ANNUAL REPORT 2006

# GREAT LAKES UK

A Member of the Munich Re Group

# CONTENTS

31 DECEMBER 2006

# DIRECTORY

31 DECEMBER 2006

## DIRECTORS

M.C.F. Hannan (Chairman)
N.J.Parr (Chief Executive Officer)
R.A.S.Harris FCA (Chief Financial Officer)
W.J. Branum
C.Schurig
N.H.H. Smith
J.J. Ludbrook

## SECRETARY

M.A. Odell

## REGISTERED OFFICE

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1 Minster Court
Mincing Lane
London EC3R 7YH
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Facsimile: 020-7623 5220
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## AUDITORS

KPMG Audit Plc
8 Salisbury Square, London, EC4Y 8BB

## BANKERS

Barclays Bank PLC
The Bank of New York (Europe) Ltd

## REGISTERED NUMBER

2189462

# BUSINESS REVIEW

31 DECEMBER 2006

## INTRODUCTION

This business review is intended to give an overview of the operation and performance of the business of Great Lakes UK ("the Company"), but is not intended to meet the requirements of an Operating and Financial review, which is not required of the Company. More information about the Company, its people and its service offerings are outlined in our website at www.greatlakes.co.uk.

The Company is an FSA regulated insurer and acts as an insurance vehicle for the Munich Re Group ("MR"), developing opportunities for MR and managing business using its wide range of insurance licenses. These include US licenses and passport opportunities in the EU, which allow the company to access business in these territories.

The Company enjoys the MR Group rating, currently AA- with stable outlook from Standard & Poors, which aligns its' standards of operation with the levels of professionalism expected from a Group of world renown.

## NATURE OF THE BUSINESS

The Company uses two distinct models for accessing insurance business – individual acceptances of large single risks and delegated acceptances via agency agreements. Our principal reinsurance partner is MR, which enables the Company to obtain additional capacity, expertise and resources with Group business partners.

**Large Single Risk Business**
The Company underwrites single (normally very large) risks of corporate clients in the London Market and acquires most business of this type through London brokers. Gross written premium income in 2006 amounted to £177m.

The Company retains the business it underwrites through its Munich-American RiskPartners ("MARP") London brand (£64m). MARP offers a highly respected underwriting service to target clients, which are Fortune 5000 companies and other large corporates and their captives who demonstrate a commitment to risk management, risk retention, loss prevention and loss control. Standard and bespoke solutions in the classes of Property, Casualty and Speciality Lines including Professional Indemnity, Directors and Officers' Liability, Public Offering of Securities Insurance, Employment Practices Liability and Fiduciary Liability are developed through close co-operation with the clients.

MARP also has a focus of activity on developing new product lines and in 2006 launched a service to offer Intellectual Property Rights cover.

**Agency Arrangements**
The dominant component of our book in terms of premium volume is business accepted under either a tailored form of Agency Agreement or Co-insurance arrangement, for which Gross Written Premium Income in 2006 amounted to £827m .

Each arrangement is specific to a market segment, ranging from large risks or smaller commercial risks, through to personal lines customers. The classes of business covered include Motor, Aviation, Health, Property, Marine and Jewellers Block.

The Company added to its network of highly respected agency distribution channels during 2006 by providing the capacity for a prestigious UK healthcare provider (2006 GWPI £100m) under an agreement until 2013 which included a successful Part VII transfer under FSMA of existing business. The financial effect of the Part VII transfer is shown within the technical account on pages 9 and 10. We also successfully renewed our principal agreement with a major UK Motor provider, thereby continuing to deploy the Company security for this important account for a further 8 years.

## HIGH LEVEL STRATEGIC OBJECTIVES

The Company's principal mission is to add value for the MR Group by being a best practice insurance solutions provider.

**Financial Performance**
Financial performance is measured against Munich Re's Value Based Management ("VBM") concept, where financial results are compared with a risk based capital approach, thereby underpinning the financial incentive to manage and proactively reduce risks. There is no incentive therefore to underwrite for business volume, with attention being focused on achieving positive value added results.

For 2006 the VBM result for MARP exceeded the target and showed significantly positive value added. This means that rating business to technical levels, which is regularly monitored through the actuarial function is a successful strategy in achieving the desired results.

**Best Practice**
In order to achieve our goal of best practice, we benchmark ourselves against MR, the London Market and FSA regulatory standards.

The Company also works closely with a Group Consultation Service Centre for developing the operating standards of agency programme arrangements, and collectively these measures help to de-risk the operational aspects of the business to acceptable levels. The Company is committed to minimising risk for all transactions and we have therefore enhanced our risk and compliance arrangements during 2006 accordingly.

## RISK MANAGEMENT

In 2006, the Company developed an improved operational risk monitoring and evaluation process using an IT system which was developed in house for the purpose of the identification and management of risk inherent in, or emerging from, the different operating departments. This is supported by a regular internal audit programme, reporting to the Audit Committee, which tests the efficiency of internal processes and procedures.

The main risks that the Company is faced with are :

- Controlling the delegation of Underwriting Authority to Agents
- Managing the Insurance Risk of potential large losses arising from underwriting large single risks

**Delegation of Underwriting Authority to Agents**
Our strategic emphasis of using a partnership approach with our business partners (including reinsurers) to ensure a close cooperation and a focus on developing risk management systems, puts the Company in a strong position to monitor and control its agents. This includes a regular programme of on-site compliance reviews at our agents.

A holistic, tiered Management Information ("MI") concept has been enhanced during 2006, which will lead in turn to the progressive delivery during 2007 of automated MI, through a major project investing substantially in a revised IT landscape which includes the construction of a bespoke data warehouse. This will consolidate existing MI and improve risk specific data available for directing the business.

**Insurance Risk arising from Large Single Risks**
The insurance risk is managed via the Individual Capital Assessment ("ICA") process and is limited by diversifying the book wherever possible and by reinsurance covers that are placed with MR. The Company is always keen to explore innovative forms of cover that increase diversification and thereby help to balance exposures in the book.

The ICA model itself is being further refined on an on-going basis and is a process that is embedding the perception, recognition and evaluation of risk into the daily business operations.

## PERFORMANCE AND MEASUREMENT

The Company is committed to empowering our staff to take decisions that can be made speedily and at the right level. To support this we began a process in 2006 to assess the skill sets within our teams and to develop a range of practical personal development plans.

During 2007 we will restructure our operations, which will have the effect of strengthening the position of the MARP London division and amalgamating the Finance and Actuarial functions.

Strategy is formulated and controlled via the Balanced Scorecard process. All initiatives that were developed for action in 2006 have been progressed in accordance with the plan with the necessary challenge provided by a quarterly Board review process. Senior management refine and develop new initiatives at the beginning of each year and all staff are familiar with the communication of these to them via the Balanced Scorecard and individual performance objectives aligned thereto.

Apart from qualitative indicators which are monitored, the Board will customarily judge the performance of the business with the help of the following key performance indicators, which are stated excluding the effect of the Part VII transfer.

**Gross Account:**

- Gross Loss Ratio : 46.8% (Very Satisfactory) - important to judge the profitability of the overall book of business. The Board looks at more detailed information to satisfy itself that the development by Line of business and by Underwriting Year is satisfactory.

- Growth Rate of Gross Premium Written : 1.2% (Stable) - business development indicator that shows how fast the business is growing.

- Gross Expense Ratio : 1.4% (Very Satisfactory) - measure of the cost efficiency of the business

- Solvency Margin : 243% (Very Satisfactory) - monitored constantly to ensure solvency of the business and efficient use of capital.

**MARP London business**

The following ratios indicate that the performance of the division has exceeded expectations and that a favourable result for the business has been achieved.

- Loss Ratio, Net of Reinsurance: 75.0% - judging the profitability of the underlying business of MARP London account (with further analysis by Line of business and Underwriting Year).

- Combined Ratio, Net of Reinsurance: 87.8% - judging the profitability of the whole MARP London account (with further analysis by Line of business and Underwriting Year).

- Retention Rate: 89.2% - business development indicator that shows the share of the MARP London retained after reinsurance protections.

# REPORT OF THE DIRECTORS

31 DECEMBER 2006

## PRINCIPAL ACTIVITY

The principal activity of the Company is the transaction of insurance business. The Company has been awarded the following Group Ratings

A+ Superior (A M Best)
AA- Strong (Standard & Poors)

## DIRECTORS & SECRETARY

The Directors of the Company are as stated on page 2; there have been no changes to the Board during the year.

N. J. Parr holds one Ordinary Share of £10 (2005 - 1) as trustee. None of the directors had a beneficial interest in the shares of the Company. Under the provisions of the Companies (Disclosures of Directors' Interests) (Exceptions) Regulations 1985, the directors of the company are exempt from disclosing any interests in the shares of the ultimate holding company.

## RESULTS AND DIVIDENDS

The results for the year are set out in the profit and loss account on pages 9 to 11. A dividend of £20m was paid during the year.

## DEVELOPMENT OF THE COMPANY

During the year the Company has continued to underwrite insurance business, and has maintained a prudent approach to the spread of risk both by class of business and by location.

## CREDITORS PAYMENT POLICY

In respect of all its suppliers, it is the Company's policy to:

- settle the terms of payment with those suppliers when agreeing the terms of each transaction;
- ensure that those suppliers are made aware of the terms of payment;
- abide by the terms of payment; and
- pay all suppliers on a weekly basis

All suppliers are now paid via the Company's service company subsidiary, Great Lakes Services Limited; application of the above policy by that company has led to an average creditors payment period of 20 days.

## DIRECTORS' RESPONSIBILITIES

The directors are responsible for preparing the Directors' Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with UK Accounting Standards.

## DIRECTORS' RESPONSIBILITIES (cont.)

The financial statements are required by law to give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period.

In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

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

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

## MAJOR SHAREHOLDINGS

The Company is a wholly owned subsidiary of Münchener Rückversicherungs-Gesellschaft, a Company incorporated in Germany. Copies of the Group accounts are available from 107 Koniginstrasse, 80802, Munich, Germany.

## CORPORATE GOVERNANCE

The Company is committed to business integrity, high ethical values and professionalism in all of its activities. As an essential part of this commitment, the Board supports high standards in Corporate Governance.

## DISCLOSURE OF INFORMATION TO AUDITORS

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

## AUDITORS

KPMG Audit Plc have expressed their willingness to continue in office as auditors and, in accordance with section 384 of the Companies Act 1985, a resolution proposing their reappointment will be submitted at the annual general meeting.

By order of the Board

M.A. Odell
Company Secretary
30 March 2007

# INDEPENDENT AUDITORS' REPORT TO THE MEMBER OF GREAT LAKES REINSURANCE (UK) PLC

We have audited the financial statements of Great Lakes Reinsurance (UK) PLC for the year ended 31st December 2006 which comprise the Profit and Loss Account, the Balance Sheet and the related notes. These financial statements have been prepared under the accounting policies set out therein.

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

## RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

The directors' responsibilities for preparing the financial statements in accordance with applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice) are set out in the Statement of Directors' responsibilities on pages 6 and 7.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

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

We read the Directors' Report and consider the implications for our report if we become aware of any apparent misstatements within it.

## BASIS OF AUDIT OPINION

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

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

## OPINION

In our opinion the financial statements:

- give a true and fair view, in accordance with UK Generally Accepted Accounting Practice, of the state of the company's affairs as at 31 December 2006 and of its profit for the year then ended.
- have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the financial statements.

KPMG Audit Plc
Chartered Accountants
Registered Auditor
London
30 March 2007

# PROFIT AND LOSS ACCOUNT

## TECHNICAL ACCOUNT - GENERAL BUSINESS

31 DECEMBER 2006

| | Notes | 2006 £'000 | 2006 £'000 | 2005 £'000 | 2005 £'000 |
|---|---|---|---|---|---|
| **EARNED PREMIUMS, NET OF REINSURANCE** | | | | | |
| Gross premiums written | | | | | |
| Continuing activities | | | 1,068,706 | | 1,063,647 |
| Discontinued activities | | | 1,412 | | (5,809) |
| | 15 | | 1,070,118 | | 1,057,838 |
| Outwards reinsurance premiums before Part VII transfer | | 1,011,345 | | 878,606 | |
| Effect of Part VII transfer | | 40,908 | | - | |
| Outward reinsurance premiums | | | 1,052,253 | | 878,606 |
| Net premiums written before Part VII transfer | | 58,773 | | 179,232 | |
| Effect of Part VII transfer | | (40,908) | | - | |
| Net premiums written | | | 17,865 | | 179,232 |
| Increase in the gross provision for unearned premiums | | | (49,302) | | (16,802) |
| (Increase)/Decrease in the provision for unearned premiums - reinsurers' share | | | (52,596) | | 21,189 |
| (Increase)/Decrease in the net provision for unearned premiums | | | 3,294 | | (37,991) |
| Earned premiums, net of reinsurance | 3 | | 21,159 | | 141,241 |
| Investment income | | | 3,534 | | 7,639 |
| Other technical income, net of reinsurance | | | 16,839 | | 13,997 |
| **TOTAL TECHNICAL INCOME** | | | 41,532 | | 162,877 |

# PROFIT AND LOSS ACCOUNT

## TECHNICAL ACCOUNT - GENERAL BUSINESS

31 DECEMBER 2006

| | Notes | 2006 £'000 | 2006 £'000 | 2005 £'000 | 2005 £'000 |
|---|---|---|---|---|---|
| **CLAIMS INCURRED, NET OF REINSURANCE** | | | | | |
| Claims paid | | | | | |
| - gross amount | | | 509,686 | | 458,857 |
| - reinsurers' share before Part VII transfer | | 497,276 | | 440,375 | |
| - effect of Part VII transfer | | 40,908 | | - | |
| - reinsurers' share | | | 538,184 | | 440,375 |
| - net of reinsurance before Part VII transfer | | 12,410 | | 18,482 | |
| - effect of Part VII transfer | | (40,908) | | - | |
| - net of reinsurance | | | (28,498) | | 18,482 |
| Change in the provision for claims | | | | | |
| - gross amount | | | (8,966) | | 458,044 |
| - reinsurers' share | | | (35,173) | | 365,808 |
| - net of reinsurance | | | 26,207 | | 92,236 |
| Claims incurred net of reinsurance | 4 | | (2,291) | | 110,718 |
| Net operating expenses | 6 | | 15,059 | | 15,913 |
| **TOTAL CHARGES** | | | 12,768 | | 126,631 |
| **BALANCE ON THE TECHNICAL ACCOUNT FOR GENERAL BUSINESS** | | | | | |
| Continuing activities | | | 21,045 | | 33,246 |
| Discontinued Activities | | | 7,719 | | 3,000 |
| | | | 28,764 | | 36,246 |

# PROFIT AND LOSS ACCOUNT

## NON-TECHNICAL ACCOUNT

31 DECEMBER 2006

| | Notes | 2006 £'000 | 2005 £'000 |
|---|---|---|---|
| **BALANCE ON THE GENERAL BUSINESS TECHNICAL ACCOUNT** | | 28,764 | 36,246 |
| Investment income | 9 | 6,190 | 17,569 |
| | | 34,954 | 53,815 |
| Investment expenses and charges | | | |
| - investment management expenses | | (1,238) | (1,318) |
| Investment income allocated to the technical account | | (3,534) | (7,639) |
| | | (4,772) | (8,957) |
| **OTHER CHARGES** | | | |
| Exchange losses | | (1,910) | (185) |
| **OPERATING PROFIT ON ORDINARY ACTIVITIES BEFORE TAX** | | 28,272 | 44,673 |
| Tax on profit on ordinary activities | 10 | (19,549) | 14,701 |
| **PROFIT ON ORDINARY ACTIVITIES AFTER TAX, RETAINED FOR THE FINANCIAL YEAR** | | 47,821 | 29,972 |

There were no other recognised gains or losses other than the profit for the year. All gains and losses relate to continuing activities.

# BALANCE SHEET

## ASSETS

31 DECEMBER 2006

| | Notes | 2006 £'000 | 2005 £'000 |
|---|---|---|---|
| **INVESTMENTS** | | | |
| Financial investments | 11 | 369,938 | 273,060 |
| Deposits with ceding undertakings | | 149 | 272 |
| | | 370,087 | 273,332 |
| Investment in Subsidiary | | 50 | 50 |
| **REINSURERS' SHARE OF TECHNICAL PROVISIONS** | | | |
| Unearned premium provision | 3 | 472,866 | 420,270 |
| Claims outstanding | 4 | 1,286,948 | 1,322,121 |
| | | 1,759,814 | 1,742,391 |
| **DEBTORS** | | | |
| Arising out of direct insurance operations | 19 | 106,954 | 333,743 |
| Arising out of reinsurance operations | | 22 | 1,314 |
| Corporation tax recoverable | | 5,609 | - |
| Deferred tax | 10 | 15,154 | - |
| Other debtors | | 326 | 934 |
| | | 128,065 | 335,991 |
| **OTHER ASSETS** | | | |
| Cash at bank and in hand | | 47,147 | 44,350 |
| **PREPAYMENTS AND ACCRUED INCOME** | | | |
| Accrued interest and rent | | 3,427 | 3,089 |
| Deferred acquisition costs | 6 | 73,472 | 66,432 |
| | | 76,899 | 69,521 |
| **TOTAL ASSETS** | | 2,382,062 | 2,465,635 |

# BALANCE SHEET

## LIABILITIES

31 DECEMBER 2006

| | Notes | 2006 £'000 | 2005 £'000 |
|---|---|---|---|
| **CAPITAL AND RESERVES** | | | |
| Called up share capital | 12 | 114,000 | 114,000 |
| Profit and loss account | 14 | 130,433 | 102,612 |
| Shareholders' funds attributable to equity interests | | 244,433 | 216,612 |
| **TECHNICAL PROVISIONS - GROSS** | | | |
| Unearned premium provision | 3 | 516,050 | 466,748 |
| Claims outstanding | 4 | 1,451,437 | 1,460,403 |
| | | 1,967,487 | 1,927,151 |
| **PROVISIONS FOR OTHER RISKS AND CHARGES** | | | |
| Taxation | | - | 13,401 |
| **CREDITORS** | | | |
| Arising out of direct insurance operations | 19 | 88,144 | 195,165 |
| Arising out of reinsurance operations | | 32 | 689 |
| Other creditors including taxation and social security | 13 | 10,077 | 47,582 |
| | | 98,253 | 243,436 |
| **ACCRUALS AND DEFERRED INCOME** | | | |
| Deferred reinsurance commissions | 6 | 71,889 | 65,035 |
| | | 2,382,062 | 2,465,635 |

Approved by the board on 30 March 2007

N. J. Parr - Chief Executive Officer R. A. S. Harris - Chief Financial Officer

# NOTES TO THE ACCOUNTS

31 DECEMBER 2006

## 1. BASIS OF PREPARATION OF THE FINANCIAL STATEMENTS

The financial statements have been prepared in accordance with the provisions of section 255 of, and Schedule 9A to, the Companies Act 1985. The financial statements comply with applicable accounting standards and comply with the revised Statement of Recommended Practice issued by the Association of British Insurers in December 2005, amended in 2006. The ABI SORP have been prepared under the historic cost accounting rules, modified to include the revaluation of investments.

As the company is a wholly owned subsidiary of Münchener Rückversicherungs Gesellschaft AG (‘Munich Re’) the company has taken advantage of the exemption contained in FRS 8 and not disclosed transactions with entities which form part of the Munich Re group. The consolidated financial statements of Munich Re, within which the Company is included, can be obtained from the Company' registered office. As the company is a wholly owned subsidiary undertaking it is exempted from producing consolidated financial statements and so these financial statements present information for the Company as an individual undertaking. Under FRS 1 the company is exempt from the requirement to prepare a cash flow statement on the grounds that the company is included in the consolidated financial statements of Munich Re.

## 2. ACCOUNTING POLICIES

The following accounting policies have been applied consistently in dealing with material items in the company’s financial statements.

***Basis of accounting***

- The annual basis of accounting has been applied to all classes of business.

***Premiums***

- Written premiums comprise the amount receivable including an estimate of pipeline premiums during the financial year for the whole period for the Company is on risk in respect of contracts of insurance entered into and incepting during that period, together with any further adjustments to premiums receivable for prior accounting periods that had not been fully recognised in previous financial statements.

- Reinsurance premiums payable are recognised in the same period as the written premiums for the original risks and are accounted on the same basis.

- Premiums exclude any associated insurance premium taxes and are shown before deduction of amounts payable to intermediaries.

- An adjustment is made to both premiums receivable and reinsurance premiums payable to reflect the time during which the Company is on risk in respect of the underlying cover. Depending on the profile of the underlying business, this calculation is made using an approach no less accurate than the 24ths basis.

***Claims***

- Claims paid include both claims and associated claims settlement expenses paid during the year.

- The provision for outstanding claims comprise provisions for the estimated costs of settling all claims incurred up to but not paid at the balance sheet date, whether reported or not, together with related internal and external claims handling expenses. Where applicable, prudent estimates are made of expected reinsurance recoveries and salvage and subrogation recoveries, which are shown separately in the balance sheet as assets.

- In estimating the amount to carry forward for IBNR, the Company adopts a statistical approach to quantifying the amount. In particular the Company estimates, based on exposure analysis or past experience for each class of business, the expected development of claims over time in order to determine the likely ultimate claims to be experienced, In addition, the Company makes allowance for differences between years in respect of the type of business written, as well as the underlying terms and conditions of that business. Inherent in these approaches is the assumption that the past is a reasonable predictor of the likely level of claims development and that the models used for current business are appropriate.

- In estimating the IBNR for both large claims and catastrophes, the Company considers the likely exposure arising from the individual loss or, in the case of catastrophes, the underlying event.

- Although the provision for IBNR is fairly stated based on information available and assumptions extant at the balance sheet date, it is inevitable that the ultimate liability will vary as a result of subsequent information and events (including legal decisions) which may result in significant adjustments to the amounts provided; these adjustments will be reflected in future sets of financial statements.

***Part VII transfer***

- The Part VII transfer has been accounted in accordance with the ABI SORP; any associated reinsurance transaction has been reflected in the Technical Account.

***Unexpired risks***

- Provision is made for unexpired risks where the claims and administrative expenses likely to arise after the end of the financial year in respect of contracts concluded before that date are expected to exceed the unearned premiums provision in respect of such policies after deduction of any acquisition costs deferred. The provision for unexpired risks is calculated after taking into account relevant investment income. Surpluses and deficits are aggregated where classes of business are managed together.

***Acquisition costs***

- Acquisition costs comprise the expenses, both direct and indirect, of acquiring policies written during the financial year.

- Costs which vary with and are primarily related to the acquisition of business (including both new and renewal business) are deferred to the extent that they are attributable to premiums unearned at the balance sheet date.

***Other technical income***

- Overriding commission receivable is reflected in the technical account on the same basis as the underlying business to which it relates.

***Investments and investment income***

- Quoted investments are stated at current value (which is represented by the bid value) at the balance sheet date.

- The subsidiary company is valued at cost.

- The directors believe that the net asset value of the subsidiary company is an appropriate indication of its current value.

- Investment income comprises interest and dividends receivable, together with both realised and unrealised investment gains. Realised gains are calculated as the difference between net sales proceeds and original cost or, if previously revalued, the valuation at the balance sheet date.

- Investment income on the assets supporting technical provisions, consisting of fixed interest investments, is allocated to the technical account on the average value of those provisions held during the year.

***Deferred taxation***

- Deferred taxation is recognised, without discounting, in respect of all timing differences between the accounting and tax value which have arisen at the balance sheet date, except as otherwise required by FRS 19.

***Foreign currencies***

- Assets and liabilities denominated in currencies other than sterling are translated to sterling at the rate of exchange ruling at the balance sheet date.

- Revenue transactions in other currencies are converted to sterling at the rate ruling at the time of the transaction.

***Operating leases***

- Rental costs relating to operating leases are included within management expenses over the term of lease on a straight line basis.

## 3. EARNED PREMIUMS, NET OF REINSURANCE

| | 2006 Gross £'000 | 2006 Reinsurance £'000 | 2006 Net £'000 | 2005 Gross £'000 | 2005 Reinsurance £'000 | 2005 Net £'000 |
|---|---|---|---|---|---|---|
| Premiums receivable | 1,070,118 | 1,052,253 | 17,865 | 1,057,838 | 878,606 | 179,232 |
| Unearned premiums - 1 January | 466,748 | 420,270 | 46,478 | 449,946 | 441,459 | 8,487 |
| Unearned premiums - 31 December | 516,050 | 472,866 | 43,184 | 466,748 | 420,270 | 46,478 |
| Effect of exchange rate differences | (16,543) | (14,914) | (1,629) | - | - | - |
| (Increase)/decrease in unearned premiums | (32,759) | (37,682) | 4,923 | (16,802) | 21,189 | (37,991) |
| Premiums earned | 1,020,816 | 999,657 | 21,159 | 1,041,036 | 899,795 | 141,241 |

The Part VII transfer is more fully explained in note 5.

## 4. CLAIMS INCURRED, NET OF REINSURANCE

| | 2006 Gross £'000 | 2006 Reinsurance £'000 | 2006 Net £'000 | 2005 Gross £'000 | 2005 Reinsurance £'000 | 2005 Net £'000 |
|---|---|---|---|---|---|---|
| Claims paid | 509,686 | 538,184 | (28,498) | 458,857 | 440,375 | 18,482 |
| Outstanding Claims - 1 January | 1,460,403 | 1,322,121 | 138,282 | 1,002,359 | 956,313 | 46,046 |
| Outstanding claims - 31 December | 1,451,437 | 1,286,948 | 164,489 | 1,460,403 | 1,322,121 | 138,282 |
| Effect of exchange rate differences | (46,950) | (20,946) | (26,004) | - | - | - |
| Increase/(decrease) in Outstanding Claims | 37,984 | (14,227) | 52,211 | 458,044 | 365,808 | 92,236 |
| Claims incurred | 500,720 | 503,011 | (2,291) | 916,901 | 806,183 | 110,718 |

The Part VII transfer is more fully explained in note 5.

Overprovisions for net claims at the beginning of the year compared to payments and provisions at the end of the year in respect of prior years' claims amounted to £19.7 million (2005 - £3 million overprovision).

## 5. PART VII TRANSFER

On 31 March 2006 a portfolio of business from RSA was transferred to the company for no consideration in accordance with a scheme under Part VII of the Financial Services and Markets Act 2000 approved by the High Court on 8 February 2006. The assets and liabilities transferred are set out below:

| | £'000 |
|---|---|
| Assets | |
| Investments | 40,301 |
| Deferred acqusition costs | 10,151 |
| Debtors | 59,345 |
| | 109,797 |
| Liabilities | |
| Technical provisions | 40,908 |
| Unearned premium reserve | 46,590 |
| Creditors | 22,299 |
| | 109,797 |

Following the transfer the Company reinsured 100% of this portfolio with Munich Re UK Life Branch. The premium payable was £40.9m as disclosed in the technical account.

## 6. OPERATING EXPENSES

| | 2006<br>£'000 | 2005<br>£'000 |
|---|---|---|
| Acquisition costs | | |
| - gross amount | 229,149 | 147,826 |
| - reinsurers' share | 226,378 | 141,771 |
| - net of reinsurance | 2,771 | 6,055 |
| Net deferred acquisition costs - 1 January | 1,397 | 1,840 |
| Net deferred acquisition costs - 31 December | 1,583 | 1,397 |
| (Increase)/Decrease | (186) | 443 |
| Acquisition costs | 2,585 | 6,498 |
| Administration expenses | 12,474 | 9,415 |
| | 15,059 | 15,913 |
| Direct insurance commissions amounted to | 221,571 | 142,078 |

## 7. ADMINISTRATIVE EXPENSES

All administration expenses, including auditors' remuneration amounting to £162,000 (2005 - £148,000) for audit services and £288,315 (2005 - £130,000) for non audit services, are paid by the Company's wholly owned subsidiary, Great Lakes Services Limited. These expenses are recharged to Great Lakes Reinsurance (UK) PLC, with disclosures being made in the accounts of the service company.

The fees paid in respect of non audit services can be broken down as follows:

| | |
|---|---|
| • Services relating to taxation | 87,645 |
| • Services relating to IT | 2,388 |
| • All other services | 198,282 |
| | 288,315 |

The Company has no employees and does not pay any remuneration other than fees to its Directors. Any pension contributions to the multi employer pension scheme are disclosed in the accounts of the service company.

## 8. REMUNERATION OF DIRECTORS

| | 2006<br>£'000 | 2005<br>£'000 |
|---|---|---|
| Directors' emoluments | 100 | 446 |
| Pension contributions | - | 55 |
| | 100 | 501 |

Directors' remuneration consists of the emoluments on behalf of two (2005 - four) directors.

| In respect of the highest paid director: | 2006<br>£'000 | 2005<br>£'000 |
|---|---|---|
| Directors' emoluments | 60 | 192 |
| Pension contributions | - | 31 |
| | 60 | 223 |

## 9. INVESTMENT INCOME

| | 2006<br>£'000 | 2005<br>£'000 |
|---|---|---|
| Investment income | 18,519 | 16,325 |
| Realised gains | 425 | 148 |
| Unrealised (losses)/gains | (5,198) | 1,096 |
| Foreign exchange losses | (7,556) | - |
| Total | 6,190 | 17,569 |

## 10. TAXATION

| | 2006<br>£'000 | 2005<br>£'000 |
|---|---|---|
| UK Corporation tax at 30% (2005: 30%) | - | 13,401 |
| Deferred Tax | (15,154) | 1,300 |
| Overprovision in prior year | (4,395) | - |
| | (19,549) | 14,701 |

Reconciliation of the standard tax rate to the effective tax rate:

| | 2006<br>£'000 | 2005<br>£'000 |
|---|---|---|
| Profit before tax | 28,272 | 44,673 |
| Corporation tax at 30% | 8,482 | 13,401 |
| Unutilised loss relief in previous year now recognised and utilised | (28,031) | 1,300 |
| | (19,549) | 14,701 |

Deferred Tax Asset

Under FRS 19, deferred tax is provided for in full on unrelieved trading losses carried forward.

| | 2006<br>£'000 | 2005<br>£'000 |
|---|---|---|
| Balance at start of the year | - | 1,300 |
| Deferred tax charge in Profit and Loss Account | 15,154 | (1,300) |
| Balance at end of year | 15,154 | - |

## 11. INVESTMENTS

| | Current value | | Historical value | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| | £'000 | £'000 | £'000 | £'000 |
| Financial investments: | | | | |
| Equities - Listed | 21,256 | 11,327 | 19,119 | 10,299 |
| Government fixed interest | 160,548 | 168,566 | 163,234 | 168,989 |
| Other listed fixed interest securities | 72,202 | 68,322 | 74,166 | 66,241 |
| Deposits with credit institutions | 115,932 | 24,801 | 115,932 | 24,801 |
| Staff mortgages | - | 44 | - | 44 |
| | 369,938 | 273,060 | 372,451 | 270,374 |
| Deposits with ceding undertakings | 149 | 272 | 149 | 272 |
| Total investments | 370,087 | 273,332 | 372,600 | 270,646 |
| Investment in subsidiary | 50 | 50 | 50 | 50 |

All listed equities and fixed interest securities are quoted on the London Stock Exchange. The investment in subsidiary represents 100% shareholding in Great Lakes Services Limited, a company incorporated in England and Wales. The Company owns 50,000 shares of £1 each.

## 12. SHARE CAPITAL

| | 2006 | 2005 |
|---|---|---|
| | £'000 | £'000 |
| Authorised | | |
| 11,400,000 (2005 - 11,400,000) Ordinary Shares of £10 each | 114,000 | 114,000 |
| Allotted, called up and fully paid | | |
| 11,400,000 (2005 - 11,400,000) Ordinary Shares of £10 each | 114,000 | 114,000 |

## 13. CREDITORS

All creditors are payable within a period of one year.

## 14. RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS

| | Ordinary Share Capital | Profit and loss account | Total |
|---|---|---|---|
| | £'000 | £'000 | £'000 |
| At 1 January 2006 | 114,000 | 102,612 | 216,612 |
| Profit for year | - | 47,821 | 47,821 |
| Dividends paid | - | (20,000) | (20,000) |
| At 31 December 2006 | 114,000 | 130,433 | 244,433 |

In accordance with the amendment to FRS3 published in June 1999 no note of historical cost profits has been prepared as the company's only material gains and losses on assets relate to the holding and disposal of investments.

## 15. SEGMENTAL INFORMATION

| | Direct marine & aviation £'000 | Direct property £'000 | Direct general liability £'000 | Direct motor £'000 | Total direct £'000 | Re-insurance accepted £'000 | Total £'000 |
|---|---|---|---|---|---|---|---|
| **2006** | | | | | | | |
| Gross premiums written | 258,372 | 206,774 | 226,185 | 377,375 | 1,068,706 | 1,412 | 1,070,118 |
| Gross premiums earned | 287,939 | 145,392 | 219,654 | 366,419 | 1,019,404 | 1,412 | 1,020,816 |
| Gross claims incurred | 109,327 | 2,873 | 204,465 | 194,688 | 511,353 | (10,633) | 500,720 |
| Gross operating expenses | 30,033 | 47,523 | 56,022 | 100,424 | 234,002 | 580 | 234,582 |
| Gross technical result | 148,579 | 94,996 | (40,833) | 71,307 | 274,049 | 11,465 | 285,514 |
| Reinsurance balance | (147,592) | (84,112) | 45,140 | (69,974) | (256,538) | (3,746) | (260,284) |
| Net technical result | 987 | 10,884 | 4,307 | 1,333 | 17,511 | 7,719 | 25,230 |
| Net technical provisions | - | 34,137 | 155,478 | - | 189,615 | 18,057 | 207,672 |

| | Direct marine & aviation £'000 | Direct property £'000 | Direct general liability £'000 | Direct motor £'000 | Total direct £'000 | Re-insurance accepted £'000 | Total £'000 |
|---|---|---|---|---|---|---|---|
| **2005** | | | | | | | |
| Gross premiums written | 230,151 | 232,842 | 255,331 | 345,323 | 1,063,647 | (5,809) | 1,057,838 |
| Gross premiums earned | 224,679 | 227,306 | 249,260 | 337,113 | 1,038,358 | 2,678 | 1,041,036 |
| Gross claims incurred | 119,927 | 297,224 | 231,982 | 270,693 | 919,826 | (2,925) | 916,901 |
| Gross operating expenses | 24,119 | 39,395 | 13,404 | 76,277 | 153,195 | 4,489 | 157,684 |
| Gross technical result | 80,633 | (109,313) | 3,874 | (9,857) | (34,663) | 1,114 | (33,549) |
| Reinsurance balance | (80,633) | 115,750 | 3,185 | 9,857 | 48,159 | - | 48,159 |
| Net technical result | - | 6,437 | 7,059 | - | 13,496 | 1,114 | 14,610 |
| Net technical provisions | - | 34,237 | 116,513 | - | 150,750 | 34,010 | 184,760 |

All premiums resulted from contracts of insurance or reinsurance concluded in the United Kingdom.

The column headed "Reinsurance Accepted" represents discontinued activities, all other activities are continuing.

## 16. CONTINGENT LIABILITIES

There were no contingent liabilities at 31 December 2006 other than those arising in the normal course of the Company's underwriting business (2005 - Nil).

## 17. CAPITAL COMMITMENTS

There were no capital commitments at 31 December 2006 (2005 - Nil).

## 18. LEASES

Annual commitments under a non cancellable operating lease are as follows:

| | Land and Buildings | |
|---|---|---|
| | 2006 | 2005 |
| | £'000 | £'000 |
| Operating leases which expire | | |
| • Within one year | - | - |
| • Between two and five years | - | - |
| • Over five years | 618 | 345 |
| Operating lease payments made during the financial year | 578 | 345 |

## 19. GROUP COMPANIES

a) The Company is a wholly owned subsidiary of Münchener Rückversicherungs Gesellschaft (the immediate and ultimate holding company), a company incorporated in Germany that issues publicly available consolidated accounts and,accordingly, the company is exempt from the disclosure requirements of FRS 8.

b) Included in creditors arising out of direct insurance operations are the following:

| | 2006<br>£'000 | 2005<br>£'000 |
|---|---|---|
| Amounts due to holding company | 64,229 | 167,524 |
| Amounts due to fellow subsidiaries | 1,627 | 10,961 |

c) Included in debtors arising out of direct insurance operations are the following:

| | 2006<br>£'000 | 2005<br>£'000 |
|---|---|---|
| Amounts due from holding company | - | 146,973 |
| Amounts due from fellow subsidiaries | 128 | 13,515 |

d) Included in other debtors and creditors are the following:

| | 2006<br>£'000 | 2005<br>£'000 |
|---|---|---|
| Other debtors | | |
| Amounts due from holding company | - | 607 |
| Amounts due from subsidiary company | 221 | - |
| | | |
| Other creditors | | |
| Amounts due to subsidiary company | - | 113 |

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