balance at 1 January 2005	230.5	_	_	_	_	230.5
Foreign exchange translation differences	_	_	(1.1)	_	_	(1.1)
Balance at 31 December 2005	230.5	-	(1.1)	_	-	229.4
Issue of shares	0.3	_	_	_	_	0.3
Foreign exchange translation differences	_	_	1.2	_	_	1.2
Balance at 31 December 2006	230.8	_	0.1	_	_	230.9
22 Equity compensation plans						
Employee share trust				2006	:	2005
			Number (m)	£m	Number (m)	£m

The shares are owned by the employee share trust to satisfy awards under the group's deferred share plan and retention plan. These shares are purchased on the market and carried at cost.

On the third anniversary of an award the shares under the deferred share plan are transferred from the trust to the employees. Under the retention plan, on the third anniversary, and each year after that, 15.0% of the shares awarded are transferred to the employees.

1.9

3.3

5.2

1.6

4.0

5.6

1.9

1.9

1.6

1.6

The deferred share plan is recognised in the income statement on a straight-line basis over a period of three years, while the retention share plan is recognised in the income statement on a straight-line basis over a period of six years.

Balance at 1 January

Balance at 31 December

Additions

Costs debited to employee share trust reserve

## 22 Equity compensation plans continued

#### Employee share option plans

The group has a long term incentive plan (LTIP), approved share option plan, unapproved share option plan, phantom share option and SAYE that entitle employees to purchase shares in the group. In accordance with these plans, options are exercisable at the market price of the shares at the date of the grant.

In addition, the group further granted share options before 7 November 2002. The recognition and measurement principles in IFRS 2 "Sharebased payment" have not been applied to these grants in accordance with the transitional provisions in IFRS 1 "First-time Adoption" and IFRS 2.

The terms and conditions of the grants are as follows:

Share option plan	Grant date	No. of options (m)	Vesting conditions	Contractual life of options
LTIP	15/05/2003	0.6		10 years
	13/06/2003	0.1		•
	29/03/2004	0.4	Three years' service + NAV + TSR comparator	
	06/12/2004	0.1	•	
	21/03/2005	2.0		
	21/03/2006	1.7		
Approved share option plan	13/11/2002	0.8	Three years' service + NAV	10 years
	29/03/2004	0.5		
Unapproved share option plan	15/05/2003	1.1		10 years
	13/06/2003	0.2	Three years' service + NAV	
	29/03/2004	0.7	The years service Than	
	06/12/2004	0.3		
Phantom share option	08/07/2003	0.4	Three years' service + NAV + TSR comparator	10 years
SAYE	20/04/2004	0.4		
	14/04/2005	0.3	Three years' service	
	13/04/2006	0.6	•	
Total share options outstanding	ng	10.2		

# Vesting conditions

In summary the vesting conditions are defined as:

Three years' service An employee has to remain in employment until the third anniversary from the grant date.

NAV The NAV growth is greater than the risk-free rate of return plus a premium per year.

The group's TSR growth is compared with that of members of the comparator group TSR comparator over a three-year period starting with the year in which the award is made.

Further details of equity compensation plans can be found in the directors' remuneration report on pages 37 to 45.

The number and weighted average exercise prices of share options are as follows:

		2006		2005		
	Weighted average exercise price (pence per share)	No. of options	Weighted average exercise price (pence per share)	No. of options		
Outstanding at 1 January	50.4	8.8	65.4	6.5		
Forfeited during the year	73.2	(0.4)	62.3	(0.1)		
Exercised during the year	73.0	(0.4)	_	_		
Granted during the year	115.0	2.2	10.2	2.4		
Outstanding at 31 December	43.2	10.2	50.4	8.8		
Exercisable at 31 December		_		_		

## 22 Equity compensation plans continued

## Employee share option plans continued

The share option programme allows group employees to acquire shares of the company. The fair value of options granted is recognised as an employee expense with a corresponding increase in employee share options reserve. The fair value of the options granted is measured at grant date and spread over the period in which the employees become unconditionally entitled to the options. The fair value of the options granted is measured using the Black Scholes model, taking into account the terms and conditions upon which the options were granted. The amount recognised as an expense is adjusted to reflect the actual number of share options that vest, except where forfeiture is due to the share option achieving the vesting conditions.

The following is a summary of the assumptions used to calculate the fair value:

	2006 £m	2005 £m
Share options charge to income statement	1.0	0.4
Weighted average share price (pence per option)	95.9	90.1
Weighted average exercise price (pence per option)	43.2	50.4
Weighted average expected life of options	6.0 yrs	6.0 yrs
Expected volatility	25.0%	25.0%
Expected dividend yield	4.0%	4.0%
Average risk-free interest rate	4.0%	4.0%

The expected volatility is based on historic volatility over a period of at least two years.

23 Insurance liabilities and reinsurance assets		
	2006	2005
	£m	£m
Gross		
Claims reported and loss adjustment expenses	278.2	349.3
Claims incurred but not reported	587.8	479.5
Gross claims liabilities	866.0	828.8
Unearned premiums	359.6	267.6
Total insurance liabilities, gross	1,225.6	1,096.4
Recoverable from reinsurers		
Claims reported and loss adjustment expenses	103.1	198.5
Claims incurred but not reported	166.8	140.8
Reinsurers' share of claims liabilities	269.9	339.3
Unearned premiums	75.4	55.2
Total reinsurers' share of insurance liabilities	345.3	394.5
Net		
Claims reported and loss adjustment expenses	175.0	150.8
Claims incurred but not reported	421.1	338.7
Net claims liabilities	596.1	489.5
Unearned premiums	284.2	212.4
Total insurance liabilities, net	880.3	701.9

The gross claims reported, the loss adjustment liabilities and the liabilities for claims incurred but not reported are net of expected recoveries from salvage and subrogation.

#### Movements in insurance liabilities and reinsurance assets

## Claims and loss adjustment expenses

	2006		2005			
	Gross	Reinsurance	Net	Gross	Reinsurance	Net
	£m	£m	£m	£m	£m	£m
Claims reported and loss adjustment expenses	349.3	(198.5)	150.8	57.4	(12.2)	45.2
Claims incurred but not reported	479.5	(140.8)	338.7	209.8	(51.1)	158.7
Balance at 1 January	828.8	(339.3)	489.5	267.2	(63.3)	203.9
Claims paid	(258.3)	132.5	(125.8)	(140.4)	30.5	(109.9)
Increase in claims						
<ul> <li>Arising from current year claims</li> </ul>	394.6	(92.9)	301.7	498.9	(211.7)	287.1
<ul> <li>Arising from prior year claims</li> </ul>	(36.3)	5.3	(31.0)	(21.8)	9.6	(12.2)
<ul> <li>Reinsurance to close</li> </ul>	23.4	(9.9)	13.5	184.6	(88.9)	95.7
Net exchange differences	(86.2)	34.4	(51.8)	40.4	(15.5)	24.9
Balance at 31 December	866.0	(269.9)	596.1	828.8	(339.3)	489.5
Claims reported and loss adjustment expenses	272.3	(103.1)	169.2	349.3	(198.5)	150.8
Claims incurred but not reported	593.7	(166.8)	426.9	479.5	(140.8)	338.7
Balance at 31 December	866.0	(269.9)	596.1	828.8	(339.3)	489.5

## Unearned premiums reserve

	2006			2005		
	Gross £m	Reinsurance £m	Net £m	Gross £m	Reinsurance £m	Net £m
Balance at 1 January	267.6	(55.2)	212.4	193.3	(35.0)	158.3
Increase in the year Release in the year	749.5 (657.5)	(170.6) 150.4	578.9 (507.1)	564.6 (490.3)	(38.7) 18.5	525.9 (471.8)
Balance at 31 December	359.6	(75.4)	284.2	267.6	(55.2)	212.4

Assumptions, changes in assumptions and sensitivity

Process used to decide on assumptions

# The peer review reserving process

Beazley uses a quarterly dual track process to set its reserve:

- The actuarial team uses several actuarial and statistical methods to estimate the ultimate premium and claims costs. The most appropriate methods are selected depending on the nature of each class of business; and
- The underwriting teams concurrently review the development of the incurred loss ratio over time, work with our claims managers to set specific reserve estimates for flagged claims and utilise their detailed understanding of the risks underwritten to establish an alternative estimate of ultimate claims cost which are compared to the actuarially established figures.

A formal internal peer review process is then undertaken to determine the reserves held for accounting purposes which, in totality, is not lower than the actuarially established figure. The group also commissions an annual independent review by the group's syndicate reporting actuary to ensure that the reserves established are reasonable.

## Assumptions, changes in assumptions and sensitivity continued

#### Actuarial assumptions

Chain-ladder techniques are applied to premiums, paid claims and incurred claims (i.e. paid claims plus case estimates). The basic technique involves the analysis of historical claims development factors and the selection of estimated development factors based on historical patterns. The selected development factors are then applied to cumulative claims data for each underwriting year that is not yet fully developed to produce an estimated ultimate claims cost for each underwriting year.

Chain-ladder techniques are most appropriate for classes of business that have a relatively stable development pattern. Chain-ladder techniques are less suitable in cases in which the insurer does not have a developed claims history for a particular class of business or for underwriting years that are still at immature stages of development where there is a relatively higher level of assumption volatility.

The Bornhuetter-Ferguson method uses a combination of a benchmark/market based estimate and an estimate based on claims experience. The former is based on a measure of exposure such as premiums; the latter is based on the paid or incurred claims observed to date. The two estimates are combined using a formula that gives more weight to the experience-based estimate as time passes. This technique has been used in situations where developed claims experience was not available for the projection (i.e. recent underwriting years or new classes of business).

The expected loss ratio method uses a benchmark/market-based estimate applied to the expected premium and is used for classes with little or no relevant historical data.

The choice of selected results for each underwriting year of each class of business depends on an assessment of the technique that has been most appropriate to observed historical developments. In certain instances, this has meant that different techniques or combinations of techniques have been selected for individual underwriting years or groups of underwriting years within the same class of business. As such, there are many assumptions used to estimate general insurance liabilities.

We also review triangulations of the paid/outstanding claim ratios as a way of monitoring any changes in the strength of the outstanding claim estimates between underwriting years so that adjustment can be made to mitigate any subsequent over or under reserving. To date, this analysis indicates no systematic change to the outstanding claim strength across underwriting years.

Where a significantly large loss impacts an underwriting year (e.g. the events of 11 September 2001 and the hurricanes in 2004 and 2005), its development is usually very different from the attritional losses. In these situations, the large loss is extracted from the remainder of the data and analysed separately by the respective claims managers using exposure analysis of the policies in force in the areas affected.

Further assumptions are required to convert gross of reinsurance estimates of ultimate claims cost to a net of reinsurance level and to establish reserves for unallocated claims handling expenses and reinsurance bad debt.

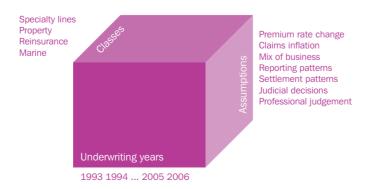
## Major assumptions

The main assumption underlying these techniques is that the group's past claims development experience (with appropriate adjustments for known changes) can be used to project future claims development and hence ultimate claims costs. As such these methods extrapolate the development of premiums, paid and incurred losses, average costs per claim and claim numbers for each underwriting year based on the observed development of earlier years.

Throughout, judgement is used to assess the extent to which past trends may not apply in the future, for example, to reflect changes in external or market factors such as economic conditions, public attitudes to claiming, levels of claims inflation, premium rate changes, judicial decisions and legislation, as well as internal factors such as portfolio mix, policy conditions and claims handling procedures.

# Changes in assumptions

As already discussed, general insurance business requires many different assumptions. The diagram below illustrates the main categories of assumptions used for each underwriting year and class combinations.



#### Assumptions, changes in assumptions and sensitivity continued

#### Changes in assumptions continued

Given the range of assumptions used, the group's profit or loss is relatively insensitive to changes to a particular assumption used for an underwriting year/class combination. However, the group's profit or loss is potentially more sensitive to a systematic change in assumptions that affect many classes, such as judicial changes or when catastrophes produce more claims than expected. The group uses a range of risk mitigation strategies to reduce the volatility including the purchase of reinsurance. In addition, the group holds additional capital as ICA.

The net of reinsurance estimates of ultimate claims costs on the 2004 and prior underwriting years has improved by £31.0m during 2006 (2005: £12.2m). This movement has arisen from a combination of better than expected claims experience coupled with small changes to the many assumptions reacting to the observed experience and anticipating any changes as a result of the new business written.

## Sensitivity analysis

The estimation of IBNR reserves for future claim notifications is subject to a greater degree of uncertainty than the estimation of the outstanding claims already notified. This is particularly true for the specialty lines business, which will typically display greater variations between initial estimates and final outcomes as a result of the greater degree of difficulty in estimating these reserves. The estimation of IBNR reserves for other business written is generally subject to less variability as claims are generally reported and settled relatively quickly.

As such, our reserving assumptions contain a reasonable margin for prudence given the uncertainties inherent in the insurance business underwritten, particularly on the longer tailed specialty lines classes.

Since March 2005, we have identified a range of possible outcomes for each class and underwriting year combination directly from our ICA process. Comparing these with our pricing assumptions and reserving estimates gives our management team increased clarity into our perceived reserving strength and relative uncertainties of the business written.

To illustrate the robustness of our reserves, the loss development tables below provide information about historical claims development by the four segments - specialty lines, property, reinsurance and marine. The tables are by underwriting year which in our view provides the most transparent reserving basis. We have supplied tables for both ultimate gross claims and ultimate net claims.

The top part of the table illustrates how the group's estimate of claims ratio for each underwriting year has changed at successive year-ends. The bottom half of the table reconciles the gross and net claims to the amount appearing in the balance sheet.

While the information in the table provides a historical perspective on the adequacy of the claims liabilities established in previous years, users of these financial statements are cautioned against extrapolating redundancies or deficiencies of the past on current claims liabilities. The group believes that the estimate of total claims liabilities as at 31 December 2006 are adequate. However, due to inherent uncertainties in the reserving process, it cannot be assured that such balances will ultimately prove to be adequate.

	2002ae	2003	2004	2005	2006	
Gross ultimate claims		%	%	%	%	
Specialty lines						
12 months		71.4	70.7	71.1	68.9	
24 months		67.3	69.9	68.3	_	
36 months		65.0	66.3	_	_	
48 months		57.4	_	_	-	
Property						
12 months		51.1	65.2	85.5	59.3	
24 months		38.3	65.1	82.9	_	
36 months		35.6	65.6	_	_	
48 months		34.9	_	_	_	
Reinsurance						
12 months		58.5	86.7	193.1	52.5	
24 months		33.5	80.7	183.9	_	
36 months		28.0	75.9	_	_	
48 months		28.2	_	_	_	
Marine						
12 months		60.2	62.0	82.6	57.3	
24 months		44.9	64.5	80.2	_	
36 months		39.0	62.2	_	_	
48 months		36.2	_	_	_	
Total						
12 months		62.9	69.7	90.0	63.2	
24 months		52.5	69.0	87.3	_	
36 months		49.4	66.5	_	_	
48 months		45.1	_	_	_	
Total ultimate losses (£m)	1,072.3	294.6	490.3	692.7	579.1	3,129.0
Less paid claims net of reinsurance (£m)	(811.8)	(136.6)	(227.2)	(237.7)	(15.1)	(1,428.4
Less unearned portion of ultimate losses (£m)	_	_		(27.0)	(311.4)	(338.4
Gross claims liabilities (100% level) (£m)	260.5	158.0	263.1	428.0	252.6	1,362.2
Less unaligned share (£m)	(119.8)	(72.7)	(121.0)	(128.4)	(54.3)	(496.2)
Gross claims liabilities, group share (£m)	140.7	85.3	142.1	299.6	198.3	866.0

Assumptions, changes in assumptions and sensitivity continued

Net ultimate claims	2002ae	2003 %	<b>2004</b> %	<b>2005</b> %	2006 %	
Specialty lines						
12 months		68.1	67.9	69.1	671.	
24 months		64.9	67.8	67.4	-	
36 months		63.0	65.0	-	_	
48 months		55.9	-	_	_	
Property						
12 months		49.0	59.7	65.0	62.3	
24 months		42.4	61.6	62.9	02.5	
36 months		40.1	60.9	-	_	
48 months		39.6	00.9	_	_	
40 1110111115		39.0	_	_	_	
Reinsurance						
12 months		60.4	88.0	153.2	54.4	
24 months		38.2	84.7	128.9	_	
36 months		33.4	82.2	_	_	
48 months		34.1	_	_	-	
Marine						
12 months		55.5	57.7	55.6	54.3	
24 months		44.7	52.5	49.4	_	
36 months		39.5	48.7	_	_	
48 months		39.2	_	_	-	
Total						
12 months		60.3	66.2	73.5	63.0	
24 months		53.1	65.5	69.1	_	
36 months		50.5	63.1	_	_	
48 months		46.8	-	_	-	
Total ultimate losses (£m)	575.4	247.5	379.2	434.6	458.5	2,095.2
Less paid claims net of reinsurance (£m)	(455.3)	(124.9)	(176.4)	(110.1)	(14.4)	(881.1)
Less unearned portion of ultimate losses (£m)	-	_	_	(24.1)	(259.5)	(283.6)
Net claims liabilities (100% level) (£m)	120.1	122.6	202.8	300.4	184.6	930.5
Less unaligned share (£m)	(55.2)	(56.4)	(93.3)	(90.1)	(39.4)	(334.4)
Net claims liabilities, group share (£m)	64.9	66.2	109.5	210.3	145.2	596.1

#### Analysis of movements in loss development tables

## Initial ultimate loss ratios (reading across the first line of each segment)

The 2004 and 2005 hurricanes have increased the initial gross and net ultimate loss ratios on the 2004 and 2005 underwriting years for the property, reinsurance and marine teams compared with the initial 2003 underwriting year ratios.

The initial property 2006 underwriting year gross and net ultimate loss ratios are higher than the initial 2003 underwriting year ultimate loss ratios because of an increased catastrophe loading following the 2004 and 2005 hurricanes and due to less Javourable underwriting conditions in UK homeowners in 2006.

The initial reinsurance 2006 underwriting year gross and net ultimate loss ratios are lower than the initial 2003 underwriting year ultimate loss ratios as a result of the premium rate increases achieved and the changes made to the business mix following the 2005 hurricanes.

## Development of ultimate loss ratios (reading down the columns of the tables)

#### Specialty lines

The gross and net ultimate loss ratios on all underwriting years have continued to reduce as the impact of increased rates, tighter terms and conditions and an improved claims environment has become clearer.

## Analysis of movements in loss development tables continued

#### Property

The 2003 underwriting year gross and net ultimate loss ratios have continued to reduce as the level of attritional losses has become clear.

The 2004 underwriting year gross ultimate loss ratio has been relatively stable with better than expected attritional claim experience and stable 2004 hurricane estimates offsetting the increase following the 2005 hurricanes. The net ultimate loss ratio has increased slightly from its 12 month position as a result of the additional premiums paid to reinstate reinsurance cover ("reinstatement premiums") following the 2005 hurricanes which reduced our net premium estimates.

The 2005 underwriting year reduction has been driven by better than expected attritional claim experience.

#### Reinsurance

All years show reducing ultimate loss ratios over time reflecting our initially cautious reserving philosophy.

#### Marine

The 2003 underwriting year gross and net ultimate loss ratios have continued to reduce as the level of attritional losses has become clear.

During the second development year of the 2004 underwriting year we wrote more premium than expected. At a gross of reinsurance level, the claims impact of the 2005 hurricanes more than offset this additional premium thereby increasing the gross ultimate loss ratio. At a net of reinsurance level, however, the claims impact of the hurricanes was less than the additional premium (as a result of the relatively low reinsurance retention) thereby reducing the net ultimate loss ratio. Thereafter, both gross and net ultimate loss ratios have reduced at the end of the third development year as a result of better than expected attritional claims experience. The 2005 underwriting year reduction has been driven by better than expected attritional claims experience.

The table below illustrates movements in our net claims recognised in the income statement in 2006 by both underwriting year and by business segment:

	Specialty lines	Property	Reinsurance	Marine	Total
2006	£m	£m	£m	£m	£m
Current year	164.3	68.2	19.6	49.6	301.7
Prior year					
<ul> <li>2003 and earlier</li> </ul>	(12.3)	(0.7)	(0.4)	(0.4)	(13.8)
<ul> <li>2004 year of account</li> </ul>	(4.7)	(0.7)	(0.8)	(3.0)	(9.2)
- 2005 year of account	(1.0)	(0.5)	(4.7)	(1.8)	(8.0)
	(18.0)	(1.9)	(5.9)	(5.2)	(31.0)
Net insurance claims	146.3	66.3	13.7	44.4	270.7
	Specialty lines	Property	Reinsurance	Marine	Total
2005	Specialty lines £m	Property £m	Reinsurance £m	Marine £m	Total £m
2005 Current year					
	£m	£m	£m	£m	£m
Current year	£m	£m	£m	£m	£m
Current year Prior year	£m 136.5	£m 53.0	£m 60.2	£m 35.5	£m 285.2
Current year Prior year - 2002 and earlier	136.5 (0.5)	53.0 (1.0)	£m 60.2 (2.0)	£m 35.5 (1.2)	285.2 (4.7)
Current year Prior year - 2002 and earlier - 2003 year of account	136.5 (0.5) (0.8)	53.0 (1.0) (1.9)	£m 60.2 (2.0) (1.6)	£m 35.5 (1.2) (1.6)	285.2 (4.7) (5.9)

# 24 Borrowings

The carrying amount and fair values of the non-current borrowings are as follows:

	2006		2005	
	Group	Company	Group	Company
	£m	£m	£m	£m
Carrying value				
Syndicated loan	_	_	18.6	_
Subordinated debt	9.2	9.2	10.5	10.5
Tier 2 subordinated debt	145.7	147.8	_	-
	154.9	157.0	29.1	10.5
Fair value				
Syndicated loan	_	_	18.6	_
Subordinated debt	9.2	9.2	10.7	10.7
Tier 2 subordinated debt	150.2	148.2	_	-
	159.4	157.4	29.3	10.7

#### 24 Borrowings continued

The fair value of the borrowings is based on quoted market prices. When quoted market prices are not available, a discounted cash flow model is used based on a current yield curve appropriate for the remaining term to maturity. The discount rates used in the valuation techniques are based on the borrowing rates.

In November 2004, the group issued subordinated debt of US \$18m to JPMorgan Chase Bank, N.A. (JPMorgan). The loan was unsecured and interest was payable at the US London interbank offered rate (LIBOR) plus a margin of 3.65% per annum. The subordinated notes are due in November 2034.

In October 2006, the group issued £150m of unsecured fixed/floating rate subordinated notes that are due in October 2026 with a first callable date of October 2016. Interest of 7.25% per annum is paid annually in arrears for the period up to October 2016. From October 2016, the notes will bear annual interest at the rate of 3.28% above LIBOR. The notes were assigned a credit rating of BBB—by S&P's rating services.

The group entered into a cross-currency swap transaction with Lloyds TSB Bank plc (Lloyds TSB) and JPMorgan in October 2006. In exchange for £42.3m the group received US\$40m from each party which will be finally exchanged on termination of the contract, being October 2016. Lloyds TSB charges interest at US three-month LIBOR plus 2.25%, while JPMorgan charges interest at US three-month LIBOR plus 2.23%. As part of the agreement, the group receives interest at 7.25% from both parties. There is an option to terminate the swaps in October 2011 and annually thereafter until October 2016.

The group also entered into an interest rate swap transaction with Lloyds TSB and JPMorgan in October 2006. Under this agreement, the fixed interest rate of 7.25% on the balance of £107.7m (£53.8m from each party) is exchanged for floating interest rate of UK LIBOR plus 2.24% with Lloyds TSB and UK LIBOR plus 2.23% with JPMorgan. This agreement terminates on 17 October 2016 with an optional early termination in October 2011 and annually thereafter.

In 2005, the group had borrowing facilities of £150m available, of which £72m had been drawn down as a letter of credit with a further £18.6m being drawn as a cash borrowing. A commitment fee of 0.5% per annum was paid for any undrawn part of the facility. The utilised element of the facility drawn as cash was charged an interest of 1.5% above UK LIBOR. The utilised element drawn down as a letter of credit was charged an annual rate of 1.5%. The facility was repayable in 2008 and the group had given a fixed and floating charge over its assets to the syndicated banks led by Lloyds TSB. The other banks participating in the syndicate are Calyon, Bank of America N.A., HSH Nordbank AG and Commerzbank AG. The draw down part of this facility has now been replaced by the subordinated notes issued during the year. The overall facility has been reduced to £50m, none of which was drawn at 31 December 2006.

#### 25 Derivative financial instruments

The group uses fair value interest rate hedges and net investment hedges to manage some of its exposures. The group entered into derivative financial instruments to manage this risk.

	2006	2005
	£m	£m
Fair value		
Interest rate swap	3.0	_
Cross-currency swap	(0.6)	-
	2.4	

#### Fair value hedges

As described in note 24, the group has hedged its fixed rate borrowing using fixed-to-floating interest rate swaps. In 2006, the hedge was deemed 100% effective and therefore the group did not recognise any portion in the income statement.

## Hedge of net investment in foreign entity

The group's US dollar denominated borrowing is designated as a hedge of the net investment in the group's US subsidiaries. The foreign exchange gains of £2.1m on translation of the borrowing to sterling at the balance sheet date was recognised in "foreign currency translation reserve". This offsets the gain or loss on translation of the net investment in the group's US based subsidiaries. In 2006, the hedge was deemed effective and therefore the group did not recognise any portion in the income statement.

# 26 Deferred income tax

	£m	2005 £m
Deferred income tax asset	3.5	2.4
Deferred income tax liability	(11.6)	(6.0)
	(8.1)	(3.6)

# 26 Deferred income tax continued

The movement in the net deferred income tax is as follows:

Balance at 31 December	(8.1)	(3.6)
Foreign exchange translation differences	(0.4)	_
Income tax charge	(4.1)	2.0
Balance at 1 January	(3.6)	(5.6)

	Balance 1 Jan 06	Recognised in income £m	Balance 31 Dec 06 £m
	£m		
Plant and equipment	0.4	0.8	1.2
Intangible assets	(0.3)	(0.4)	(0.7)
Other receivables	(0.4)	0.3	(0.1)
Trade and other payables	1.1	1.1	2.2
Syndicate profits	(7.7)	<b>(7.1)</b>	(14.8)
Retirement benefit obligations	0.9	(0.3)	0.6
Tax losses	2.4	1.1	3.5
Net deferred income tax account	(3.6)	(4.5)	(8.1)

	Balance 1 Jan 05	Recognised in income £m	Balance 31 Dec 05 £m
	£m		
Plant and equipment	_	0.4	0.4
Intangible assets	(0.1)	(0.2)	(0.3)
Financial investments	0.2	(0.2)	_
Other receivables	(0.7)	0.3	(0.4)
Trade and other payables	1.2	(0.1)	1.1
Syndicate profits	(7.3)	(0.4)	(7.7)
Retirement benefit obligations	1.1	(0.2)	0.9
Tax losses	_	2.4	2.4
Net deferred income tax account	(5.6)	2.0	(3.6)

The group has recognised deferred tax assets on unused tax losses to the extent that it is probable that future taxable profits will be available against which unused tax losses can be utilised.

# 27 Other payables

	2006		2005		
	Group Company £m £m	Group	Company	Group	Company
		£m	£m		
Reinsurance premiums payable	108.2	_	78.3	_	
Accrued expenses including staff bonuses	25.4	_	18.0	0.1	
Other payables	9.9	0.1	5.2	-	
Amounts due to subsidiaries	_	37.6	_	31.5	
Due to syndicate 623 and associates	9.2	_	22.6	1.8	
	152.7	37.7	124.1	33.4	
Current	152.7	37.7	124.1	33.4	
Non current	_	_	_	_	
	152.7	37.7	124.1	33.4	

#### 28 Retirement benefit obligations 2006 2005 £m £m Retirement benefit obligations 1.9 2.9

Of the £1.9m (2005: £2.9m) of retirement benefit obligations £0.5m (2005: £1.3m) is recoverable from syndicate 623. Beazley Furlonge Limited operates a funded pension scheme ("the Beazley Furlonge Limited Pension Scheme") providing benefits based on final pensionable pay, with contributions being charged to the income statement so as to spread the cost of pensions over employees' working lives with the company. The contributions are determined by a qualified actuary using the projected unit method and the most recent valuation was at 31 December 2006.

## Pension benefits

Pension benefits	2006 £m	2005 £m
Amount recognised in the balance sheet		
Present value of funded obligations	16.0	14.1
Fair value of plan assets	(13.3)	(10.1)
	2.7	4.0
Unrecognised actuarial losses	(0.8)	(1.1)
Liability in the balance sheet	1.9	2.9
Amounts recognised in the income statement		
Current service cost	0.3	0.9
Interest cost	0.6	0.6
Expected return on plan assets	(0.6)	(0.5)
	0.3	1.0
Movement in present value of funded obligations recognised in the balance sheet		
Balance at 1 January	14.1	10.9
Current service cost	0.3	0.9
Interest cost	0.6	0.5
Actuarial losses	1.0	1.8
Balance at 31 December	16.0	14.1
Movement in fair value of plan assets recognised in the balance sheet	10.1	6.7
Balance at 1 January  Expected return on plan assets	0.6	0.4
Actuarial gains	0.5	1.2
Employer contributions	2.1	1.8
Benefits paid		_
Balance at 31 December	13.3	10.1
Plan assets are comprised as follows: Equities	10.9	8.2
Bonds	2.4	1.9
Total	13.3	10.1
The actual return on plan assets was £1.2m (2005: £1.5m).		
Principal actuarial assumptions		
Discount rate	5.2%	4.9%
Inflation rate	3.2%	2.9%
Expected return on plan assets	6.3%	5.8%
Future salary increases	4.4%	4.4%
Future pensions increases Life expectancy	2.7% 84 years	2.5% 84 years
Life capediandy	64 years	O4 years

#### 29 Acquisition of subsidiaries

On 29 December 2006, the group acquired all the shares in Santam Corporate Limited for £14.5m in cash. The company was renamed Tasman Corporate Limited.

The acquisition had the following effect on the group's assets and liabilities:

Fair value of net assets on acquisition	£m
Cash and cash equivalents	12.6
Insurance receivables	0.8
Other receivables	0.6
Other payables	(1.7)
Intangible assets – syndicate capacity	0.5
Intangible assets – goodwill	1.7
Consideration paid	14.5
	£m
Revenue	2.8
Profit before tax	2.5

On 22 March 2005, the group acquired all the shares in Omaha Property and Casualty Insurance Company for US\$20.5m in cash. The company was renamed BICI.

The acquisition had the following effect on the group's assets and liabilities:

	£m
Acquiree's net assets at the acquisition date:	
Cash and cash equivalents	6.0
Intangible assets – licences	4.6
Consideration paid	10.6

As part of the BICI acquisition, the group acquired licences to underwrite admitted lines business in all 50 states in the US. The licences have an indefinite useful life and are carried at cost less accumulated impairment.

In addition, the group increased its shareholding in Asia Pacific Underwriting Agency Limited to 100% on 26 January 2006 and subsequently changed its name to Beazley Limited. The group owned 79.8% at 31 December 2005.

# 30 Operating lease commitments

The group leases land and buildings under a non-cancellable operating lease agreement.

The future minimum lease payments under the non-cancellable operating lease are as follows:

	2006 £m	2005 £m
No later than 1 year	1.3	1 2
Later than 1 year and no later than 5 years	5.3	4.8
Later than 5 years	5.3	5.8
	11.9	11.8

## 31 Related party transactions

The group has a related party relationship with syndicate 623, its subsidiaries, associates and its directors.

## Syndicate 623

Beazley Furlonge Limited, a wholly owned subsidiary of the group, received management fees and profit commissions for providing a range of management services to syndicate 623 in which the corporate member subsidiaries participated.

The value of the services provided and the balances with the syndicate are as follows:

	2006 £m	2005 £m
Services provided:		
Syndicate 623	15.9	12.9
Balances due:		
Due to syndicate 623	(6.3)	(19.7)
Key management compensation		
	2006	2005
	£m	£m
Salaries and other short-term benefits	8.3	7.1
Post-employment benefits	0.4	0.4
Share-based remuneration	0.5	0.3
	9.2	7.8

Key management includes executives and non-executive directors and key management.

Further details of directors' shareholdings and remuneration can be found in the directors' remuneration report on pages 37 to 45.

# Other related party transactions

At 31 December 2006, the group had a balance payable to the associates of £1.8m (2005: £2.6m). All transactions with associates are priced on an arm's length basis.

# 32 Subsidiary undertakings

The following is a list of all the subsidiaries:

	Country of	Ownership	
	incorporation	interest	Nature of business
Beazley Furlonge Holdings Limited	England	100%	Intermediate holding company
Beazley Furlonge Limited	England	100%	Lloyd's underwriting agents
BFHH Limited	England	100%	Dormant since 30 June 1994
Beazley Investments Limited	England	100%	Investment company
Beazley Corporate Member Limited	England	100%	Underwriting at Lloyd's
Beazley Dedicated No.2 Limited	England	100%	Underwriting at Lloyd's
Global Two Limited	England	100%	Underwriting at Lloyd's
Beazley Underwriting Limited	England	100%	Underwriting at Lloyd's
Beazley Management Limited	England	100%	Intermediate management company
Beazley Staff Underwriting Limited	England	100%	Underwriting at Lloyd's
Beazley Solutions Limited	England	100%	Insurance services
Beazley Corporate Member No. 2	England	100%	Dormant
Beazley Corporate Member No. 3	England	100%	Dormant
Beazley USA Services, Inc.	USA	100%	Insurance services
Beazley Holdings, Inc.	USA	100%	Holding company
Beazley Group (USA) General Partnership	USA	100%	General partnership
Beazley Insurance Company, Inc.	USA	100%	Underwrite admitted lines
Beazley Limited	Hong Kong	100%	Insurance services
Tasman Corporate Limited	England	100%	Underwriting at Lloyd's
Beazley Pte. Limited	Singapore	100%	Underwriting at Lloyd's

# 33 Contingencies

# Funds at Lloyd's

The following amounts are subject to a deed of charge in favour of Lloyd's to secure underwriting commitments:

	2006	2005
Company	£m	£m
Debt securities and other fixed income securities	292.0	231.5
Letter of credit	_	70.0
	292.0	301.5

# Collateralised guarantee at Lloyds TSB

The collateralised guarantee of £0.5m that existed with Lloyds TSB at the end of 2005 has been disposed of during 2006.

## Foreign exchange rates

The group used the following exchange rates to translate foreign currency assets, liabilities, income and expenses into the group's presentation currency:

	2006 2005			
	Average	Year end spot	Average	Year end spot
US dollar	1.84	1.96	1.82	1.72
Canadian dollar	2.09	2.28	2.21	2.01
Euro	1.47	1.48	1.46	1.46

#### Admitted carrier

An insurance company authorised to do business in the US. A charger agreement is entered into which stipulates the terms and conditions under which a business must conduct within a state in the US.

#### Aggregates/aggregations

Accumulations of insurance loss exposures which result from underwriting multiple risks that are exposed to common causes of loss.

## Aggregate excess of loss

The reinsurer indemnifies an insurance company (the reinsured) for an aggregate (or cumulative) amount of losses in excess of a specified aggregate amount.

#### A.M. Best rating

A.M. Best is a worldwide insurance-rating and information agency whose ratings are recognised as an ideal benchmark for assessing the financial strength of insurance related organisations, following a rigorous quantitative and qualitative analysis of a company's balance sheet strength, operating performance and business profile. A.M. Best has more than 100 years of experience and offices located in the US, UK and Hong Kong. Beazley Group plc obtained an A rating, while BICI received a rating of A-.

#### Binding authority

A contracted agreement between a managing agent and a coverholder under which the coverholder is authorised to enter into contracts of insurance for the account of the members of the syndicate concerned, subject to specified terms and conditions.

## Capacity

This is the maximum amount of premiums that can be accepted by a syndicate. Capacity also refers to the amount of insurance coverage allocated to a particular policyholder or in the marketplace in general.

## Catastrophe reinsurance

A form of excess of loss reinsurance which, subject to specified limits, indemnifies the reinsured company for the amount of loss in excess of a specified retention with respect to an accumulation of losses resulting from a catastrophic event or series of events.

Demand by an insured for indemnity under an insurance contract.

# Claims ratio

Ratio, in percent, of net insurance claims to earned premiums.

# Combined ratio

Ratio, in percent, of the sum of net insurance claims, expenses for acquisition of insurance contracts and administrative expenses to net earned premiums. This is also the sum of the expense ratio and the claims ratio.

# Coverholder/managing general agent

A firm either in the UK or overseas authorised by a managing agent under the terms of a binding authority to enter into contracts of insurance in the name of the members of the syndicate concerned, subject to certain written terms and conditions. A Lloyd's broker acts as a coverholder.

## Deferred acquisition costs

Costs incurred for the acquisition or the renewal of insurance policies (e.g. brokerage, premium levy and staff related costs) which are capitalised and amortised over the term of the contracts.

#### Dividend per share

Ratio, in pence calculated by dividing the dividends paid in the year by the number of shares eligible to receive those dividends in the year.

# Earnings per share (EPS) - basic/diluted

Ratio, in pence, calculated by dividing the consolidated profit after tax by the weighted average number of ordinary shares issued, excluding shares issued by the group. For calculating diluted EPS, the number of shares and profit or loss for the year is adjusted for all dilutive potential ordinary shares like share options granted to employees.

#### Excess per risk reinsurance

A form of excess of loss reinsurance which, subject to a specified limit, indemnifies the reinsured company against the amount of loss in excess of a specified retention with respect to each risk involved in each loss.

#### Expense ratio

Ratio, in percent, sum of expenses for acquisition of insurance contracts and administrative expenses to net earned premiums.

#### Facultative reinsurance

A reinsurance risk that is placed by means of separately negotiated contract as opposed to one that is ceded under a reinsurance treaty.

#### Gross premiums written

Amounts payable by the insured, excluding any taxes or duties levied on the premium, including any brokerage and commission deducted by intermediaries.

## Hard market

An insurance market where prevalent prices are high, with restrictive terms and conditions offered by insurers.

## Horizontal limits

Reinsurance coverage limits for multiple events.

# Individual capital assessment (ICA)

Beazley's ICA is an estimation of the capital the business needs so that it can absorb unexpected losses. This assessment takes account of losses that can arise from all major sources of risk: underwriting, investment, credit, liquidity, operational and group. The ICA is signed off by the board.

## Incurred but not reported (IBNR)

These are anticipated or likely claims that may result from an insured event although no claims have been reported so far.

## International accounting standards (IAS)/international financial reporting standards (IFRSs)

Standards formulated by the IASB with the intention of achieving internationally comparable financial statements. Since 2002, the standards adopted by the IASB have been referred to as IFRSs. Until existing standards are renamed, they continue to be referred to as IAS.

#### Lead underwriter

The underwriter of a syndicate who is responsible for setting the terms of an insurance or reinsurance contract that is subscribed by more than one syndicate and who generally has primary responsibility for handling any claims arising under such a contract.

#### Line

The proportion of an insurance or reinsurance risk that is accepted by an underwriter or which an underwriter is willing to accept.

#### Lloyd's

Lloyd's is the world's leading specialist insurance market and expects to have the capacity to write approximately £16.1bn of business in 2007. It occupies sixth place in terms of global reinsurance premium income, and is the second largest surplus lines insurer in the US. In 2007, 66 syndicates are underwriting insurance at Lloyd's, covering all classes of business from more than 200 countries and territories worldwide.

#### Long tail

This refers to a type of insurance where claims may be made many years after the period of the insurance has expired. Liability insurance is an example of long tail business.

## Managed syndicate

The combination of syndicates 2623 and 623 through which the group underwrites insurance business.

#### Managing agent

A company that is permitted by Lloyd's to manage the underwriting of a syndicate.

#### Medium tai

A type of insurance where the claims may be made three to five years after the period of insurance has expired.

#### Net assets per share

Ratio, in pence, calculated by dividing the net assets (total equity) by the weighted average number of shares issued.

## Net premiums written

Net premiums written is equal to gross premiums written less outward reinsurance premiums written.

## pro-rata reinsurance

A generic term describing quota share and surplus share reinsurance in which the reinsurer shares a proportional part of the ceded insurance liability, premiums, and losses of the ceding company. Also known as participating reinsurance and proportional reinsurance.

## Provision for outstanding claims

Provision for claims that have already been incurred at the balance sheet date but have either not yet been reported or not yet been fully settled.

#### Rate

The premium expressed as a percentage of the sum insured or limit of indemnity.

## Reinsurance to close (RITC)

A reinsurance which closes a year of account by transferring the responsibility for discharging all the liabilities that attach to that year of account (and any year of account closed into that year) plus the right to any income due to the closing year of account into an open year of account in return for a premium.

#### Reinstatement premiums

The restoration of cover following its exhaustion as a result of a loss by payment of an additional (reinstatement) premium. Many reinsurances provide for one or more automatic reinstatement of covers.

#### Retention limits

Limits imposed upon underwriters for retention of exposures by the group after the application of reinsurance programmes.

# Return on equity (ROE)

Ratio, in percent calculated by dividing the consolidated profit after tax by the average total equity.

#### Risk

This term may variously refer to:

- The possibility of some event occurring which causes injury or loss:
- · The subject-matter of an insurance or reinsurance contract; or
- · An insured peril.

#### Short tail

A type of insurance where claims are usually made during the term of the policy or shortly after the policy has expired. Property insurance is an example of short tail business.

#### Soft market

An insurance market where prevalent prices are low, and terms and conditions offered by insurers are less restrictive.

#### Stamp capacity

The volume of business measured in gross written premiums net of acquisition costs underwritten by the group through its managed syndicates at Lloyd's of London.

#### Surplus lines insurance

These are insurance risks that have been certified by a local broker as having been declined by a prescribed number (usually three or four) of licensed insurers in a given state in the US and which therefore can be underwritten as "surplus lines".

## Total shareholders return (TSR)

The increase in the share price plus the value of any dividends paid and proposed during the year.

# Treaty reinsurance

A reinsurance contract under which the reinsurer agrees to offer and to accept all risks of certain size within a defined class.

## Unearned premiums reserve

The portion of premium income in the business year that is attributable to periods after the balance sheet date is accounted for as unearned premiums in the underwriting provisions.

# Vertical limits

Reinsurance coverage limits which exceed the group's retention limits.



Plantation Place South 60 Great Tower Street London EC3R 5AD

T: +44 (0)20 7667 0623 F: +44 (0)20 7674 7100 www.beazley.com

Company number: 4082477