

# ACE European Group Limited

Annual Report and Financial Statements

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31 December 2010



**ACE European Group Limited**

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

Authorised and  
Regulated by the  
Financial Services Authority

Registered in England  
Number 1112892

# ACE European Group Limited

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## Chairman's Report

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### Performance in 2010

ACE European Group Limited ("AEGL") is one of Europe's leading commercial insurance and reinsurance players. With a premium base in excess of £2.2 billion, AEGL provides a range of tailored property and casualty ("P&C"), accident and health ("A&H") and specialty personal lines insurance solutions for a diverse range of clients. It is a well capitalised company offering a fresh and dynamic approach to risk solutions and operates a successful underwriting franchise throughout the UK, Ireland and Continental Europe.

Despite the continuing economic pressures and soft market conditions throughout 2010, AEGL maintained its gross written premiums at 2009 levels, with reductions in the London market and Continental Europe businesses offset by new products and business wins in the UK retail portfolio, and growth in specialty personal lines.

AEGL has again proved its ability to generate substantial returns despite difficult market conditions, reporting pre-tax profits for the 2010 financial year of £195.1 million. AEGL achieved an excellent combined ratio of 96.9% for the year, reflecting the company's continued focus on underwriting discipline and cost control. Shareholders' funds at the close of 2010 were £872.8 million.

### Achievements during the year

#### *Celebrating 25 years of ACE*

ACE Limited celebrated its 25th anniversary on 30 August 2010. Our commemoration of this milestone included advertisements in publications around the globe thanking our friends, distribution partners and customers who have supported us over the years, and a global road show by ACE senior management to meet with clients and brokers. As a company, we make it one of our priorities to support the communities where we live and work by giving back through charitable efforts, and another highlight of the year's activities was ACE's Global Day of Service on 22 October when employees around the world demonstrated their appreciation to the communities that have supported us throughout the years by working on volunteer service projects in partnership with local organisations.

#### *S&P financial strength rating upgrade*

On 10 December 2010, Standard & Poor's ("S&P") upgraded the financial strength ratings of the ACE group's core operating insurance entities, including AEGL, from "A+ (Strong)" to "AA- (Very Strong)", citing ACE's "very strong and consistent operating performance, very strong competitive position, positive management and corporate strategy, and very strong and improved capital adequacy". AEGL continues to hold a financial strength rating of "A+ (Superior)" from A.M. Best.

#### *Management changes*

In July 2010, Joseph Clabby was appointed President of ACE Continental Europe. Joe, who previously led ACE USA's regional operations, has responsibility for the further profitable growth and development of AEGL's insurance business in 18 countries across Europe. Joe succeeded David Furby following his promotion to Division President, Commercial Property & Casualty, for ACE's Overseas General operations in New York.

Also in July, Matthew Shaw, previously AGM's Chief Underwriting Officer was appointed as President, ACE Global Markets ("AGM"). Following his significant contribution to the development of the AGM business over the past two years, Matthew has been given additional responsibilities to ensure the segments continued profitability and maintain its market leading position. Richard Pryce continues in his role as President, ACE UK, with responsibility for ACE's UK and Ireland retail operations and the oversight of the AGM business.

Matthew and Joe were appointed to the board of AEGL in August and September 2010, respectively.

Graham Williams, a non executive director of AEGL since 2003, retired from the board in October 2010. Graham's experience, guidance and judgement have helped facilitate AEGL's growth into one of the UK's pre-eminent insurance companies, and on behalf of myself and the board, I would like to thank him for his support throughout the years, and wish him well for the future.

In October 2010, Malcolm Cox and Philip Stamp were appointed as non executive directors of AEGL. Malcolm brings with him over 40 years' experience in the Lloyd's insurance market, and has been a member of a various

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boards and committees including the Lloyd's Market Board, Lloyd's North American Board, and the Lloyd's Underwriters' Non Marine Association, of which he was Chairman in 1998. Philip was most recently Chairman and Chief Executive Officer of Aon Re UK Limited, and brings with him a wealth of experience in the financial services industry, including the field of risk management.

I would like to take this opportunity to formally welcome both Malcolm and Philip to AEGL.

### Market environment

UK and European economic growth has been weak throughout 2010, unemployment remains high, and reductions in client revenues, shrinking insurance budgets and pressures on consumer sales have all impacted the insurance markets. Underwriting conditions have remained competitive, with prices generally soft around the world.

2010 also saw significant natural catastrophe activity including the devastating earthquakes in Haiti, Chile and New Zealand, Windstorm Xynthia, flooding in Europe and Pakistan and the eruption of Eyjafjallajökull, an Icelandic sub-glacier volcano which disrupted air travel in northern Europe for several weeks. The year was also notable for the Deepwater Horizon disaster in the Gulf of Mexico, the largest accidental marine oil spill in the history of the petroleum industry. According to estimates from Swiss Re's *sigma* team<sup>1</sup>, worldwide economic losses from natural catastrophes and man-made disasters were \$222 billion in 2010 (2009: \$63 billion), with eight events triggering losses in excess of \$1 billion. Although the cost to the global insurance industry was \$36 billion, an increase of 34% over the previous year, these losses did not significantly impact the overall rating environment.

There have already been a number of significant events in 2011.

The floods across the east coast of Australia were some of the worst seen in the past 20 years. Similarly, no one anticipated that, having just recovered from a major earthquake, Christchurch, New Zealand would experience another one six months later, with devastating consequences and tragic loss of life.

<sup>1</sup> Swiss Re media release: Preliminary 2010 catastrophe estimates from *sigma*, November 2010

We are seeing a challenge to established political powers across a number of countries on the south shores of the Mediterranean. The instability appears to be contagious and could signal a period of political and economic unrest in that area for many years to come.

The increasing frequency of catastrophes coupled with economic and political uncertainty across the globe will provide both challenges and opportunities for the insurance industry. Whether, this will be enough to prompt an upturn in the insurance cycle is yet to be seen.

### Future prospects

Despite some signs of recovery, the economic environment continues to adversely impact many of the lines of business AEGL operates in. Significant cuts in government expenditure and continued cost cutting in all public and private sectors are likely to reduce demand for insurance protection and drive consumers and companies to review their purchasing strategies.

We are now also starting to see the effect of the continued soft market conditions on insurers' profitability. Although underwriting results are showing signs of deterioration as prior period reserve releases diminish, revealing the marginal nature of recent accident year profitability, the over supply of insurance capacity looks likely to continue into 2011. Notwithstanding a significant market changing event, we anticipate that 2011 will be another difficult year, with increased pressure on pricing and terms and conditions, particularly when accounts are re-marketed.

We continue to operate in challenging times.

While businesses everywhere examine their insurance expenditure, AEGL's philosophy is to respond with a creative approach, while never compromising on quality or security. We balance local knowledge and service with underwriting and engineering centres of excellence across the world, enabling us to offer the best solutions to clients, wherever they are.

Preservation of capital and balance sheet strength remain our utmost priorities, and underwriting discipline continues to be at the forefront of our business strategy. Our conservative investment policy aims to ensure that consistent investment returns with low levels of volatility are generated, hence preserving the asset side of the balance sheet.

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AEGL will aim to maintain profitability margins through the soft market cycle, rebalancing the portfolio as necessary to achieve planned combined ratios. We employ a proactive business retention strategy and aim to meet new business targets without compromising our stringent risk selection parameters.

The company has a well balanced underwriting portfolio, with the A&H and specialty personal lines businesses complementing the more cyclical UK, Ireland & Continental Europe P&C retail business and the London market wholesale insurance and reinsurance business. Our product and geographical diversity allows us to focus on lines that offer the greatest potential for growth and to reduce our involvement in areas that face more competition or have less attractive returns.

Our comprehensive reinsurance programmes ensure that we are not unduly exposed to large losses, and vigilant price monitoring and actual versus expected loss analysis conducted by the actuarial team allows us to quickly make any underwriting adjustments deemed necessary to sustain our profitability. Our relationships with our clients and intermediaries remain strong and our ability to offer flexible, tailor-made insurance and risk management solutions has continued to stand us in good stead.

AEGL continues to benefit from a flight to quality, capability and balance sheet strength – especially in those lines of business or risk layers where price is not the single determining factor. This business – such as primary and excess casualty layers, D&O, construction and multinational global programs – tends to be less cyclical and as such we experience higher retentions, better rates and firmer terms and conditions.

### Regulation

The European Union Solvency II Directive is expected to be implemented by 1 January 2013. Covering over 30 countries, it is the biggest ever exercise in establishing a single set of rules governing insurer capital and risk management, and represents a fundamental shift in regulatory requirements for the insurance industry.

As one of the UK's largest commercial P&C insurers, AEGL has chosen to adopt the Internal Model regime

and has entered into a pre-approval process with the Financial Services Authority ("FSA"). Solvency II preparations are well underway, under the guidance of the Solvency II Steering Committee established in January 2010. AEGL has also participated in the Quantitative Impact Study 5 ("QIS 5") testing and the FSA benchmarking exercises.

The Steering Committee is also tracking wider Solvency II issues including the equivalence of third country regulatory regimes and the impact of Group supervision.

### In conclusion

AEGL is a leader in insurance, reinsurance and risk solutions with excellent balance sheet strength and exceptional market standing. It has substantial geographical diversity, wide ranging product capabilities, a strong underwriting culture and a team of highly talented, optimistic and motivated people. AEGL's performance is driven by values and is a testament to our strategy of maintaining underwriting discipline, stringent cost controls and a conservative investment policy.

We acknowledge that our clients have the right to demand world class products, security and service, and we endeavour to provide this throughout the whole policy lifecycle, backed by some of the best people in the risk and insurance industry and our constant drive to enhance technologies.

We have a superb business support network encompassing claims, finance and actuarial, risk management, legal and compliance, human resources, operations and IT. AEGL would not be able to operate to the high standards it has set itself without the hard work and dedication of both our front line and functional support staff, and I would like to take this opportunity to thank all staff throughout the UK and Europe for contributing to AEGL's tremendous performance this year.

AEGL remains committed to taking on the responsibility of risk so that our clients can take on the responsibility of making things happen – *insuring progress*<sup>®</sup>.

A.J. Kendrick  
Chairman and Chief Executive Officer  
15 March 2011

## Business Review

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### Business Review

The board of AEGL has prepared this review in accordance with Section 417 of the Companies Act 2006.

In addition to this statutory requirement, this report also addresses other aspects of the company's business which the board believes will be of benefit to all stakeholders.

### Business objectives and strategy

AEGL is a major contributor to the ACE group of Companies, providing approximately 18% of the ACE group's overall gross written premium for 2010.

The ACE group is one of the world's largest providers of commercial property and casualty insurance and reinsurance. With \$83.4 billion in assets and \$19.5 billion of gross written premiums in 2010, the ACE group is distinguished by its underwriting expertise, superior claims handling and global franchise, which includes offices in 53 countries and clients in over 170.

The insurance companies of the ACE group serve a diverse range of clients: multinational corporations and local businesses with property and casualty exposures; companies and affinity groups looking to provide or offer accident and health insurance programmes and life insurance to their employees or members; insurers seeking reinsurance coverage; and individuals purchasing life, personal accident, supplemental health and high-valued homeowners, automobile, and umbrella insurance.

ACE Limited, the Swiss-incorporated parent company of the ACE group, is listed on the New York Stock Exchange (NYSE: ACE) and is a component of the S&P 500 stock index. The ACE group maintains executive offices in Zurich, Bermuda and New York, among other locations, and employs more than 15,000 people worldwide.

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

conditions that reflect clients' changing requirements in the current, challenging environment. The company strives to offer superior service levels in all aspects of its operations, ranging from policy processing to engineering risk management and claims handling, and has invested in technology to improve its operational efficiency, underwriter support and broker interfaces.

AEGL is headquartered in London but can issue policies locally throughout its network of UK and European branch offices. This encourages underwriting flexibility and high levels of service for brokers and clients whilst ensuring local regulatory and tax requirements are adhered to. AEGL is an established player in the multinational marketplace with the capability to front business and provide fully integrated international insurance programmes for clients. AEGL's dedicated and experienced international underwriting and service teams work with the ACE group's global network of offices to provide seamless, tailored solutions to the often unique and complex needs of multinational companies which includes agreeing coverage, issuing policies, adjusting claims and moving funds, all in accordance with legislative requirements and agreed service standards. The continuing trend of companies expanding beyond their own borders makes multinational business a key priority for AEGL.

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

### Organisation of the business

Headquartered in the UK and with branch offices in another 19 countries across Europe, AEGL holds cross-border permissions throughout the European Economic Area and is eligible to underwrite excess & surplus lines ("E&S") business in 42 US states. AEGL is also able to underwrite risks and issue reinsurance policies to insurance companies throughout most of the world's markets on a non-admitted basis. Business is accessed by a variety of distribution channels and the company has strong relationships with the broker community, corporate partners and direct markets.

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

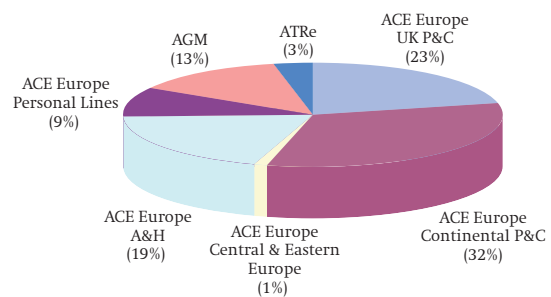
ACE Europe specialises in client-focused solutions for a diverse range of UK and European multinational and large commercial clients. Its product range includes property, primary and excess casualty, financial lines (D&O and crime) surety, marine cargo and construction-related risks. ACE Europe also underwrites an accident and health and travel insurance portfolio, providing benefits and services to individuals, employee groups and affinity groups throughout Europe. In some cases these products are packaged under other brands or form part of another service provider’s products. ACE Europe has successfully blended the knowledge of its local markets with the worldwide perspective available through the global organisation, building a significant position in Europe. The principal business segments of ACE Europe are managed as UK & Ireland property & casualty (“P&C”), Continental Europe P&C, accident & health (“A&H”) and specialty personal lines.

ACE Global Markets (“AGM”) is the ACE group’s specialty international underwriting business. Its parallel distribution capabilities mean that underwriting products may be offered through both AEGL and Lloyd’s Syndicate 2488, managed by ACE Underwriting Agencies Ltd. This flexibility allows AGM to provide risk solutions to clients in over 140 countries and territories throughout the world, including a significant presence in the US. AGM’s product range includes aviation, energy, financial lines, marine, property, political risks and E&S business.

ACE Tempest Re (Europe) (“ATRe”) is ACE’s European reinsurance arm, underwriting a wide-ranging portfolio of property and liability reinsurance classes, operating both in London and on the Continent. Treaty underwriting capabilities include casualty, property, marine and aviation, with products offered through both AEGL and Lloyd’s Syndicate 2488.

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

Calendar year 2010 gross written premiums split by management reporting



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

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

### Significant business achievements & new product launches

#### Launch of ACE Global Programme Solutions (GPS<sup>SM</sup>)

The ability to operate effectively across different regulatory and legal regimes is increasingly important to multinational businesses. ACE UK’s launch of ACE GPS<sup>SM</sup> in June 2010 enables AEGL to meet this need and offer multinational clients the most effective and compliant global solution available.

As an integral part of the GPS<sup>SM</sup> platform, the company has launched a web-based portal called ACE Worldview<sup>SM</sup>. This portal enables risk managers to

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monitor and manage their entire global insurance programme, including information on all policies and claims from their desktops.

ACE GPS<sup>SM</sup> is designed to provide risk managers and brokers access to the full range of ACE's global capabilities including its underwriting, international network, global client management, servicing and claims expertise spanning property, casualty, specialty and A&H lines within a dynamic platform that provides tailored solutions to businesses across sectors and geographies.

### *Introduction of new multi-line products to drive growth in UK & Ireland*

In May, ACE UK launched a suite of multi-line products targeting medium to large sized businesses in four industry sectors: professional companies or partnerships with one or more overseas branches, retailers, hotel groups and machinery manufacturers. The new products have been designed to offer a wide range of covers reflecting the specific needs and buying patterns of clients in these sectors. The focus on these new products forms part of the initiative to better align ACE's service capabilities and underwriting expertise directly with the needs of brokers and clients in sectors where ACE has particular strength and experience.

### *Launch of new Environmental Risk cover*

In response to significant broker demand, ACE UK has launched a new Environmental Protect policy offering coverage for both small to medium sized companies and multinational operations. The new policy reflects ACE UK's commitment to providing all markets with the broadest cover and comes as submissions from regional and London market brokers across a range of risks continue to increase.

ACE Environmental Protect has been developed to provide a broad standard wording and the flexibility of coverage for multiple markets including UK corporate risk, multi-national operations and major risk casualty business. Environmental Protect is aimed primarily at ongoing operational environmental risks, but can also address the legacy liabilities from historical contaminated land exposures.

### *Expansion of A&H product availability via ACE Online*

AEGL has recently launched a range of new 'Express' A&H products on the company's UK & Ireland e-commerce platform, ACE Online. The flexible products will provide cover for single or multi business trips and director and employee injury, in order to protect both clients' businesses and their workforce. These products are the latest in a line of covers that ACE has added to its online portfolio as part of its strategy to make its specialist products accessible to a wide range of brokers. Other products available via the ACE Online platform include D&O, Pension Trustee Liability, Environmental Impairment Liability, Excess Casualty and Marine Cargo.

### *Launch of ACE D&O product on PowerPlace*

In August 2010, AEGL became the first insurer to offer a D&O product on PowerPlace, an online marketplace for commercial insurance which provides brokers with the ability to compare the marketplace quickly and efficiently, and get access to competitive cover – not just for the simpler lines of business but also for specialty products traditionally viewed as perhaps too complex for online quote and buy. This provides AEGL with a significant opportunity to distribute its products to independent brokers, and the company has the potential to make more products available to PowerPlace users during 2011.

### *AGM opens US West Coast Political Risk & Credit Operation*

In June, ACE opened a new US Political Risk and Credit operation based in Los Angeles. The office provides enhanced levels of service to existing West Coast clients and enables us to generate additional business in a region which offers significant growth potential in the trade credit area.

### *AEGL completes its first year of trading in Turkey*

2010 marked the first full year of trading for AEGL's newest branch, ACE Turkey. Following its authorisation to start underwriting business in June 2009, the Istanbul office has grown its premium base considerably. This is an encouraging start in a region with a fast developing economy and continuing development of the local insurance market, and represents a significant opportunity for AEGL.

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### Business environment

Despite growth in the emerging markets, the global economic outlook remains uncertain, with financial markets remaining fragile and the economies of many developed countries recovering at a much slower pace than others.

The economic situation, continuing high unemployment, low interest rates, rising inflation, excess capacity and competitive market conditions are expected to continue to be the major factors influencing the performance of the London, UK and European insurance markets in 2011.

Despite the notable market losses of 2010, pressures on accident year loss ratios and lower favourable prior period loss reserve releases, the insurance industry continues to see high levels of competition and greater pressure on rating levels.

ACE Europe's UK and Continental Europe retail businesses have experienced pricing pressures during 2010 however rates within AGM's London Market portfolio have fared slightly better, with some upward movement seen within the financial lines, political risks and marine classes. AEGL's A&H and specialty personal lines divisions have experienced growth through the launch of new products and increased market penetration despite the negative impact of recession on the consumer markets.

Although no immediate widespread improvement in rating is anticipated, AEGL's focused, disciplined and conservative approach to underwriting, expense control, investments and risk management should ensure the company's continued success.

### Presentation of financial statements

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

### Key performance indicators

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

£ million	2010	2009
Net written premiums	956.0	937.2
Combined ratio*	96.9%	95.5%
Profit before tax	195.1	262.2

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

The board also monitors the capital needs of the company. Further details in this regard are set out in the 'Financial position' section of this Business Review. Management also use a variety of other performance indicators including production volumes, retention ratios, price monitoring, loss and expense analyses, and operating metrics in assessing the performance of each of the individual business segments. All financial results are monitored against plan, forecast and prior year on a regular basis.

### Results and performance

2010 produced a pre-tax operating profit of £195.1 million and a combined ratio of 96.9%. A summary of the reported financial results is shown in the following table.

£ million	2010	2009
Gross written premiums	2,204.1	2,202.6
Net written premiums	956.0	937.2
Net earned premiums	950.9	932.9
Incurred losses	572.3	580.4
Operating expenses	349.4	310.2
Equalisation reserve movement	12.2	(7.5)
Underwriting profit	17.0	49.8
Investment return	176.7	219.2
Net other income (charges)	1.4	(6.8)
Net pre-tax profit	195.1	262.2
Combined ratio	96.9%	95.5%

AEGL underwrites UK, Continental Europe, US and international business which is principally transacted in sterling, euros and US dollars. For accounting purposes,

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the results of this business are presented in sterling. The currency risk section within Note 2 to the Financial Statements discusses currency exposure in more detail.

Despite recession related declines and soft market pricing, gross written premiums were effectively in line with those of the prior year as growth in specialty personal lines and UK P&C business offset premium reductions within the Continental P&C and London Market portfolios. Although the A&H business continued to be impacted by declines in global consumer spending, credit and travel, and reductions in employer related benefits, premium income was maintained at approximately 2009 levels due to new business wins within the Classic portfolio.

AEGL purchases reinsurance to mitigate the impact of major events and an undue frequency of smaller losses. The principal reinsurance programmes operated by AEGL during 2010 are with an ACE group company, ACE Tempest Reinsurance Ltd. AEGL also has the benefit, particularly for US and worldwide catastrophe exposures, of reinsurance programmes shared with other ACE companies, including ACE European Group's Lloyd's Syndicate 2488. These arrangements result in an increase in the reinsurance purchasing power of the ACE group, which ultimately benefits all ACE subsidiaries, including AEGL.

Although there were no major changes to AEGL's reinsurance programme in 2010, comparatively more UK P&C business was written during the year than in 2009. This business has a higher retention ratio than other management segments and as a result, 2010 net written premiums increased to £956.0 million, £18.8 million higher than last year.

Despite the high level of natural disasters during 2010, AEGL's catastrophe related losses after reinsurance recoveries amounted to £3.9m. Prior period reserve releases were £45.4m (2009: £41.7 million). Excluding catastrophe losses and prior period development, the current accident year loss ratio for the year was 64.6% (2009: 66.7%) – an excellent performance that illustrates the strength of the company's core business.

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

Overall AEGL generated solid total investment returns in 2010 of over 7% based on funds available for investment. AEGL's investment structure and commentary is detailed in the financial position section detailed below.

### Financial position

#### *Investments*

AEGL maintains six active investment grade fixed income portfolios, the core currencies of which are sterling, euro and US dollars. AEGL also maintains actively managed portfolios for US dollar high yield fixed income securities and sterling and euro denominated financial debt securities. A further passive Swiss franc portfolio is maintained to meet local solvency requirements. The approximate currency split of AEGL's investment portfolios is GBP 39%, US dollars 34%, euro 26% and other currencies 1%. AEGL held no equities throughout 2010.

After the extreme volatility witnessed in 2008 and stabilisation in 2009 resulting from measures taken by governments, fixed income investments continued to perform strongly in 2010 for most sectors as government yields fell and corporate bonds delivered strong positive excess returns. As in 2009, sectors which bore the brunt of the falling valuations, such as financial bonds, asset and mortgage backed securities, generated the strongest returns. However, risk assets performed less well in the latter part of the year in response to heightened market concerns evidenced by de-risking measures undertaken by investors principally relating to peripheral and financial investments.

AEGL implemented no significant changes to the existing asset allocation or investment strategy and continued to maintain diversified actively managed portfolios with exposure to a broad range of sectors. However, ACE's investment guidelines and external manager positioning ensured AEGL suffered minimal exposure to the well publicised peripheral Eurozone countries which detracted from performance for many

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investors. In addition, manager security selection, typically targeting higher quality credits in favour of sovereign debt, provided positive relative returns in the year.

AEGL's high yield portfolio focuses on upper tier high yield fixed income securities, targeting average Standard & Poor's quality of "B" or higher. Although returns were significantly lower than those achieved in 2009, the portfolio performed satisfactorily in view of the higher quality portfolio bias, generating a total return of nearly 12% for the year.

### *Capital*

AEGL maintains an efficient capital structure consistent with the company's risk profile and regulatory and market requirements. The company assesses its capital needs on a risk management basis, and then seeks to maintain financial strength and capital adequacy to support business objectives and meet the requirements of policyholders, regulators and rating agencies whilst retaining financial flexibility by ensuring liquidity.

AEGL assesses its capital requirements using an internal model based on Individual Capital Assessment ("ICA") principles which is subject to review by the FSA.

AEGL also manages its capital levels in the context of the minimum requirement, the Capital Resources Requirement, and the Enhanced Capital Requirement which computes a capital level using an allowance for industry risk factors related to premiums, reserves and assets. The company was issued with Individual Capital Guidance by the FSA. The company currently maintains a comfortable margin against each of these key capital measures based on the admissible shareholders' funds of £837.5 million. AEGL continues to develop its internal model to meet continuously developing best practice industry standards and to further embed risk and capital assessment within the business as it prepares to meet Solvency II regulatory requirements.

### *Ratings*

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

The A.M. Best rating was upgraded from "A (Excellent)" in October 2006 and most recently affirmed at "A+

(Superior)" with a stable outlook in May 2010. The FSR reflects A.M. Best's expectation that AEGL will maintain its strong stand-alone risk adjusted capitalisation and good anticipated technical results. The rating also factors AEGL's strategic importance to its parent company, ACE Limited and its strong business profile in the UK and Continental Europe. A.M. Best also affirmed AEGL's issuer credit rating ("ICR") of "aa-" and revised the outlook to positive from stable. This change reflects the change in outlook to positive from stable on the ICR of ACE Limited.

On 10 December 2010, Standard & Poor's raised its financial strength ratings of ACE Ltd's core operating subsidiaries, including AEGL, from "A+" (with a positive outlook) to "AA-" (with a stable outlook). In support of the upgrade, S&P's credit analysis report cited ACE's "very strong and consistent operating performance, very strong competitive position, positive management and corporate strategy, and very strong and improved capital adequacy." In its announcement, S&P said ACE's "top managers are actively involved in the operations of the business, backed by a strong staff with significant depth and breadth" and also noted that the ratings reflect the company's "strong enterprise risk management practices."

In addition, S&P upgraded the issuer credit (senior debt) rating of ACE Limited to "A" from "A-", citing the company's "very strong liquidity and improved financial flexibility."

### *Solvency II*

ACE recognises the importance of Solvency II, not just to its EU-based operations, but also to the wider group. The ACE Solvency II programme was initiated by ACE Limited's Enterprise Risk Management ("ERM") Board in 2009 and AEGL's Solvency II project was formally established in early 2010 within the structure of the global project.

AEGL's Solvency II project is managed against a comprehensive plan. The project has been broken down into a number of workstreams each with a leader and detailed project plan. Resource needs have been identified and deliverables and milestones have been defined.

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Weekly implementation meetings take place where progress across all the workstreams is monitored and project governance is provided through both the ACE European Group Solvency II Steering Committee and ultimately the ACE Solvency Program Global Steering Committee.

AEGL's approach to the implementation of Solvency II has been to build on existing processes, where possible, incorporating business operational improvements with a focus on ensuring these to be cost effective and deliver tangible business benefits as well as meet regulatory requirements. AEGL is also seeking to engage early with the FSA to ensure there is an opportunity to influence the overall direction and allow ourselves sufficient time to ensure that all the necessary requirements are met.

### Governance

AEGL continues to work closely with its regulator, the FSA, and the board of directors fully supports their approach to regulation and their contribution to the development of the Solvency II directive.

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

The board of directors of AEGL ("the board") is comprised of members of the executive management team and four non-executives. The role of a non-executive director is to constructively challenge management, help develop proposals on strategy and to bring strong independent judgement, knowledge and experience to the board's deliberations. The board meets at least four times a year and delegates certain oversight responsibilities to three committees, the Audit Committee, the Risk Committee and the Executive Committee, under formal terms of reference. AEGL's non-executive directors take an active role in the Audit and Risk committees, with the Audit Committee being solely comprised of non-executive directors.

The board reviews and approves the annual business plan for the company, which includes assessing the risk appetite for the company and considering the strategy, limits and reinsurance protections for each business

class. The board also receives reports from each of the Risk and Audit committees, reviews the ICA, quarterly financial information, Treating Customers Fairly metrics and significant management decisions.

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

### Risk & control framework

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

#### *Risk Committee*

The board has delegated responsibility for the approval, oversight and implementation of its risk management framework to the Risk Committee. Various committees which have responsibility for specific risks, financial controls and functional areas have been created to comprehensively cover the major risk sources facing the company.

The Risk Committee assists the board by providing oversight of risk management and overseeing the development and embedding in the business of risk management and capital assessment. It also ensures that business risks and controls are recorded and monitored.

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

#### *Executive Committee*

The Executive Committee, another principal committee of the board, includes all executive directors of AEGL. The primary role of the Executive Committee is to oversee the day to day management of business operations, performance and to implement and oversee operational strategies and decisions determined by the board. The Executive Committee is also responsible for

## Business Review

31 December 2010

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the oversight of support function activities, key steering groups and sub-committees including broker review, reserving and project reporting.

### *Audit Committee*

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

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

### **Principal Risks**

The company is exposed to both underwriting and financial risk.

#### *Underwriting Risk*

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

Underwriting risks and line sizes are continually monitored through the established peer review process and automated exception reporting. Formal price monitoring procedures have been in place since early 2002 and form part of the standard monthly management statistics. These contribute to the quarterly actuarial review whereby the loss outcome of the underwriting activity is continually re-assessed and considered by the Reserve Sub-Committee. With such a large and diverse book, it is vital that the company's aggregate exposures are continually monitored and adjustments made to the underwriting profile as appropriate. The company operates a dedicated catastrophe management function independent of underwriting management, whose responsibility is to model aggregate risk and determine pricing for individual policies, providing a key control to the underwriting process.

#### *Group Risk*

This is the potential impact on the company of risks arising in other parts of the ACE group. This could include direct or indirect financial loss and operational, reputational or regulatory issues.

As part of the ACE group, the company uses group resources in a number of areas, including IT and asset management, as well as reinsurance and capital support.

As part of the company's risk management processes, group risk is assessed, monitored and reported.

#### *Financial Risk*

The company is exposed to financial risk in the form of interest rate risk, equity risk, currency risk, liquidity risk and credit risk. These risks are discussed in more detail in Note 2 to the financial statements.

### **Compliance**

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

## Business Review

31 December 2010

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Annual affirmation of the ACE group Code of Conduct is required of all employees and directors. As a material subsidiary of ACE Limited, a US listed company, the control environment in which the US GAAP financial statements are derived is subject to the requirements of US Sarbanes-Oxley legislation. The company has formalised documentation and tested controls to enable ACE Limited to fulfil the requirements of the legislation.

AEGL continues to work with its regulator, the FSA. The company employs a highly skilled and proficient workforce to manage its regulatory and compliance undertakings and aims to operate to a standard of best practice. AEGL enjoys good relationships with regulators in each of its jurisdictions and engages in open dialogue and communication to address and resolve any issues.

### Employees

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

ACE is an equal opportunity employer. One of the three key ACE mission statements is to provide “superior employee value by creating a rewarding and ethical environment.” In support of this, it is ACE’s policy to take whatever steps reasonably practicable to promote equality of opportunity and to eliminate discrimination in employment. The ACE group has implemented a number of policies relating to diversity and equal opportunities including, but not limited to, age, disability, race, religious and sex discrimination.

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

persons should, as far as possible, be identical with that of other employees.

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

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

### ACE and the environment

The ACE group is focused on the implications of climate change in all areas of its business and is taking action across the company, both internally and externally, to make a positive and lasting difference.

Climate change is an important and serious issue for the global property and casualty insurance industry because it is its business to provide security against many of the risks posed by such change. Natural catastrophes, in the form of hurricanes, windstorms, flooding, drought and other weather-related events, may be increasing in both frequency and severity due to climate change.

ACE’s risk management modelling and underwriting practices in its insurance and reinsurance businesses continue to adapt to the developing risk exposures attributed to climate change. ACE offers insurance products and services that address a broad range of risks so that companies can develop new, renewable sources of energy and engage in sustainable business development activities around the world.

ACE is committed to reducing its carbon footprint and controlling its environmental impact, even as it continues to expand its operations around the globe. Carbon reduction initiatives in ACE’s offices address both direct and indirect sources of emissions. ACE has made significant strides towards reducing its environmental footprint and improved its position in Newsweek’s 2010 Green Rankings of America’s 500 largest public companies, ranking 6th in the banks and insurance sector (2009: 9th) and 64th overall (2009: 103rd). Companies were rated based on a weighted average of scores for environmental impact, green policies and reputation.

## Business Review

31 December 2010

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In December 2010, ACE announced that it had achieved its company-wide greenhouse gas emissions reduction goal – to reduce its global emissions by eight percent per employee from 2006 to 2012 – more than two years ahead of the original 2012 target date. The goal was reached through a range of activities, including making energy-efficient lighting upgrades and heating/ventilation/air conditioning improvements in its largest owned and leased facilities, reducing non-essential business travel and optimizing its real estate square footage.

Responsibility for ACE's environmental action program is a shared commitment at the senior management level and involves a comprehensive, coordinated effort integrating activity across all areas of the organisation.

### ACE in the community

The ACE group supports the communities around the world through the established "ACE Foundations" and through group sponsored volunteer initiatives, with focus on the areas of education, poverty and health and the environment. ACE encourages the development of local and regional initiatives, which reflect its employees' commitment to the needs of the communities in which they live and work, and ACE employees direct a significant portion of the group's charitable giving.

AEGL employees involved with charitable activities and fund raising in their local community or a national registered charity may also apply to the ACE European Group Community Support Programme Committee ("ACS") for a financial donation to their chosen cause. During 2010, requests for donations or matched funding were received from offices throughout the UK, Ireland and Continental Europe, covering a wide range of charities. In addition to the requests that fulfilled the ACS criteria, a small number of donations were also made in response to external charity requests, bringing total donations made during 2010 to approximately £109,000.

On 22 October 2010, employees throughout AEGL joined together to take part in the ACE group's second "Global Day of Service", and demonstrated their appreciation to their communities by working with volunteer service projects in partnership with local organisations.

Projects throughout Europe ranged from cleaning, painting and carrying out repairs at schools, foundations, homeless shelters, petting zoos and public areas, and volunteering with UNICEF and various conservation projects to visiting and entertaining sick and disadvantaged children and organising tea dances and bingo for the elderly. Fund raising activities including cake sales, raffles and donations also raised significant funds and resources for numerous charities including those for the homeless, the NSPCC, Age UK, Barnardo's, the Salvation Army and children's hospices.

**Approved by the Board of Directors**

10 March 2011

## Directors' Report

31 December 2010

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The directors are pleased to submit their report and the audited financial statements for the year to 31 December 2010.

### Principal activity

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

### Business review

A review of the company's activities and its future prospects is set out in the Business Review.

### Principal risks and uncertainties

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

### Results and dividends

The company made a profit on ordinary activities before tax for the year to 31 December 2010 of £195.1 million (2009: £262.2 million).

Shareholders' funds at the 31 December 2010 totalled £872.8 million (2009: £825.3 million). A reconciliation of the movement in shareholders' funds during the year is set out in note 18 to the financial statements.

An interim dividend of £75.0 million (2009: £nil) was paid in November. The directors do not propose a final dividend (2009: £nil).

### Employees

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

### Directors

The following have been directors from 1 January 2010 to the date of this report unless otherwise indicated:

#### *Executive directors:*

J S Clabby (appointed 8 September 2010)  
D M A Furby (resigned 13 September 2010)  
A A Hollenberg  
A J Kendrick  
R P Murray  
R V Pryce  
M T Reynolds  
A M W Shaw (appointed 2 August 2010)

#### *Non-executive directors:*

M Cox (appointed 29 October 2010)  
R V Emerson  
D S Marston  
P Stamp (appointed 29 October 2010)  
G D Williams (resigned 29 October 2010)

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

## Directors' Report

31 December 2010

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### Financial risk management

Information on the use of financial instruments by the company and its management of financial risk is disclosed in note 2 to the financial statements. In particular the company's exposures to interest rate risk, equity price risk, currency risk, credit risk and liquidity risk are separately disclosed in that note. The company's exposure to cash flow risk is addressed under the headings of "Credit risk" and "Liquidity risk".

### Statement as to disclosure of information to auditors

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

1. so far as each of them is aware, there is no information relevant to the audit of the company's financial statements for the year ended 31 December 2010 of which the auditors are unaware, and
2. the director has taken all steps that he/she ought to have taken in his/her duty as a director in order to make him/herself aware of any relevant audit information and to establish that the company's auditors are aware of that information.

### Auditors

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

By Order of the Board

for and on behalf of  
ACE London Services Limited  
Secretary, 15 March 2011

ACE Building  
100 Leadenhall Street  
London  
EC3A 3BP

## Statement of Directors' Responsibilities

31 December 2010

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The directors are required by the Companies Act 2006 to prepare financial statements for each financial period which give a true and fair view of the state of affairs of the company as at the end of the financial period and of the profit or loss of the company for the financial period.

The directors confirm that suitable accounting policies have been used and applied consistently, with the exception of changes arising on the adoption of new accounting standards in the year, and reasonable and prudent judgements and estimates have been made in the preparation of the financial statements for the year ended 31 December 2010. The directors also confirm that applicable accounting standards have been followed and that the financial statements have been prepared on a going concern basis.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

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

## Independent Auditors' Report

31 December 2010

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We have audited the financial statements of ACE European Group Limited for the year ended 31 December 2010 which comprise the Profit and Loss Account, the Balance Sheet, the Statement of Total Recognised Gains and Losses, and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

### Respective responsibilities of directors and auditors

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

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

### Scope of the audit of the financial statements

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

### Equalisation provisions

Our evaluation of the presentation of information in the financial statements has had regard to the statutory requirement for insurance companies to maintain equalisation provisions. The nature of equalisation provisions, the amounts set aside at 31 December 2010, and the effect of the movement in those provisions during the year on shareholders' funds, the balance on the general business technical account and profit before tax, are disclosed in note 19.

### Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2010 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

### Opinion on other matter prescribed by the Companies Act 2006

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

## Independent Auditors' Report

31 December 2010

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### **Matters on which we are required to report by exception**

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

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

Gavin Phillips (Senior Statutory Auditor)  
For and on behalf of **PricewaterhouseCoopers LLP**  
Chartered Accountants and Statutory Auditors  
London  
15 March 2011

**Profit and Loss Account**

for the year ended 31 December 2010

	Note	2010 £'000	2009 £'000
<b>Technical account – general business</b>			
<b>Earned premiums, net of reinsurance:</b>			
Gross premiums written – continuing operations	3	2,203,354	2,201,753
– discontinued operations	3	705	873
Gross premiums written	3	2,204,059	2,202,626
Outward reinsurance premiums		(1,248,094)	(1,265,425)
Net premiums written		955,965	937,201
Change in the gross provision for unearned premiums		(11,281)	(41,035)
Change in the provision for unearned premiums – reinsurers' share		6,201	36,704
<b>Earned premiums, net of reinsurance</b>		<b>950,885</b>	<b>932,870</b>
<b>Claims incurred, net of reinsurance:</b>			
Claims paid:			
Gross amount	3	(1,137,288)	(1,036,876)
Reinsurers' share		620,474	553,798
Net paid claims		(516,814)	(483,078)
Change in the provision for claims outstanding:			
Gross amount	3	(103,029)	(11,581)
Reinsurers' share		47,518	(85,720)
Change in the net provision for claims outstanding		(55,511)	(97,301)
<b>Claims incurred, net of reinsurance</b>		<b>(572,325)</b>	<b>(580,379)</b>
Net operating expenses	5	(349,404)	(310,145)
Change in the equalisation provision	19	(12,192)	7,493
<b>Balance on the technical account for general business</b>		<b>16,964</b>	<b>49,839</b>

## Profit and Loss Account

for the year ended 31 December 2010

	Note	2010 £'000	2009 £'000
<b>Non-technical account</b>			
<b>Balance on the general business technical account</b>		<b>16,964</b>	49,839
Investment income	9	164,949	199,751
Unrealised gains on investments	9	147,960	227,294
Investment expenses and charges	9	(37,029)	(87,572)
Unrealised losses on investments	9	(99,207)	(120,230)
Foreign exchange differences		1,356	(7,326)
Other income		68	472
<b>Profit on ordinary activities before taxation</b>		<b>195,061</b>	262,228
<hr/>			
<i>Continuing operations</i>		197,800	264,490
<i>Discontinued operations</i>		(2,739)	(2,262)
<hr/>			
Taxation on profit on ordinary activities	10	(43,958)	(81,536)
<b>Profit for the financial year</b>		<b>151,103</b>	180,692

## Statement of Total Recognised Gains and Losses

for the year ended 31 December 2010

		2010 £'000	2009 £'000
<b>Profit for the financial year</b>		<b>151,103</b>	180,692
Currency translation differences	17	(28,292)	(74,995)
Actuarial loss recognised in relation to pension schemes	17	(411)	(2,203)
Movement on deferred taxation relating to pension liability	17	121	617
<b>Total recognised gains relating to the year</b>		<b>122,521</b>	104,111

ACE European Group Limited

## Balance Sheet

at 31 December 2010

	Note	2010 £'000	2009 £'000
<b>Assets</b>			
<b>Investments</b>			
Other financial investments	12	2,597,385	2,731,111
Financial derivative instruments	12	2,703	1,784
Deposits with ceding undertakings		14,237	-
		<u>2,614,325</u>	<u>2,732,895</u>
<b>Reinsurers' share of technical provisions</b>			
Provision for unearned premiums		345,656	341,290
Provision for claims outstanding		2,076,199	2,055,451
		<u>2,421,855</u>	<u>2,396,741</u>
<b>Debtors – amounts falling due within one year</b>			
Debtors arising out of direct insurance operations:			
amounts owed by policyholders		6,995	5,151
amounts owed by intermediaries		377,244	402,764
Debtors arising out of reinsurance operations		239,244	228,273
Other debtors	13	84,530	67,142
		<u>708,013</u>	<u>703,330</u>
<b>Other assets</b>			
Tangible assets	15	5,474	6,569
		<u>5,474</u>	<u>6,569</u>
<b>Prepayments and accrued income</b>			
Accrued interest and rent		38,590	42,129
Deferred acquisition costs		108,380	104,596
Other prepayments and accrued income		58,280	72,297
		<u>205,250</u>	<u>219,022</u>
<b>Total assets excluding pension surplus</b>		<u>5,954,917</u>	<u>6,058,557</u>
<b>Pension surplus</b>	1	671	391
<b>Total assets</b>		<u>5,955,588</u>	<u>6,058,948</u>

**Balance Sheet**

31 December 2010

	Note	2010 £'000	2009 £'000
<b>Liabilities</b>			
<b>Capital and reserves</b>			
Called-up share capital	16	544,741	544,741
Profit and loss account	17	302,434	254,913
Merger reserve	17	25,653	25,653
<b>Total shareholders' funds</b>	18	<b>872,828</b>	<b>825,307</b>
<b>Technical provisions</b>			
Provision for unearned premiums		724,516	717,311
Provision for claims outstanding		3,710,670	3,655,464
Equalisation provision	19	64,567	52,375
		<b>4,499,753</b>	<b>4,425,150</b>
<b>Deposits received from reinsurers</b>		<b>4,083</b>	<b>3,736</b>
<b>Creditors – amounts falling due within one year</b>			
Creditors arising out of direct insurance operations		19,471	25,816
Creditors arising out of reinsurance operations		276,723	283,945
Bank overdraft	2	24,423	11,860
Other creditors including taxation and social security	20	177,061	396,512
		<b>497,678</b>	<b>718,133</b>
<b>Other financial liabilities</b>	12	<b>2,609</b>	<b>2,514</b>
<b>Accruals and deferred income</b>			
Deferred acquisition costs relating to reinsurance		48,030	49,842
Other accruals and deferred income		30,607	34,266
		<b>78,637</b>	<b>84,108</b>
<b>Total liabilities</b>		<b>5,955,588</b>	<b>6,058,948</b>

The financial statements on pages 20 to 48 were approved by the board of directors on 10 March 2011 and were signed on its behalf by:

**M T Reynolds**  
Chief Financial Officer

15 March 2011

## Notes to the Financial Statements

31 December 2010

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### 1. Accounting policies

#### Basis of preparation

The financial statements have been prepared in accordance with The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (“SI2008/410”) relating to insurance companies’ individual accounts and in accordance with the Statement of Recommended Practice on Accounting for Insurance Business issued by the Association of British Insurers (“the ABI SORP”) dated December 2005 (as amended in December 2006) and applicable accounting standards in the United Kingdom. The company is a wholly owned subsidiary within the ACE Limited group and is included within the consolidated financial statements of ACE Limited, which are publicly available. Consequently, the company has taken advantage of the exemption from preparing a cash flow statement under the terms of FRS1 (revised) “Cash Flow Statements”.

#### Continuing and discontinued operations

Discontinued operations include business underwritten by ACE European Group Limited (“AEGL”) prior to its reauthorisation by the Financial Services Authority (“FSA”) in 2003. This business included UK marine and aviation business underwritten until 1994, accident and health business underwritten until 1995 and United States surplus lines business underwritten until 1998. Following the group reconstruction in 2005 (see note 17), discontinued operations now also include marine and aviation business underwritten by ACE Insurance S.A.-N.V. in the London market prior to 1999. All other operations are classified as continuing.

#### Premiums written

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

#### Unearned premiums

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

#### Acquisition costs

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

#### Claims incurred

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

#### Provision for claims outstanding and related reinsurance recoveries

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

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

## Notes to the Financial Statements

31 December 2010

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### 1. Accounting policies – continued

#### **Provisions for claims outstanding and related reinsurance recoveries – continued**

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

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

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

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

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

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

#### ***Third party liability (including marine and aviation liability)***

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

#### ***Reinsurance acceptances***

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

#### ***Asbestos, pollution and health claims ("APH")***

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

## Notes to the Financial Statements

31 December 2010

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### 1. Accounting policies – continued

#### **Unexpired risks provision**

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

#### **Equalisation provision**

Amounts are set aside as equalisation provisions in accordance with the FSA's Handbook for the purpose of mitigating exceptionally high loss ratios in future years. The amounts provided are not liabilities because they are in addition to the provisions required to meet the anticipated ultimate cost of settlement of outstanding claims at the balance sheet date. Notwithstanding this, they are required by Schedule 3 to SI 2008/410 to be included within technical provisions.

#### **Financial Assets and Liabilities**

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

#### ***Investments – fair value through profit and loss***

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

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

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

#### ***Cash at bank and in hand***

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

#### ***Insurance and other receivables***

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

#### ***Derivative financial instruments***

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

## Notes to the Financial Statements

31 December 2010

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### 1. Accounting policies – continued

#### Financial Assets and Liabilities – continued

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

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

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

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

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

#### Stock lending

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

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

#### Investment return

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

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

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

#### Tangible assets

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

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

## Notes to the Financial Statements

31 December 2010

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### 1. Accounting policies – continued

#### Deferred taxation

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

#### Operating leases

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

#### Pension costs

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

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

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

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

#### Foreign currencies

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

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

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

### 2. Capital management & financial risk management

#### Capital management

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

## Notes to the Financial Statements

31 December 2010

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### 2. Capital management & financial risk management – continued

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

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

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

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

#### Financial risk management objectives

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

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

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

#### Investment activity governance

The company operates an Investment Committee which functions under terms of reference determined by the Risk Committee of the Board. The Committee is charged with establishing and effecting an appropriate investment policy for the company having regard to the financial risk appetite of the company. In addition, the Committee has the responsibility for recommending the appointment and removal of investment managers, for reviewing the managers' performance and for reporting on all other material aspects of the investment function.

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

The investment management function is outsourced to specialist external managers: Western Asset Management, Goldman Sachs Asset Management, Blackrock and Pacific Investment Management.

## Notes to the Financial Statements

31 December 2010

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### 2. Capital management & financial risk management – continued

#### Asset allocation policy

The Investment Committee has established a broad asset allocation policy which defines the limits for different asset types. The asset allocation policy cites two major asset classes: investment grade fixed income securities and alternative assets. Alternative assets can include equities, high yield and emerging market instruments although in 2010 the company only maintained allocations to high yield. The policy stipulates a target range of between 75% and 95% for investment grade fixed income securities and a range of between 5% and 25% for alternative asset classes. The current allocation to alternative assets continues to sit at the lower of the target range, however, the position is regularly reviewed by the Investment Committee.

#### Investment guidelines

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

#### Interest rate risk

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

Interest rate risk arises in the fixed income investment portfolio primarily through instrument duration. Accordingly, the investment guidelines include restrictions relating to the maximum weighted average duration of the portfolio. The restriction is stated by reference to the permissible duration variance compared to the customised benchmark index by which the external investment managers' performance is assessed.

Sensitivity analysis for interest rate risk illustrates how changes in the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates at the reporting date. To illustrate the downside risk within the fixed interest portfolio of £2,437 million at external managers as at 31 December 2010 (2009: £2,398 million), an increase of 100 basis points in interest yields across all portfolios consecutively (principally sterling, euro and US dollars) has been calculated. Such an increase would decrease the market value of the investment portfolio and lead to a decrease in the total investment return of £80.1 million and accordingly decrease total shareholders' funds by some £56.1 million.

#### Equity price risk

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

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

AEGL held no equities at the end of 2010 (2009: £0.2 million). Due to this, if the value of all equity markets in which the company invests decreased by 10%, with all other variables held constant, the total investment return would remain the same.

#### Currency risk

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

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

## Notes to the Financial Statements

31 December 2010

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### 2. Capital management & financial risk management – continued

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

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

For the profit and loss account, the 2010 average euro/sterling rate of €1.16/£1 is up on the prior period (2009: €1.12/£1) and the US dollar/sterling rate of US\$1.54/£1 is down on the prior period (US\$1.55/£1). Had sterling weakened by 10% against all currencies (primarily the euro and US dollar) and all other variables remained constant, the profit before tax for the year would have been £6.7 million less than the amount reported.

For the monetary components of the balance sheet, the year end rates used to convert euro to sterling have risen by 5% to €1.18 /£1 and US dollar to sterling has decreased by 4% to US\$1.55 /£1(2009: €1.12/£1 and US\$1.61/£1). Assuming sterling had weakened by 10% against all currencies (primarily the euro and US dollar) and all other variables remained constant, the effect of translating year end foreign branch net assets based on these parameters would have resulted in decreased shareholders' funds of £4.0 million, which would have appeared as a loss in the statement of total recognised gains and losses.

#### Liquidity risk

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

AEGL participates in a notional pooling programme with other ACE group companies under a facility operated by Bank Mendes Gans, a subsidiary of ING, which specialises in global liquidity management. The facility operates by the notional pooling of designated balances of the ACE group participants in order to provide additional liquidity. ACE group participants may overdraw individual account balances to fund immediate short term needs against credit balances held elsewhere within the pool. On this basis, AEGL maintained an overdraft in the notional pool of £46.6 million at year end (2009: £41.9 million). Positive cash balances of £22.2 million (2009: £30.0 million) bring the overall net overdraft to £24.4 million (2009: £11.9 million) as presented on the balance sheet.

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

As indicated in the balance sheet, the company's financial liabilities are all payable within one year. Non-derivative financial liabilities with contractual maturities are payable within normal terms of trade, which is on average 60 days. Non-derivative financial liabilities with contractual maturities are limited to reinsurance premiums payable and expense accruals. Derivative financial liabilities at the balance sheet date have remaining contractual maturities of £1.6 million within 1 month, £0.7 million between 1 and 3 months, £nil between 3 months and 1 year and £0.3 million after more than one year.

#### Credit risk

Credit risk is the risk that a counterparty will be unable to pay amounts in full when due. The company is exposed to credit risk through its investment activity and its insurance operations.

## Notes to the Financial Statements

31 December 2010

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### 2. Capital management & financial risk management – continued

#### Credit risk – investment

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

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

Fixed income holdings of £2,485 million (2009: £2,430 million) represented 100% (2009: 100%) of the total investment portfolio. The average credit quality of investment portfolios using Standard and Poor's ratings remained high throughout the year and at year end was "AA". This is comparable to the previous year. AEGL had nil equity holdings at 2010 year end (2009: £0.2 million).

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

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

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

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

#### Credit risk – insurance operations

The company is exposed to credit risk as a result of its regular insurance and reinsurance activity. The areas of key exposure are:

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

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

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

## Notes to the Financial Statements

31 December 2010

### 2. Capital management & financial risk management – continued

The assets bearing credit risk are summarised below:

	2010	2009
	£'000	£'000
Other financial investments	2,597,385	2,731,111
Derivative financial securities	2,703	1,784
Reinsurers' share of technical provisions	2,421,855	2,396,741
Debtors arising out of direct insurance operations	384,239	407,915
Debtors arising from reinsurance operations	239,244	228,273
<b>Total assets bearing credit risk</b>	<b>5,645,426</b>	<b>5,765,824</b>

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

	2010	2009
	£'000	£'000
AAA	1,508,143	1,583,968
AA	176,370	225,511
A	437,801	470,090
BBB	267,068	253,605
Below BBB or not rated	210,706	199,721
<b>Total assets bearing credit risk</b>	<b>2,600,088</b>	<b>2,732,895</b>

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

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

Reinsurers' share of technical provisions includes claims outstanding, related claims handling costs, IBNR and unearned premium reserve. This is described along with the valuation methods in note 1. No balances are past due that have been impaired (2009: 0.0%).

Debtors arising out of direct and reinsurance operations are held at fair value less any provision for impairment as described in note 1. They include 0.3% (2009: 0.9%) that have been impaired and 29.4% (2009: 31.2%) that are past due, but not impaired. The latter is aged 24.7% up to six months (2009: 27.2%), 2.9% six months to a year (2009: 2.4%) and the remaining 1.8% is older than a year (2009: 1.5%).

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

## Notes to the Financial Statements

31 December 2010

### 2. Capital management & financial risk management – continued

	2010	2009
	£'000	£'000
AAA	42,164	50,683
AA	2,075,820	188,718
A	337,656	2,200,986
BBB	4,095	1,297
Below BBB or not rated	201,364	183,330
<b>Total assets bearing credit risk</b>	<b>2,661,099</b>	<b>2,625,014</b>

Where appropriate the company seeks to obtain collateral from counterparties to mitigate the credit risk exposure from insurance and reinsurance receivables. At 31 December 2010 the collateral provided to the company totalled £500.2 million (2009: £274.1 million). This balance is represented by Letters of Credit – 56.0% (2009: 82.2%), trust funds – 4.6% (2009: 12.8%), cash – 7.1% (2009: 5.0%) and floating charge – 32.3% (2009: 0.0%).

The maximum exposure of receivables to credit risk at the balance sheet date is the carrying value less any collateral obtained from counterparties. For the purpose of this disclosure 'receivables' comprises 'Reinsurers' share of technical provisions', 'Debtors arising out of direct insurance operations' and 'Debtors arising from reinsurance operations'. At the balance sheet date the maximum exposure of receivables to credit risk was £2,545.1 million (2009: £2,758.8 million).

### 3. Segmental analysis

Segmental information in the format required by the Companies Act 2006 is as follows:

	Gross premiums written	Gross premiums earned	Gross claims incurred	Gross operating expenses	Reinsurance balance
	£'000	£'000	£'000	£'000	£'000
<b>Year to 31 December 2010</b>					
Continuing operations:					
Direct insurance					
Accident and health	390,333	387,340	(144,313)	(166,454)	(41,681)
Marine, aviation and transport	100,743	107,739	(75,959)	(23,340)	(11,299)
Fire and other damage to property	672,896	668,656	(434,802)	(141,959)	(142,574)
Third party liability	508,123	499,971	(272,691)	(77,313)	(123,274)
Miscellaneous	148,979	134,019	(91,415)	(52,523)	(9,381)
Reinsurance acceptances	382,280	394,348	(210,816)	(85,401)	(57,416)
	2,203,354	2,192,073	(1,229,996)	(546,990)	(385,625)
Discontinued operations	705	705	(10,321)	(46)	9,356
	2,204,059	2,192,778	(1,240,317)	(547,036)	(376,269)

## Notes to the Financial Statements

31 December 2010

### 3. Segmental analysis – continued

	Gross premiums written	Gross premiums earned	Gross claims incurred	Gross operating expenses	Reinsurance balance
	£'000	£'000	£'000	£'000	£'000
<b>Year to 31 December 2009</b>					
Continuing operations:					
Direct insurance					
Accident and health	392,703	387,588	(111,559)	(164,432)	(70,501)
Marine, aviation and transport	128,289	130,811	(109,604)	(29,255)	(11,338)
Fire and other damage to property	633,479	631,938	(346,035)	(125,272)	(203,634)
Third party liability	518,388	496,123	(257,544)	(87,805)	(113,408)
Miscellaneous	125,700	127,038	(47,703)	(40,335)	(56,875)
Reinsurance acceptances	403,194	387,220	(176,202)	(78,905)	(94,698)
	2,201,753	2,160,718	(1,048,647)	(526,004)	(550,454)
Discontinued operations	873	873	190	(68)	5,738
	2,202,626	2,161,591	(1,048,457)	(526,072)	(544,716)

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

### Analysis by geographic area – origin

	Gross written premiums		Profit (loss) before taxation		Net assets	
	2010	2009	2010	2009	2010	2009
	£'000	£'000	£'000	£'000	£'000	£'000
United Kingdom	1,087,708	1,069,685	133,643	102,337	523,450	508,809
Other EEA states	1,104,148	1,128,325	64,313	151,423	304,868	273,611
Other countries	12,203	4,616	(2,895)	8,468	44,510	42,887
	2,204,059	2,202,626	195,061	262,228	872,828	825,307

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

	2010	2009
	£'000	£'000
United Kingdom	668,521	617,839
United States of America	65,350	69,260
Continental Europe	1,172,516	1,214,329
Africa & Middle East	55,804	54,816
Asia/Pacific	71,482	65,448
Americas	51,275	59,467
Worldwide	118,406	120,594
Discontinued business	705	873
	2,204,059	2,202,626

## Notes to the Financial Statements

31 December 2010

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

The prior year's net provision for claims outstanding generated a surplus for 2010 (2009: surplus) as detailed below:

	2010	2009
	£'000	£'000
Continuing operations:		
Accident and health	4,142	7,776
Marine, aviation and transport	3,665	(9,743)
Fire and other damage to property	23,301	(15,382)
Third party liability	17,708	68,854
Miscellaneous	(3,150)	(3,557)
	<u>45,666</u>	<u>47,948</u>
Discontinued operations	(283)	(6,228)
	<u>45,383</u>	<u>41,720</u>

### 5. Net operating expenses – technical account

	2010	2009
	£'000	£'000
Acquisition costs	356,336	346,546
Change in net deferred acquisition costs	(6,425)	(2,691)
Administrative expenses	190,952	178,707
Reinsurance commissions	(191,459)	(212,417)
	<u>349,404</u>	<u>310,145</u>

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

Total commissions for direct insurance accounted for by the company during the year amounted to £265.0 million (2009: £260.7 million), and are included within acquisition costs.

## Notes to the Financial Statements

31 December 2010

### 6. Auditors' remuneration

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

	2010	2009
	£'000	£'000
<b>Audit fees</b>		
Fees payable to the company's auditor for the audit of the annual accounts	290	345
<b>Non audit fees</b>		
Other services pursuant to legislation	324	386
Other services relating to taxation	352	459
	<u>966</u>	<u>1,190</u>

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

### 7. Operating lease rentals

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

	2010	2009
	£'000	£'000
Leasehold property	4,289	4,553

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

	2010	2009
	£'000	£'000
Within 1 year	361	749
Between two and five years	2,230	3,013
More than five years	1,396	528
	<u>3,987</u>	<u>4,290</u>

### 8. Directors and employees

	2010	2009
	£'000	£'000
Cost of staff employed by the company		
Wages and salaries	47,134	47,495
Social security costs	12,883	12,440
Other pension costs	4,945	4,697
Other staff costs	4,479	4,285
	<u>69,441</u>	<u>68,917</u>

## Notes to the Financial Statements

31 December 2010

### 8. Directors and employees – continued

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

	2010	2009
	No.	No.
Underwriting	619	617
Claims	130	127
Other	143	149
	<u>892</u>	<u>893</u>

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

#### Directors' emoluments

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

	2010	2009
	£'000	£'000
Aggregate emoluments and benefits	3,730	2,927
Company pension contributions to money purchase pension schemes	99	91
	<u>3,829</u>	<u>3,018</u>

Included in the above amounts paid by AIS in respect of the directors of this company, the highest paid director was paid a total of £834,361 (2009: £876,066) in respect of emoluments and benefits. The amount of accrued pension and accrued lump sum in relation to the highest paid director at the end of the year were £30,326 (2009: £30,641) and £155,059 (2009: £153,661) respectively.

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

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

## Notes to the Financial Statements

31 December 2010

### 9. Investment return

	2010	2009
	<u>£'000</u>	<u>£'000</u>
<b>Investment income</b>		
Income from investments	96,120	108,165
Gains on the realisation of investments	68,829	91,586
	<u>164,949</u>	<u>199,751</u>
<b>Investment expenses and charges</b>		
Investment management expenses	(8,012)	(7,804)
Losses on the realisation of investments	(29,017)	(79,768)
	<u>(37,029)</u>	<u>(87,572)</u>
<b>Net unrealised gains less losses on investments</b>		
Unrealised gains on investments	147,960	227,294
Unrealised losses on investments	(99,207)	(120,230)
	<u>48,753</u>	<u>107,064</u>
<b>Total investment return</b>	<u>176,673</u>	<u>219,243</u>

## Notes to the Financial Statements

31 December 2010

### 10. Taxation on profit on ordinary activities

Analysis of charge in period	2010	2009
	£'000	£'000
UK corporation taxation at 28% (2009: 28%)		
Current taxation on income for the period	55,044	74,467
Adjustments in respect of previous periods	(12,226)	(1,625)
	<u>42,818</u>	<u>72,842</u>
Double taxation relief	(17,410)	(25,391)
	<u>25,408</u>	<u>47,451</u>
Foreign taxation		
Current taxation on income for the period	18,903	22,412
Adjustments in respect of previous periods	117	12,366
	<u>19,020</u>	<u>34,778</u>
<b>Current taxation on income for the period</b>	<b>44,428</b>	<b>82,229</b>
Deferred taxation (note 14):		
Origination and reversal of timing differences	203	(582)
Adjustments in respect of previous periods	(761)	(111)
Rate change*	88	-
	<u>(470)</u>	<u>(693)</u>
<b>Taxation on profit on ordinary activities</b>	<b>43,958</b>	<b>81,536</b>
	<u><u>43,958</u></u>	<u><u>81,536</u></u>
<b>Factors affecting taxation charge for period</b>		
The taxation assessed for the period is lower (2009: higher) than the standard rate of corporation taxation in the UK (28%).		
The differences are explained below:		
	2010	2009
	£'000	£'000
<b>Profit on ordinary activities before taxation</b>	<b>195,061</b>	<b>262,228</b>
	<u><u>195,061</u></u>	<u><u>262,228</u></u>
Profit on ordinary activities multiplied by standard rate of corporation taxation in the UK of 28% (2009: 28%)	54,617	73,424
Effects of:		
Expenses not deductible for taxation purposes	591	945
Higher taxation rates on overseas earnings	1,493	3,011
Utilisation of previously unrecognised eligible unrelieved foreign tax**	-	(5,990)
Other, including timing differences	(164)	98
Adjustments in respect of previous periods	(12,109)	10,741
	<u>(12,109)</u>	<u>10,741</u>
<b>Current taxation charge for period</b>	<b>44,428</b>	<b>82,229</b>
	<u><u>44,428</u></u>	<u><u>82,229</u></u>

\*A reduction in the UK corporation tax rate from 28% to 24% was announced on 22 June 2010, to be phased in over four years. The first reduction of 1% was enacted during 2010 and the new rate of 27% will be effective from 1 April 2011.

\*\* The company has unrecognised Eligible Unrelieved Foreign Tax ('EUFT') totalling £17.1 million as at 31 December 2010 which may be available for relief in the future.

## Notes to the Financial Statements

31 December 2010

### 11. Dividends

During 2010 the company paid a dividend of 13.8p per share totalling £75.0 million (2009: No dividend paid).

### 12. Other financial investments

	Market Value 2010	Cost 2010	Market Value 2009	Cost 2009
	£'000	£'000	£'000	£'000
Shares and other variable yield securities and units in unit trusts	-	-	213	136
Debt securities and other fixed interest securities	2,436,812	2,463,919	2,397,584	2,475,309
Deposits with credit institutions*	160,573	160,573	333,314	333,314
	<u>2,597,385</u>	<u>2,624,492</u>	<u>2,731,111</u>	<u>2,808,759</u>

\*Deposits with credit institutions includes £107.9 million (2009: £277.8 million) of collateral in respect of stock lending arrangements (note 21).

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

#### *Derivative financial instruments*

	Assets 2010	Liabilities 2010	Assets 2009	Liabilities 2009
	£'000	£'000	£'000	£'000
Forward foreign currency contracts	1,074	905	974	1,604
Fixed income options and futures	1,629	1,704	810	910
	<u>2,703</u>	<u>2,609</u>	<u>1,784</u>	<u>2,514</u>

The cost of entering into derivative financial instruments was £2,281 (2009: £27,290).

#### *Currency derivatives*

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

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

	2010	2009
	£'000	£'000
Forward foreign exchange contracts	<u>187</u>	<u>43</u>

At 31 December 2010, the fair value of the company's currency derivatives results in a gain of £0.2 million (2009: loss of £0.6 million). These amounts are based on rates of exchange at the balance sheet date, comprising £1.1 million of assets (2009: £1.0 million) and £0.9 million of liabilities (2009: £1.6 million).

Amounts of £0.6 million (2009: £0.1 million) have been recognised in the profit and loss account in respect of contracts which matured during the period.

## Notes to the Financial Statements

31 December 2010

### 12. Other financial investments – continued

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

#### *Fixed income options and futures*

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

At 31 December 2010, the fair value of the company's fixed income derivatives is a liability of £0.1 million (2009: liability of £0.1 million) comprising £1.6 million of assets (2009: £0.8 million) and £1.7 million of liabilities (2009: £0.9 million).

A gain of £2.3 million (2009: loss of £3.4 million) has been recognised in the profit and loss account in respect of contracts which matured in the period.

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

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

An analysis of financial instruments at 31 December 2010 by fair value hierarchy is set out below:

	Level 1	Level 2	Level 3	Total
	£'000	£'000	£'000	£'000
Assets:				
Debt securities and other fixed interest securities	201,736	2,225,043	10,033	2,436,812
Deposits with credit institutions	17,298	143,275	–	160,573
Derivative financial instruments	1,629	1,074	–	2,703
<b>Total assets at fair value</b>	<b>220,663</b>	<b>2,369,392</b>	<b>10,033</b>	<b>2,600,088</b>
Liabilities:				
Derivative financial instruments	1,704	905	–	2,609
<b>Total liabilities at fair value</b>	<b>1,704</b>	<b>905</b>	<b>–</b>	<b>2,609</b>

## Notes to the Financial Statements

31 December 2010

### 12. Other financial investments – continued

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

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

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

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

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

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

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

#### Reconciliation of Movement in Level 3 Investments

	2010	2009
	£'000	£'000
Balance at 1 January	11,598	9,394
Gains (Losses) Recognised in the Profit and Loss Account *	1,045	(438)
Gains (Losses) Recognised in the Statement of Total Recognised Gains and Losses	–	–
Purchases	984	7,650
Sales	(2,406)	(3,965)
Transfers in (out) of Level 3**	(1,188)	(1,043)
Balance at 31 December	<u>10,033</u>	<u>11,598</u>

## Notes to the Financial Statements

31 December 2010

### 12. Other financial investments – continued

\* Gains (Losses) Recognised in the Profit and Loss Account comprise realised losses of £216,000 (2009: gain of £64,000) which are presented within Investment Income, unrealised gains of £802,000 (2009: gain of £248,000) and foreign exchange gains of £459,000 (2009: loss of (£750,000) all of which are presented in the Non-Technical Account. Of this amount £1,661,000 (2009: loss of £20,000) relates to investments held at the end of the period and comprises £nil of realised gains (2009: £nil), £1,255,000 (2009: gain of £208,000) of unrealised gains and £406,000 (2009: loss of £228,000) of foreign exchange gains.

\*\* During the period a small number of investment grade and high yield fixed interest investments were transferred into and out of Level 3 due to changes in their pricing source. The net value of the investments transferred was £1.2 million (2009: £1.0 million).

### 13. Other debtors

	2010	2009
	£'000	£'000
Amounts falling due within one year:		
Amounts due from group undertakings	62,581	58,489
Deferred taxation (note 14)	2,387	1,791
Receivable for sales of securities	13,996	257
Other debtors	5,566	6,605
	<u>84,530</u>	<u>67,142</u>

### 14. Deferred taxation

	2010	2009
	£'000	£'000
At 1 January	1,791	466
Foreign exchange differences	5	15
Movement relating to pension liability	(79)	538
Adjustment in respect of previous periods	761	111
Utilisation in year	(3)	661
Change in rate	(88)	-
At 31 December	<u>2,387</u>	<u>1,791</u>
Analysis of asset at 31 December		
Accelerated capital allowances	878	717
Pension contributions	(181)	(110)
Other timing differences	1,690	1,184
Undiscounted deferred taxation asset as above	<u>2,387</u>	<u>1,791</u>

## Notes to the Financial Statements

31 December 2010

### 15. Tangible assets

	Land and Buildings	Motor Vehicles	Leasehold improvements, fixtures and fittings	Computer, office equipment and software	Total
	£'000	£'000	£'000	£'000	£'000
<b>Cost</b>					
At 1 January 2010	1,535	2,429	11,407	6,749	22,120
Additions	-	252	414	775	1,441
Disposals	-	(299)	(385)	(21)	(705)
Transfers	-	42	(1,624)	1,582	-
Foreign exchange differences	(68)	(91)	(460)	(140)	(759)
At 31 December 2010	<u>1,467</u>	<u>2,333</u>	<u>9,352</u>	<u>8,945</u>	<u>22,097</u>
<b>Accumulated depreciation</b>					
At 1 January 2010	808	1,420	8,063	5,260	15,551
Charge for the period	52	437	810	657	1,956
Disposals	-	(198)	(57)	(93)	(348)
Transfers	-	23	(1,919)	1,896	-
Foreign exchange differences	(39)	(55)	(324)	(118)	(536)
At 31 December 2010	<u>821</u>	<u>1,627</u>	<u>6,573</u>	<u>7,602</u>	<u>16,623</u>
<b>Net book value</b>					
31 December 2010	<u>646</u>	<u>706</u>	<u>2,779</u>	<u>1,343</u>	<u>5,474</u>
31 December 2009	<u>727</u>	<u>1,009</u>	<u>3,344</u>	<u>1,489</u>	<u>6,569</u>

### 16. Called-up share capital

	2010	2009
	£'000	£'000
<b>Allotted, issued and fully paid:</b>		
376,567,035 'A' Ordinary £1 shares	376,567	376,567
168,174,109 'B' Ordinary £1 shares	168,174	168,174
	<u>544,741</u>	<u>544,741</u>
<b>Authorised:</b>		
500,000,000 'A' Ordinary £1 shares (2009: 500,000,000 'A' Ordinary £1 shares)	500,000	500,000
250,000,000 'B' Ordinary £1 shares (2009: 250,000,000 'B' Ordinary £1 shares)	250,000	250,000
	<u>750,000</u>	<u>750,000</u>

## Notes to the Financial Statements

31 December 2010

### 17. Reserves

	Share capital	Profit and loss account	Merger reserve	Total
	£'000	£'000	£'000	£'000
At 1 January	544,741	254,913	25,653	825,307
Profit for the year	-	151,103	-	151,103
Currency translation differences	-	(28,292)	-	(28,292)
Actuarial loss recognised in relation to pension schemes	-	(411)	-	(411)
Movement of deferred taxation relating to pension liability	-	121	-	121
Dividend paid (note 11)	-	(75,000)	-	(75,000)
<b>At 31 December</b>	<b>544,741</b>	<b>302,434</b>	<b>25,653</b>	<b>872,828</b>

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

### 18. Reconciliation of movements in shareholders' funds

	2010	2009
	£'000	£'000
Profit for the financial year	151,103	180,692
Currency translation differences	(28,292)	(74,995)
Actuarial loss recognised in relation to pension schemes	(411)	(2,203)
Movement on deferred taxation relating to pension liability	121	617
Dividend paid (note 11)	(75,000)	-
Net increase in shareholders' funds	47,521	104,111
Opening shareholders' funds	825,307	721,196
At 31 December	872,828	825,307

### 19. Equalisation provision

As laid out in the accounting policies, an equalisation provision is established in the financial statements. The effect of this provision is to reduce shareholders' funds by £64.6 million (2009: £52.4 million). The increase during the year had the effect of decreasing the balance on the technical account for general business and decreasing the profit on ordinary activities before taxation by £12.2 million (2009: increase of £7.5 million).

## Notes to the Financial Statements

31 December 2010

### 20. Other creditors including taxation and social security

	2010	2009
	£'000	£'000
Corporation taxation payable	14,702	29,812
Payable for purchases of securities	8,579	46,320
Other creditors	45,849	42,630
Liability for stock lending collateral (note 21)	107,931	277,750
	<u>177,061</u>	<u>396,512</u>

### 21. Stock lending

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

	2010	2009
	£'000	£'000
Aggregate value of securities on loan at 31 December	338,393	361,728
Income from stock lending during the year	565	1,500

In respect of securities on loan at the year end, the company held £335.5 million (2009: £352.4 million) as collateral, the value of which fell below the value of the loan securities by 0.8% (2009: 2.6%), as a result of unrealised losses generated by the liquidity fund in which the collateral is invested. These unrealised losses are included in investment return.

Included within the £335.5 million (2009: £352.4 million) of collateral held is £107.9 million (2009: £277.8 million) in the form of cash which has been reinvested by the company. This is included on the face of the balance sheet within 'Other financial investments'.

### 22. Letter of credit facilities

Under a facility with Citibank NA, the value of letters of credit outstanding was £73.55 million (2009: £68.04 million) with associated collateral of £103.2 million (2009: £99.2 million). Under a facility with Lloyds TSB Bank plc, there is a further letter of credit outstanding for £0.77 million (2009: £0.84 million), equally matched by collateral. Collateral is included within other financial investments and cash at bank and in hand on the face of the balance sheet.

### 23. Capital commitments

No capital expenditure was authorised at 31 December 2010 which has not been provided for in these financial statements.

## Notes to the Financial Statements

31 December 2010

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### **24. Transactions with related parties**

During the year the company incurred a management fee from AIS, a fellow group company of £111.3 million (2009: £99.7 million), this charge is in relation to costs incurred by AIS on behalf of AEGL and includes the cost of AIS staff engaged in the business of AEGL.

During the year, there were no other material transactions or balances between AEGL and fellow group companies, key management personnel or members of their close family, which require disclosure under the Companies Act 2006.

Advantage has been taken of the exemption in FRS 8 from disclosing details of transactions with ACE Limited and its subsidiary undertakings as required by that standard.

### **25. Ultimate parent company**

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

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