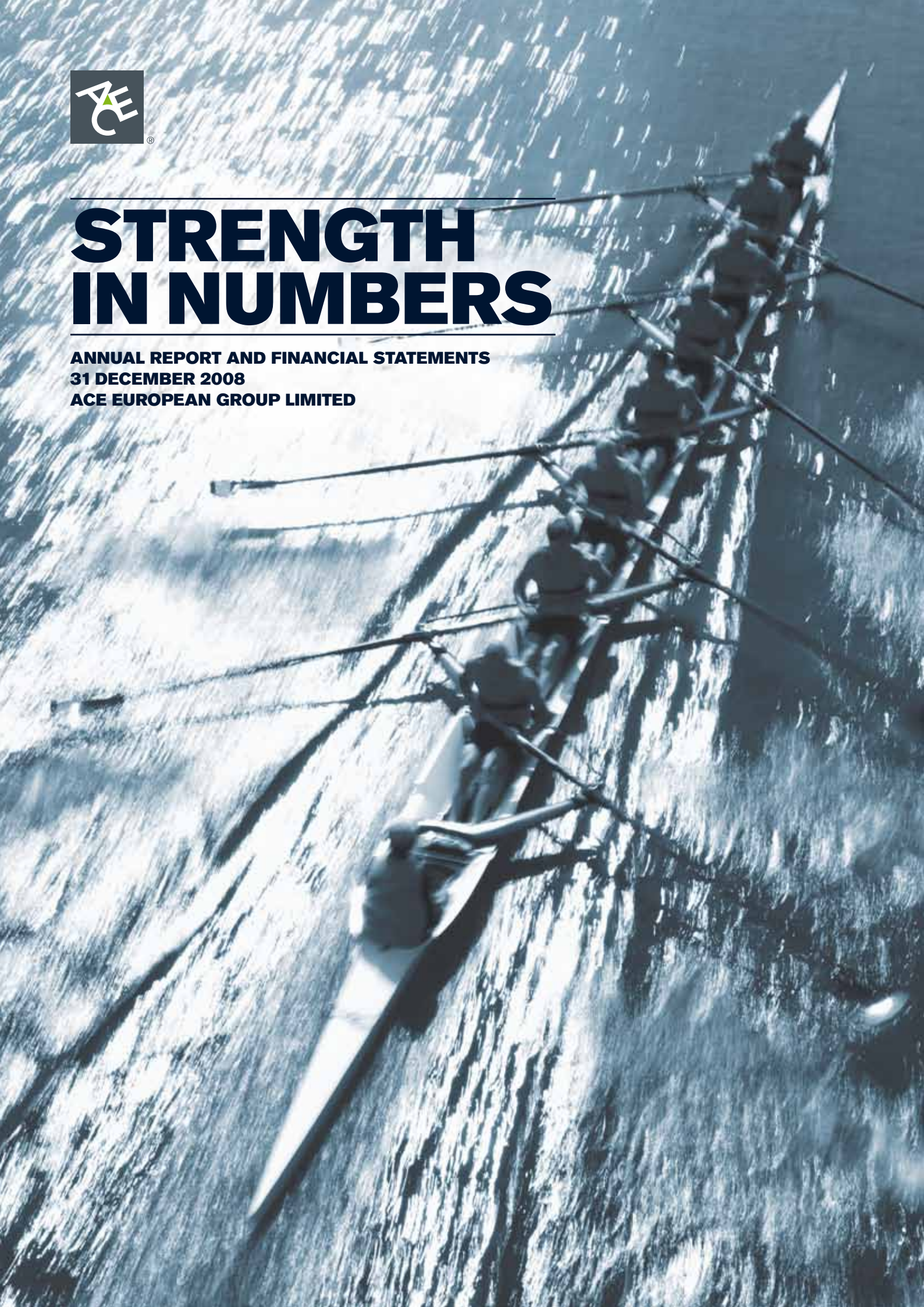




STRENGTH IN NUMBERS

**ANNUAL REPORT AND FINANCIAL STATEMENTS
31 DECEMBER 2008
ACE EUROPEAN GROUP LIMITED**



ACE European Group Limited

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

Authorised and
Regulated by the
Financial Services Authority

Registered in England
Number 1112892

ACE European Group Limited

Contents

Chairman's Report	2
Business Review	5
Directors' Report	15
Statement of Directors' Responsibilities	17
Independent Auditors' Report	18
Profit and Loss Account	20
Statement of Total Recognised Gains and Losses	21
Balance Sheet	22
Notes to the Financial Statements	24

Chairman's Report

31 December 2008

Performance in 2008

ACE European Group Limited ("AEGL") is one of Europe's leading insurance and reinsurance players, with a premium base approaching £2 billion. The increasingly challenging market conditions and relentless competition in the insurance markets noted last year continued into 2008. The year also saw unprecedented turmoil in the global financial markets. Despite this, AEGL generated a 2008 pre-tax profit of £2.8 million.

The balance sheet of AEGL remains strong with shareholders' funds at the close of the financial year at £721.2 million, compared to £716.1 million at the preceding year end. AEGL holds financial strength ratings of "A+ (Strong)" from Standard & Poor's and "A+ (Superior)" from A.M. Best. Standard & Poor's affirmed the rating in December 2008 and revised the outlook for the rating upwards from "stable" to "positive".

AEGL's underwriting portfolio is well diversified and has a broad geographical scope. The accident and health ("A&H") portfolio provides balance to the more cyclical UK & Continental Europe property and casualty ("P&C") retail business. Both complement the London market wholesale insurance and reinsurance business also underwritten in the company. AEGL's product range and diversity are key in producing consistent earnings over the insurance cycle.

Market environment

To say this was a difficult year for the global financial markets is an obvious understatement. The structure and order of the financial services industry – banking, investment banking, broking and insurance – are changing before our eyes. In the insurance industry this year we have witnessed a significant and rapid destruction of capital. We began 2008 with an overcapitalised industry feeding a soft market. Since then, natural catastrophes and financial market losses have destroyed a great deal of this excess capital. Insurance company margins are under greater pressure as underwriting experience deteriorates due to catastrophes, soft market pricing and declining, indeed negative, returns on investment portfolios.

The crisis in the world's financial markets has already affected the viability of some insurance companies. The

reduced availability and soaring cost of capital is also having an impact in other industries. Out of this turmoil, some companies will emerge much stronger, having seized the opportunities that will inevitably present themselves. AEGL is one of those companies.

Achievements during the year

Switzerland

AEGL is a wholly owned subsidiary of ACE Limited. Following the re-domestication of ACE Limited's holding company from the Cayman Islands to Zurich in July 2008, the ACE Group launched a new Swiss insurance company, ACE Insurance (Switzerland) Limited which commenced operations on 1 November 2008. ACE has been active as a local insurer in Switzerland since the opening of the Zurich branch of AEGL in 2003, underwriting reinsurance business from Zurich two years later. In November 2008, AEGL transferred the business, assets and liabilities of its Swiss branch to ACE Insurance (Switzerland) Limited, with the goal of further strengthening ACE's position in the Swiss market.

New AEGL branches & initiatives

In late 2008, AEGL opened a new office in Turkey, bringing the number of operating branches throughout the UK and Europe to 20. This physical presence allows local brokers and clients to easily access AEGL underwriting expertise.

In addition, 2008 saw a number of new product initiatives and distribution channels developed, examples of which can be found within the Business Review. The ability of AEGL to extend both its product base and geographical scope, particularly in a changing market place, ensures that we remain one of the key insurance providers across the UK and Europe.

Expansion of the risk management framework

As a key step in further embedding risk and capital management into the business, AEGL expanded its risk management function during the year. This dedicated function will improve risk measurement and monitoring across all areas of risk to which the business is exposed. The team's focus is to enhance the risk management techniques rooted in the business and governance framework of the company. This should

Chairman's Report

31 December 2008

ensure that AEGL is well positioned to meet the demands and direction of both the Financial Services Authority ("FSA") and Solvency II.

Future prospects

AEGL is first and foremost an underwriting company. We focus on maintaining underwriting discipline and robust risk selection whilst preserving our leadership position and remaining alert to new opportunities. Our ultimate goals are to produce an underwriting profit and protect our capital. This approach enables us to build our financial strength, providing the security our clients have come to expect.

Service levels are one of the key differentiators in the insurance market and we recognise the importance of providing an efficient and responsive service to our brokers and customers. We strive to ensure that AEGL's service levels are amongst the best in the market. From straightforward policy issuance to timely claims payments and provision of complex business solutions for multinational enterprises, AEGL can demonstrate that it meets the insurance needs of a wide ranging client base.

At the heart of our customer service ethos is Treating Customers Fairly ("TCF"), a core principle of our regulatory framework and one which fits well with AEGL's culture of integrity. TCF is core to our daily interaction with customers and brokers and is relevant not only to our A&H retail customers, but to all our commercial relationships.

The majority of AEGL's P&C business is conducted via registered brokers. We recognise the added value brokers bring to our underwriting transactions and their help in arranging insurance solutions which provide tangible benefits to clients. In addition, the success of AEGL's A&H business would not have been possible without the support of our partners and sponsors throughout the UK and Europe. I would like to take this opportunity to thank our partners, sponsors and the wider broking community for their continued support.

At ACE we are continually looking for ways to enhance our client and broker service proposition, using both traditional and technology driven methods. The growing success of our e-commerce platform, ACE Online, offers brokers quick and efficient access to AEGL's speciality products, with the ability to quote, bind and issue policies online in a timely and cost effective manner, achieving instant contract certainty.

AEGL has the right structure, the right products and the right people in the right jobs. It has already laid the foundations to adapt to today's challenging and changing marketplace. We will continue to focus on the solid, core ACE Europe and ACE Global Markets branded business and increase our market penetration in Central & Eastern Europe. Growth, whether organic or through acquisition, will be sought only when the right opportunities arise. And despite the disruption in the financial market place, I am confident that such opportunities will present themselves.

2009 should herald the end of the soft market. Across the industry, underwriting margins are diminishing and investment returns can no longer be relied upon to boost the sub-standard underwriting results of some of our competitors. We at ACE will seek to use our proven underwriting skills to increase price and/or tighten terms and conditions where necessary in order to protect our bottom line.

Notwithstanding the above, it is my expectation that 2009 will be another challenging year for the insurance market. The threat of global recession is likely to bring with it an increase in claims frequency, with claims inflation far outstripping interest rates. With our clients facing increasing fiscal pressures and the projected rise in unemployment we may see a diminished demand for insurance products, particularly in the emerging markets. However, with capital becoming even more difficult to access, many companies may become more risk adverse and seek to utilise insurance products to protect their assets.

Chairman's Report

31 December 2008

Thanks to our people

AEGL has a strong franchise, a solid balance sheet, a broad product base and great producer relationships. The quality and breadth of our underwriters, claims adjusters and support staff are, I believe, second to none. Our people know exactly what they must do to build on our success. We continue to focus on talent management, arguably the single most important part of a company's fabric, which determines its growth and success. The loyalty and commitment of AEGL staff has again been demonstrated by the acceptable underwriting result achieved in a very difficult environment. There is an enthusiasm and optimism throughout the company that endures regardless of market conditions, and I would like to take this opportunity to thank the management teams and staff throughout the UK and Europe for their hard work and dedication.

I believe we can achieve our business objectives for 2009 and beyond by focusing on our core business strategies and proactively responding to opportunities when they arise, further enhancing our position as one of the pre-eminent insurers in Europe.

A.J. Kendrick

Chairman and Chief Executive Officer

12 March 2009

Business Review

31 December 2008

The board of AEGL has prepared this review in accordance with Section 234ZZB of the Companies Act 1985. In addition to this statutory requirement, this report also addresses other aspects of the company's business which the board believes will be of benefit to all stakeholders.

Business objectives and strategy

AEGL is a major contributor to the ACE Group of Companies, providing just over 19% of the ACE Group's overall gross written premium for 2008.

The ACE Group of Companies is one of the few truly global insurance and reinsurance organisations. With more than \$72 billion in assets and over \$19 billion of gross written premiums in 2008, the ACE Group is distinguished by its underwriting expertise, superior claims handling and global franchise. It has a physical presence in more than 50 countries and conducts business in over 140, employing 16,000 people worldwide. As well as being one of the world's leading providers of commercial property and casualty insurance and reinsurance, ACE also has a major presence in the accident & health business and a young, growing life insurance operation.

AEGL is a major participant in the UK and Continental European insurance markets, with acknowledged underwriting expertise, diverse products and a strong balance sheet. The underwriting portfolio encompasses property & casualty and accident & health insurance, London market, US and international specialty business, and treaty reinsurance.

AEGL's key strategies centre on the underwriting business. Underwriting discipline will be maintained, with underwriters using their skills to set pricing, terms and conditions that reflect the changing and challenging marketplace and the potential impact of global recession on the financial results. 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. AEGL will invest in technology to improve its operational efficiency, underwriter support and broker interfaces. In addition, AEGL is committed to protecting

and preserving its capital by operating a conservative investment strategy and placing increased focus on cash flow management. Fulfilling these objectives should ensure that AEGL secures its position as a long term insurer for its many clients.

Organisation of the business

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

ACE Europe provides tailored insurance solutions for a diverse range of clients. Its product range includes property, primary & excess casualty, financial lines, surety, marine cargo and construction related risks. ACE Europe also underwrites an accident & health and travel insurance portfolio, providing benefits and services to individuals, employee groups and affinity groups throughout Europe. In some cases these products are packaged under other brands or form part of another service provider's products. ACE Europe is renowned for its flexible and committed approach and its success can be attributed to many factors; most notably the depth of underwriting expertise. 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 and accident & health ("A&H").

ACE Global Markets ("AGM") is the ACE Group's specialty international underwriting business. Its parallel distribution capabilities mean that underwriting products may be offered through both AEGL and ACE European Group's Lloyd's Syndicate 2488, managed by ACE Underwriting Agencies Ltd ("AUAL"). This flexibility allows AGM to provide risk

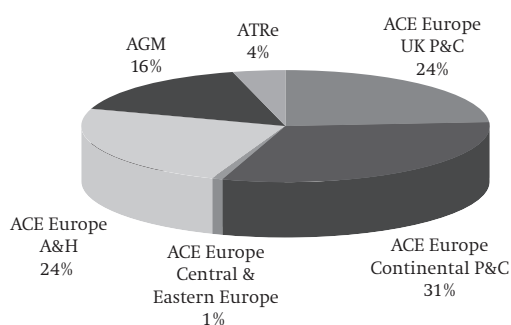
Business Review

31 December 2009

solutions to clients in over 140 countries throughout the world, including a significant presence in the US. The underwriting team prides itself on its technical approach to evaluating risk and, combined with a strong commitment to high levels of service to both clients and brokers, can react quickly to a changing market. AGM's product range covers principally excess and surplus lines ("E&S") business, aviation, financial lines, property, marine, energy and political risks.

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

Calendar year 2008 gross written premium split by management reporting category



The underwriting business of the company is organised into three management streams: ACE UK, led by Richard Pryce and encompassing AGM and AC Europe UK & Ireland P&C business; Continental Europe P&C, headed by David Furby; and A&H, headed by Andy Hollenberg. The senior management team continues to consist of Richard Pryce, David Furby and Philippa Curtis, Chief Financial Officer, and is led by Andrew Kendrick.

During 2008, the executive management team was strengthened by the appointment of Matthew Shaw as Chief Underwriting Officer, ACE Global Markets and Chairman, ACE Tempest Re Europe, and Lance Grant as European Senior Vice President for Operations and IT. Matthew was previously the Managing Director of ACETempest Re Europe and his considerable cross-class underwriting and reinsurance expertise will be invaluable to AGM as it seeks to consolidate its position as a pre-eminent global specialty and E&S insurer. Lance is responsible for establishing and implementing processes designed to enhance AEGL's operational performance and execute smoother service delivery to brokers and clients.

AEGL benefits from comprehensive and fully integrated support functions including 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.

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 E&S business in 42 US states. AEGL is also able to underwrite risks and issue reinsurance policies to insurance companies throughout most of the world's markets on a non-admitted basis. Business is accessed by a variety of distribution methods and the company has strong relationships with the broker community, corporate partners and direct markets.

Significant achievements

During the year, AEGL opened its newest branch office in Istanbul, Turkey. An application to allow AEGL to conduct insurance and reinsurance business in the country was filed with the Turkish Treasury in November 2008 and the company will begin underwriting business early in 2009. Turkey is a competitive and yet developing market place and represents a significant opportunity for AEGL in the future.

Business Review

31 December 2008

Despite the shrinkage in some countries as underwriters maintain underwriting discipline, AEGL was successful in growing its business in Spain, Portugal and the Nordic countries this year. In addition to its established A&H portfolio, AEGL began to offer its broad range of P&C and specialty products in Norway during 2008, doubling the region's year on year premium volume.

It has also been an active year in Poland and the Czech Republic, particularly in developing marketing, sales and distribution strategies to ensure AEGL is differentiating itself from the competition and offering the right products in the right markets.

AEGL is committed to developing customer focused insurance products and services to enable clients to manage their risks. New products launched in 2008 include "ACE PFI" (Private Finance Initiative), a product that builds on the company's strengths in construction, casualty, cargo and environmental impairment liability, and "ACE Dataguard Plus", a comprehensive solution for e-commerce and network risks. In early 2009, AEGL launched "ACE Evolve", a co-ordinated insurance and risk management solution for mid-sized companies with overseas subsidiaries or assets. ACE Evolve assists regional UK & Ireland companies trading internationally to manage their insurance coverage and compliance requirements across multiple jurisdictions, a service insurers usually only offer to large, London based multinational clients.

Responding to new and emerging risks, including environmental and climate-related risks, remains central to AEGL's customer proposition. This is evidenced by the expansion and further development of ACE Green, AEGL's full range of environmental liability solutions ranging from traditional risk transfer for simple operational exposures, to bespoke programmes specifically designed for complex merger, acquisition or liability relief transactions.

AEGL's A&H proposition has continued to benefit from its synergy with ACE Europe Life Limited, ACE's UK based life company which began underwriting in June 2007.

AEGL offers a market leading e-commerce platform, ACE Online, that enables brokers to quote, bind and issue policies online in a timely and cost effective manner, in addition to achieving instant contract certainty. ACE Online delivers specialty products including D&O, Pension Trustees liability, Environmental Impairment, Excess Casualty and Marine Cargo to small to medium UK enterprises. In 2008, 35% of AEGL's UK policies, predominantly in respect of D&O and excess casualty business were issued online, and plans to roll out the system across Continental Europe are underway.

Business environment

It is anticipated that 2009 will be another challenging year for the insurance industry with underwriters pushing for rate increases and tighter terms and conditions against a backdrop of continuing global financial turmoil.

Market conditions in the UK & Ireland retail market have shown signs of improvement during the last quarter of 2008 and it is anticipated that momentum for an upturn will increase through 2009. However, given the economic and financial outlook for the year, it is likely that 2009 will remain challenging, particularly for private D&O, excess casualty and construction risks.

The European insurance markets have been slower to react to diminishing financial returns, but conditions are anticipated to improve through 2009, albeit to a lesser extent than in the UK and the USA.

The London Market suffered significant natural catastrophe losses in 2008, primarily emanating from Hurricanes Ike and Gustav. These events have already started to have a positive impact on Property pricing, particularly in catastrophe exposed regions. Property pricing on non-US business is anticipated to improve but at a more gradual rate. Underwriters also expect to see rate improvement in Energy lines, particularly in the Gulf of Mexico, despite the oversupply of market capacity. Pricing is also improving within Financial Lines, particularly on US financial institutions where reduced competition is resulting in significantly better rates and terms and conditions. There have been

Business Review

31 December 2008

positive signs of improvement in Marine hull and liability classes although local markets are competitive, restricting the flow of business to London. Despite there being a continued absence of a catastrophe loss in the Aviation market, there are signs of resistance to reductions in rates however the increasingly fragile marketplace, including financial instability of airlines, may impact this class.

The economic downturn is also likely to increase pressure on attrition and response rates for A&H. However there may be opportunities for acquisitions and product expansion, particularly within the more niche travel and mobile phone categories.

AEGL's key objectives are to maintain underwriting discipline, interpret economic conditions into underwriting and retain core accounts where possible; evaluate opportunities against the global implications of market turmoil and be prepared to maximise opportunities as market changes; continue to implement effective expense control by improving operational efficiency; and retain key underwriting and support staff by focusing on talent management.

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	2008	2007
Net written premiums	787.6	752.2
Combined ratio*	101.5%	95.5%
Profit before tax	2.8	74.0
Dividend proposed	nil	80.0

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

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

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

Results and performance

2008 produced a pre-tax operating profit of £2.8 million and a combined ratio of 101.5%. A summary of the reported financial results is shown in the following table.

£ million	2008	2007
Gross written premiums	1,962.7	1,874.8
Net written premiums	787.6	752.2
Net earned premiums	786.8	763.2
Incurred losses	524.4	475.6
Operating expenses	273.9	252.9
Equalisation reserve movement	(16.9)	13.6
Underwriting profit	5.4	21.1
Profit on sale of Swiss business	9.2	-
Investment return	(88.1)	62.3
Net other income (charges)	76.3	(9.4)
Net pre-tax profit	2.8	74.0
Combined ratio %	101.5%	95.5%

AEGL's business is underwritten across the UK and Continental Europe and as such, is principally conducted in sterling, euros and US dollars. For accounting purposes, the results of this business are presented in sterling. The significant weakening of sterling against these currencies in the latter part of 2008 impacts both the comparability of prior year results and the actual 2008 results in the form of foreign exchange gains, the principal component of 'net other income' in the above table. The currency risk section within Note 2 to the Financial Statements discusses currency exposure in more detail.

Business Review

31 December 2008

On an underlying currency basis, gross written premiums were marginally below prior year. This was principally driven by reduced P&C underwriting, reflecting market conditions in 2008. The A&H and Personal Lines business compensated for this reduction by demonstrating modest growth, particularly in Continental Europe.

AEGL purchases reinsurance to mitigate the impact of major events and an undue frequency of smaller losses. The principal reinsurance programme operated by AEGL during 2008 is 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. On an underlying currency basis, 2008 net written premiums were effectively flat in comparison to prior year.

The deterioration in the combined ratio result year on year was driven principally by increasing loss costs. Accident year losses rose in 2008, particularly in the Continental Europe P&C business unit and in AGM. This was due to increases in both loss frequency and severity, particularly in the short tail lines of Property, Marine and Aviation. In addition, the Financial Lines class of business suffered losses from the sub-prime crisis and ensuing credit crunch.

Notwithstanding that 2008 saw the third most destructive hurricane ever to make landfall in the US, Hurricane Ike, this was not as significant a catastrophe loss to AEGL as last year's UK floods. In 2007, these natural catastrophe losses added some 2% to the net loss ratio; for 2008, the total impact of catastrophe losses, including Hurricane Ike, was just over 1%.

The 2008 underwriting result benefited from a release of £69.2 million (2007: £20.5 million) from prior year loss reserves in a number of business classes, predominantly within the ACE Europe UK and Continental Europe business units.

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

The global financial crisis intensified in 2008 and resulted in extreme volatility in investment valuations throughout the year. While government backed securities rose in price as a consequence of higher demand arising from a global flight-to-quality, the values of most other investments fell as a result of concerns around credit exposure and liquidity. Despite aggressive rate cutting by the major central banks in the latter part of the year, fixed income portfolio returns were poor for any assets with perceived credit risk. Notably valuations for equities and below investment grade (high yield) assets fell significantly. Despite the high quality bias of AEGL's investment portfolio and modest allocation to equities and high yield securities, AEGL suffered a negative total investment return in 2008. This negative return was primarily attributable to substantial increases in yields and the consequential fall in capital value of non-government fixed income holdings which form the majority of the investment portfolio. For AEGL, these investments principally comprise corporate bonds, but include modest allocations to other spread sectors, the prices of which fell dramatically in the year. A substantial element of the negative investment return is attributable to unrealised losses on investments, the bulk of which continue to enjoy strong ratings and offer the prospect of attractive returns.

Financial position

Investments

Throughout 2008 AEGL's investment portfolios continued to be dominated by investment grade fixed income holdings. During the year, exposure to equities was significantly reduced with a proportion of the sale proceeds allocated to high yield bonds. Following these changes, AEGL ended 2008 with 95% of the aggregate investment portfolio allocated to investment grade bonds, 4% to high yield bonds and less than 1% to equities.

Business Review

31 December 2008

Barclays Global Investors and Western Asset Management continued to manage the bulk of the investments although Goldman Sachs replaced Western Asset Management as manager of one of AEGL's sterling investment grade portfolios in the second quarter of 2008. Alliance Bernstein continued to manage a modest global equity portfolio throughout 2008 and the equity portfolio previously managed by Barclays Global Investors was liquidated at the start of May.

AEGL maintains four active investment grade fixed income portfolios, the core currencies of which are sterling, euros and US dollars; one high yield fixed income portfolio denominated in US dollars; and one equity portfolio investing in a broad range of global equities. Two passive portfolios are maintained: a sterling gilt portfolio, which acts as collateral for letter of credit issuance, and a small Swiss franc portfolio, established to meet local solvency requirements. The approximate currency split of the AEGL investment portfolios is sterling 49%, euros 29%, US dollars 21%, with other currencies totalling some 1%.

Market volatility in 2008 resulted in a wide divergence of returns between the investment managers operating to similar mandates. This was driven by a combination of their duration stance and the overall exposure to spread sectors and specific issuers. Above benchmark exposure to financial fixed income securities resulted in below benchmark performance for the investment grade portfolios managed by Western Asset Management. Barclays Global Investors generated above benchmark performance as a result of their duration strategy and lower exposure to the worst performing investments. High yield markets witnessed huge spread widening throughout the year as concerns grew over prospects for issuers. This resulted in significant negative returns during the year, although the bias of the guidelines and conservative management of the portfolio resulted in above benchmark returns.

AEGL commenced the year with equities comprising roughly 5% of the total portfolio but this allocation was reduced to around 1% with the liquidation of the equity portfolio managed by Barclays Global Investors at the start of May. Consequently, the record equity losses suffered in 2008 did not significantly impact AEGL.

In 2008, AEGL continued to lend securities through State Street Bank and Trust with no changes to the permitted lending limits of up to 40% of the aggregate investment portfolios to approved counterparties subject to limit restrictions. AEGL and fellow ACE Group companies also continued to utilise the notional pooling facility operating with Bank Mendes Gans, a subsidiary of ING, to facilitate individual short term currency overdrafts for individual participants and hence improve immediate liquidity.

Capital

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

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. During 2007, following AEGL's second Arrow assessment, the company was issued with revised Individual Capital Guidance by the FSA. In accordance with the FSA's current twenty four month ICA review cycle for AEGL, the 2007 Individual Capital Guidance continues to apply. In 2009, AEGL will submit an updated ICA to the FSA as part of the company's third Arrow assessment. The company currently maintains a comfortable margin against each of these key capital measures based on the admissible shareholders' funds of £629.4 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.

Business Review

31 December 2008

Ratings

AEGL holds financial strength ratings of “A+ (Superior)” by A.M. Best and “A+ (Strong)” by Standard & Poor’s. The ratings respectively have a stable and positive outlook.

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

In December 2008, Standard & Poor’s (“S&P”) revised its outlook on ACE Limited and related core operating subsidiaries, including AEGL, to positive from stable. At the same time, S&P affirmed the “A+” counterparty credit and financial strength ratings on ACE’s core operating insurance companies. S&P’s ratings report summary states that “the positive outlook is based on ACE’s very strong operating performance over the past five years, which compares favorably with many global (re)insurance peers, both in terms of average returns as well as quality of earnings, as measured by earnings volatility.” In addition, the ratings are based on “the group’s very strong competitive position and operating performance, as well as its strong capitalization and liquidity.”

Governance

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

The board of directors of AEGL (“the board”) is comprised of members of the executive management team and three 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 quarterly and delegates certain oversight responsibilities to two committees (Audit and Risk) under formal terms of reference, each of which operate a number of sub-committees. AEGL’s non-executive directors take an active role in these committees, with

the Audit Committee being solely comprised of non-executive directors.

In 2007, changes were initiated to the board and sub-committee structures to streamline and align their operation, composition and terms of reference. An additional sub-committee, the Control Environment Sub-Committee was introduced to oversee the effectiveness and efficiency of the control environment and to provide the Risk and Audit Committees with information to assess residual risk exposures. A number of further changes have been made to the board operation to improve efficiency and performance, including combining the AEGL and AUAL board meetings for joint issues, establishing a schedule that ensures board meetings follow on from Risk and Audit meetings, and refining the information presented in board and committee meetings.

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, TCF 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 controls, risk management and compliance with policies, procedures, internal controls and regulatory requirements.

A principal committee of the AEGL board, the Audit Committee, is responsible for oversight and review of external and internal audit processes. In the case of the external audit process, this involves working in conjunction with the ACE Group audit function 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

Business Review

31 December 2008

audit function, the role involves agreeing and monitoring, again 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.

The Risk Committee, another principal committee of the AEGL board, oversees the development, implementation and maintenance of embedded risk management across the business. The Risk Committee ensures that business risks and controls are recorded and monitored. The Risk Committee has established a number of sub-committees dedicated to managing specific areas of risk such as investment, counterparty and reserving risk.

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

The company is undertaking a significant amount of development of the risk management framework through the recent establishment of a dedicated central risk management team tasked with further embedding risk assessment within the business.

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

The principal risks from the company's insurance and reinsurance business arise from its underwriting activities, both prospective and retrospective. Key risks include unexpected losses arising from inaccurate pricing, fluctuations in the timing, frequency and

severity of claims compared to 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.

Compliance

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

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

The financial crisis is likely to lead to increased scrutiny of financial institutions by regulators, and a possible implementation of additional regulatory requirements within the insurance markets. AEGL employs a highly skilled and proficient workforce to manage its regulatory and compliance undertakings and aims to operate to a standard of best practice. The company

Business Review

31 December 2008

enjoys good relationships with regulators in each of AEGL's 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.

The ACE Group's global employee share scheme provides all eligible employees with an opportunity to participate in the Group's success as measured by the potential increase in stock price. The scheme continues to operate successfully and is open to all employees with a minimum of six months service with the company.

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

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

ACE and the environment

Climate change affects everyone throughout the world's communities, including AEGL's customers and employees. The risks it poses are serious issues for the insurance industry as it is its business to provide security from the worst of the effects, including hurricanes, windstorms, flooding and drought.

The ACE Group is committed to lessening the group's impact on the environment and is a member of the US Environmental Protection Agency's Climate Leaders program. In addition to the environmental activities at the corporate level, the ACE Group has launched ACE Green, an environmental program for its global employees. As part of this initiative, the UK has formed an ACE Green committee which is charged with viewing and assessing the environmental initiatives, actions and improvements that can be adopted across all ACE sites in the UK by staff, partners, suppliers and contractors. ACE has also launched the global site www.acegreen.com which highlights its green activity and identifies insurance products to help clients mitigate climate related risks. In October 2008, ACE announced that it will do its part to lessen its impact on the environment by reducing global greenhouse gas emissions by 8% per employee from 2006 to 2012.

The ClimateWise initiative was launched in September 2007 with the aim of encouraging insurance companies to respond effectively to the challenge of climate change. The 41 signatories, including ACE European Group, vary in their size, insurance activities and the stage they are at in addressing climate change, and include bodies such as Lloyd's and the Association of British Insurers. By signing up to ClimateWise, insurance companies agree to provide evidence of continued progress in combating climate change for independent audit. As part of this initiative, three of AEGL's UK offices were audited by the Carbon Trust. AEGL's performance put it in the top half of signatories and the company will strive to implement the resulting action plan to further improve the efficiency of its buildings. AEGL was also commended in the published ClimateWise report as a good example for its

Business Review

31 December 2008

'pioneering' property policy that provides cover for businesses wanting to rebuild to a greener standard after the loss of an existing building.

ACE in the community

The ACE Group supports the communities around the world in which its employees live and work through the established "ACE Foundations" and through group sponsored volunteer initiatives. These positive contributions to the fabric of local communities return long-lasting benefits to society, employees and the group.

In September 2007, the ACE Foundation donated £24,000 to support the Red Cross' vital work in tackling the threat of HIV within the Indian state of Uttar Pradesh. ACE's continued support for this project has subsequently helped raise awareness of HIV amongst young, vulnerable people in the region and has enabled the Red Cross to train 622 young peer educators, creating a lasting legacy of increased awareness and knowledge for future generations.

In addition, ACE European Group ("AEG") employees who are involved with charitable activities and fund raising for a local or national registered charity may apply to the ACE European Group Community Support Programme Committee ("ACS") for a financial donation to their chosen cause. The ACS programme supports registered charity community initiatives and donations totalling almost £40,000 were made during 2008 to a range of European charities including the children's foundations Hilfe für krebserkrankte Kinder and PATRIZIA KinderHaus-Stiftung in Germany, the AHOY Centre in the UK, Chickenshed theatre company, Marie Curie Cancer Care, Children's Hospice Association in Scotland, Thomley Activity Centre, Cancer Research, the Alzheimer's Society and Crossroads Caring for Carers.

Just some of the other practical initiatives in which members of AEG participate are listed below:

The Lloyd's Community Reading Partners scheme is a long running project in which employees in AEG's London office make a real difference to the lives of children in East London by devoting one lunch break every week to partner with children in a local school and help with their literacy and numeracy skills. Since

AEG's involvement began, the school's results have risen from below average to scores that are among the best in their borough.

The "Take Our Students to Work" programme is aimed at secondary school students attending inner city London schools. Some of these students were invited to take a peek into the daily workings of the insurance world when they spent a day at AEG's UK headquarters and were given the opportunity to shadow an insurance underwriter.

AEG also participates in the annual Tower Hamlets schools public speaking competition, organised by the Lloyd's Community Programme and Tower Hamlets EBP. The semi finals of this competition are held at the ACE London offices in April, and the finals at Lloyd's in May. AEG's representative joins the semi finalists in meeting local members of parliament in the House of Commons.

During 2008, AEG staff became involved with "Heart in the City", an organisation set up to help businesses in the City and its fringes to develop voluntary and socially responsible programmes with young people in the area and make a positive impact on the local community and the environment.

Approved by the Board of Directors

12 March 2009

Directors' Report

31 December 2008

The directors are pleased to submit their report and the audited financial statements for the year to 31 December 2008.

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.

Principle risks and uncertainties

A review of the company's principle 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 2008 of £2.8 million (2007: £74.0 million).

The directors do not propose a dividend (2007: £80.0 million).

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 2008 to the date of this report unless otherwise indicated:

Executive directors:

P M Curtis
D M A Furby
A J Kendrick
E M Levin (resigned 11 March 2008)
R P Murray
R V Pryce

Non-executive directors:

R V Emerson
D S Marston
G D Williams

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

Directors' Report

31 December 2008

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 2008 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, 12 March 2009

ACE Building
100 Leadenhall Street
London
EC3A 3BP

Statement of Directors' Responsibilities

31 December 2008

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

The directors confirm that suitable accounting policies have been used and applied consistently, with the exception of changes arising on the adoption of new accounting standards in the year, and reasonable and prudent judgements and estimates have been made in the preparation of the financial statements for the year ended 31 December 2008. The directors also confirm that applicable accounting standards have been followed and that the financial statements have been prepared on a going concern basis.

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

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

Independent Auditors' Report

to the members of ACE European Group Limited

We have audited the financial statements of ACE European Group Limited for the year ended 31 December 2008 which comprise the Profit and Loss account, the Balance Sheet, the Statement of Total Recognised Gains and Losses and the related notes. These financial statements have been prepared under the accounting policies set out therein.

Respective responsibilities of directors and auditors

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

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

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

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

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

Basis of audit opinion

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

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

Equalisation provisions

Our evaluation of the presentation of information in the financial statements has had regard to the statutory requirement for insurance companies to maintain equalisation provisions. The nature of equalisation provisions, the amounts set aside at 31 December 2008, and the effect of the movement in those provisions during the year on shareholders' funds, the balance on the general business technical account and profit before tax, are disclosed in notes 1 and 20 respectively.

Independent Auditors' Report

to the members of ACE European Group Limited

Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the company's affairs as at 31 December 2008 and of its loss for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the financial statements.

PricewaterhouseCoopers LLP

Chartered Accountants and Registered Auditors

London

12 March 2009

Profit and Loss Account

for the year ended 31 December 2008

	Note	2008 £'000	2007 £'000
Technical account – general business			
Earned premiums, net of reinsurance:			
Gross premiums written – continuing operations	3	1,964,080	1,874,515
– discontinued operations	3	(1,334)	331
Gross premiums written	3	1,962,746	1,874,846
Outward reinsurance premiums		(1,175,180)	(1,122,696)
Net premiums written		787,566	752,150
Change in the gross provision for unearned premiums		(3,238)	27,309
Change in the provision for unearned premiums – reinsurers' share		2,469	(16,257)
Earned premiums, net of reinsurance		786,797	763,202
Claims incurred, net of reinsurance:			
Claims paid:			
Gross amount	3	(931,260)	(835,530)
Reinsurers' share		517,297	470,109
Net paid claims		(413,963)	(365,421)
Change in the provision for claims outstanding:			
Gross amount	3	(163,200)	(238,842)
Reinsurers' share		52,722	128,654
Change in the net provision for claims outstanding		(110,478)	(110,188)
Claims incurred, net of reinsurance		(524,441)	(475,609)
Net operating expenses	5	(273,896)	(252,871)
Change in the equalisation provision	20	16,896	(13,630)
Balance on the technical account for general business		5,356	21,092

Profit and Loss Account

for the year ended 31 December 2008

		2008	2007
	Note	£'000	£'000
Non-technical account			
Balance on the general business technical account		5,356	21,092
Profit on sale of an operation	9	9,243	–
Investment income	10	187,250	128,562
Unrealised gains on investments	10	70,398	31,016
Investment expenses and charges	10	(105,457)	(45,250)
Unrealised losses on investments	10	(240,284)	(51,981)
Foreign exchange differences		75,062	(10,331)
Other income		1,187	889
Profit on ordinary activities before taxation		2,755	73,997
<i>Continuing operations</i>		14,730	74,244
<i>Discontinued operations</i>		(11,975)	(247)
Taxation on profit on ordinary activities	11	(9,004)	(20,526)
(Loss) profit for the financial year		(6,249)	53,471

Statement of Total Recognised Gains and Losses

for the year ended 31 December 2008

		2008	2007
		£'000	£'000
(Loss) profit for the financial year		(6,249)	53,471
Currency translation differences	18	89,078	22,255
Actuarial gain recognised in relation to pension schemes	18	3,142	799
Movement on deferred taxation relating to pension liability	18	(880)	(240)
Total recognised gains relating to the year		85,091	76,285

Balance Sheet

at 31 December 2008

		2008	2007
	Note	£'000	£'000
Assets			
Investments			
Other financial investments	13	2,331,441	2,065,774
Financial derivative instruments	13	6,272	5,345
Deposits with ceding undertakings		37	29
		<u>2,337,750</u>	<u>2,071,148</u>
Reinsurers' share of technical provisions			
Provision for unearned premiums		321,186	289,927
Provision for claims outstanding		2,220,306	1,867,845
		<u>2,541,492</u>	<u>2,157,772</u>
Debtors – amounts falling due within one year			
Debtors arising out of direct insurance operations:			
amounts owed by policyholders		7,126	3,914
amounts owed by intermediaries		400,218	351,566
Debtors arising out of reinsurance operations		267,964	182,051
Other debtors	14	140,083	88,817
		<u>815,391</u>	<u>626,348</u>
Other assets			
Tangible assets	16	8,467	8,093
Cash at bank and in hand	2	–	35,846
		<u>8,467</u>	<u>43,939</u>
Prepayments and accrued income			
Accrued interest and rent		46,457	37,405
Deferred acquisition costs		109,981	97,675
Other prepayments and accrued income		73,382	52,832
		<u>229,820</u>	<u>187,912</u>
Total assets excluding pension surplus		<u>5,932,920</u>	<u>5,087,119</u>
Pension surplus	1	2,432	–
Total assets		<u><u>5,935,352</u></u>	<u><u>5,087,119</u></u>

Balance Sheet

at 31 December 2008

		2008	2007
	Note	£'000	£'000
Liabilities			
Capital and reserves			
Called-up share capital	17	544,741	544,741
Profit and loss account	18	150,802	145,711
Merger reserve	18	25,653	25,653
Total shareholders' funds	19	721,196	716,105
Technical provisions			
Provision for unearned premiums		712,019	645,106
Provision for claims outstanding		3,774,395	3,110,984
Equalisation provision	20	59,867	76,763
		4,546,281	3,832,853
Deposits received from reinsurers		3,883	2,989
Creditors – amounts falling due within one year			
Creditors arising out of direct insurance operations		24,651	15,273
Creditors arising out of reinsurance operations		277,990	240,882
Bank overdraft	2	25,987	–
Other creditors including taxation and social security	21	223,546	175,022
		552,174	431,177
Other financial liabilities	13	7,178	2,720
Accruals and deferred income			
Deferred acquisition costs relating to reinsurance		55,764	52,492
Other accruals and deferred income		48,876	47,598
		104,640	100,090
Total liabilities excluding pension liability		5,935,352	5,085,934
Pension liability	1	–	1,185
Total liabilities		5,935,352	5,087,119

The financial statements on pages 20 to 45 were approved by the board of directors on 12 March 2009 and were signed on its behalf by:

P M Curtis

Chief Financial Officer

Notes to the Financial Statements

31 December 2008

1. Accounting policies

Basis of preparation

The financial statements have been prepared in accordance with the provisions of Section 255 of, and Schedule 9A to, the Companies Act 1985, the Statement of Recommended Practice on Accounting for Insurance Business issued by the Association of British Insurers ("the ABI SORP") dated December 2005 (as amended in December 2006) and applicable accounting standards in the United Kingdom. The company is a wholly owned subsidiary within the ACE Limited group and is included within the consolidated financial statements of ACE Limited, which are publicly available. Consequently, the company has taken advantage of the exemption from preparing a cash flow statement under the terms of FRS1 (revised) "Cash Flow Statements".

The securities lending collateral received in the prior year has been reclassified from cash at bank and in hand to other financial investments to enable consistent presentation with the current year classification.

Continuing and discontinued operations

Discontinued operations include business underwritten by ACE European Group Limited ("AEG") 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 18), 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 2008

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 2008

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 9A to the Companies Act 1985 to be included within technical provisions.

Financial Assets and Liabilities

The company recognises a financial asset or a financial liability on its balance sheet when it becomes a party to the contractual provisions of the instrument. On initial recognition the company 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 2008

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 2008

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 taxation in future, or a right to pay less taxation in future. An asset is not recognised to the extent that the transfer of economic benefits in future is uncertain. Deferred tax assets and liabilities recognised 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 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 level of liquidity. Once these capital needs have been met, it is the policy of the company to distribute any surplus capital through dividends to its ultimate parent company, ACE Limited.

Notes to the Financial Statements

31 December 2008

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 and more recently in 2007 through their second Arrow review. The FSA will review the ICG again in 2009 in accordance with the FSA's current 24 month ICA review cycle for AEGL.

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: Barclays Global Investors, Western Asset Management, Goldman Sachs Asset Management and Alliance Bernstein.

Notes to the Financial Statements

31 December 2008

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 2008 the company only maintained allocations to high yield and equities. The policy stipulates a target range of between 75% and 95% for investment grade fixed income securities and a range of between 5% and 25% for alternative asset classes. The current allocation to alternative assets continues to sit at the lower of the target range for alternative asset classes, however, the position is regularly reviewed by the Investment Committee.

Investment guidelines

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

Interest rate risk

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

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

Sensitivity analysis for interest rate risk illustrates how changes in the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates at the reporting date. To illustrate the downside risk within the fixed interest portfolio of £2,029 million at external managers as at 31 December 2008 (2007: £1,721 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 £74.4 million and accordingly decrease total shareholders' funds by some £52.1 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.

All equity holdings of £18 million (2007: £106 million) are listed and represent 1% (2007: 6%) of the total investment portfolio. If the value of all equity markets in which the company invests decreased by 10%, with all other variables held constant, the total investment return would decrease by £1.8 million.

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 matched by sterling and more modest surpluses held in euros and US dollars.

Notes to the Financial Statements

31 December 2008

2. Capital management & financial risk management – continued

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

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

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

For the profit and loss account, the 2008 average euro/sterling and US dollar/sterling rates of €1.28/£1 and US\$1.88/£1 respectively are down on the prior period (2007: €1.47/£1 and US\$2.00/£1). Had sterling weakened by a further 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 £10 million higher than the amount reported.

For the monetary components of the balance sheet, the year end rates used to convert euro to sterling and US dollar to sterling have fallen by 23% to €1.06/£1 and 25% to US\$1.48/£1 respectively (2007: €1.38/£1 and US\$1.98/£1). Assuming sterling had weakened by a further 10% against all currencies (primarily the euro and US dollar) and all other variables remained constant, the effect of translating year end foreign branch net assets based on these parameters would have resulted in increased shareholders' funds of £52 million, which would have appeared as a gain 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 £26.0 million at year end.

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

As indicated in the balance sheet, the company's financial liabilities are all payable within one year or on demand, as are the liabilities associated with financial derivative instruments and deposits received from reinsurers.

Credit risk

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

Notes to the Financial Statements

31 December 2008

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 £2,124.5 million (2007: £1,818.6 million) represented 99% (2007: 94%) 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, despite an increase in the upper tier high yield portfolio funded through equity disposals in the second quarter of 2008. All equity holdings of £18.2 million (2007: £106.4 million) are listed and represent 1% (2007: 6%) of the total investment portfolio.

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

The investment guidelines seek to limit the credit risk of each of the portfolios through specifying 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 2008

2. Capital management & financial risk management – continued

The assets bearing credit risk are summarised below:

	2008	2007
	£'000	£'000
Other financial investments	2,331,441	2,065,774
Derivative financial securities	6,272	5,345
Reinsurers' share of technical provisions	2,541,492	2,157,772
Debtors arising out of direct insurance operations	407,344	355,480
Debtors arising from reinsurance operations	267,964	182,051
(Bank overdraft) cash at bank	(25,987)	35,846
Total assets bearing credit risk	5,528,526	4,802,268

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

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

	2008	2007
	£'000	£'000
AAA	1,438,921	1,078,720
AA	184,811	185,231
A	413,497	471,917
BBB	180,888	222,417
Below BBB or not rated	119,596	112,834
Total assets bearing credit risk	2,337,713	2,071,119

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

Reinsurers' share of technical provisions includes claims outstanding, related claims handling costs, IBNR and unearned premium reserve. This is described along with the valuation methods in note 1. This balance includes 0.04% (2007: 0.5%) past due that have been impaired.

Debtors arising out of direct and reinsurance operations are held at fair value less any provision for impairment as described in note 1. They include 0.7% (2007: 1.1%) that have been impaired and 32.5% (2007: 23.0%) that are past due, but not impaired. The latter is aged 28.7% zero to six months (2007: 18.7%), 1.8% six months to a year (2007: 1.4%) and the remaining 2.0% older than a year (2007: 3.5%).

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 2008

2. Capital management & financial risk management – continued

	2008	2007
	£'000	£'000
AAA	61,117	43,069
AA	329,607	240,908
A	2,166,841	1,865,243
BBB	3,463	4,469
Below BBB or not rated	248,428	186,134
Total assets bearing credit risk	2,809,456	2,339,823

Where appropriate the company seeks to obtain collateral from counterparties to mitigate the credit risk exposure from insurance and reinsurance receivables. At 31 December 2008 the collateral provided to the company totalled £356.3 million (2007: £378.0 million).

3. Segmental analysis

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

	Gross premiums written	Gross premiums earned	Gross claims incurred	Gross operating expenses	Reinsurance balance
	£'000	£'000	£'000	£'000	£'000
Year to 31 December 2008					
Continuing operations:					
Direct insurance					
Accident and health	354,328	355,561	(114,688)	(162,317)	(70,310)
Marine, aviation and transport	118,826	115,262	(79,752)	(27,254)	(9,713)
Fire and other damage to property	530,337	527,156	(284,047)	(114,233)	(310,863)
Third party liability	477,802	463,717	(328,678)	(89,500)	(38,413)
Miscellaneous	113,640	122,965	(8,017)	(23,326)	(69,225)
Reinsurance acceptances	369,147	376,181	(231,054)	(78,044)	68,762
	<u>1,964,080</u>	<u>1,960,842</u>	<u>(1,046,236)</u>	<u>(494,674)</u>	<u>(429,762)</u>
Discontinued operations	(1,334)	(1,334)	(48,224)	(12)	47,860
	<u>1,962,746</u>	<u>1,959,508</u>	<u>(1,094,460)</u>	<u>(494,686)</u>	<u>(381,902)</u>
Year to 31 December 2007					
Continuing operations:					
Direct insurance					
Accident and health	324,895	325,575	(123,087)	(125,200)	(60,570)
Marine, aviation and transport	106,740	108,776	(73,599)	(26,276)	(17,353)
Fire and other damage to property	504,744	511,053	(374,851)	(128,188)	(118,318)
Third party liability	490,112	506,565	(421,820)	(95,574)	(23,638)
Miscellaneous	111,585	110,137	11,795	(29,996)	(66,734)
Reinsurance acceptances	336,439	339,718	(90,967)	(56,661)	(45,329)
	<u>1,874,515</u>	<u>1,901,824</u>	<u>(1,072,529)</u>	<u>(461,895)</u>	<u>(331,942)</u>
Discontinued operations	331	331	(1,843)	(15)	790
	<u>1,874,846</u>	<u>1,902,155</u>	<u>(1,074,372)</u>	<u>(461,910)</u>	<u>(331,152)</u>

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

Notes to the Financial Statements

31 December 2008

3. Segmental analysis – continued

Analysis by geographic area – origin

	Gross written premiums		Profit before taxation		Net assets	
	2008	2007	2008	2007	2008	2007
	£'000	£'000	£'000	£'000	£'000	£'000
United Kingdom	955,601	992,529	118,409	38,791	436,765	388,327
Other EEA states	970,597	839,131	(116,786)	30,785	256,881	308,149
Other countries	36,548	43,186	1,132	4,421	27,550	19,629
	<u>1,962,746</u>	<u>1,874,846</u>	<u>2,755</u>	<u>73,997</u>	<u>721,196</u>	<u>716,105</u>

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

	2008	2007
	£'000	£'000
United Kingdom	527,010	565,021
United States of America	69,769	70,384
Continental Europe	1,100,348	970,268
Africa & Middle East	45,627	53,416
Asia/Pacific	52,850	51,121
Americas	46,354	37,551
Worldwide	122,122	126,754
Discontinued business	(1,334)	331
	<u>1,962,746</u>	<u>1,874,846</u>

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

The prior year's net provision for claims outstanding generated a surplus for 2008 (2007: surplus) as detailed below:

	2008	2007
	£'000	£'000
Continuing operations:		
Accident and health	9,504	2,200
Marine, aviation and transport	7,251	6,509
Fire and other damage to property	4,534	6,774
Third party liability	35,583	(1,404)
Miscellaneous	12,495	6,818
	<u>69,367</u>	<u>20,897</u>
Discontinued operations	(130)	(393)
	<u>69,237</u>	<u>20,504</u>

Notes to the Financial Statements

31 December 2008

5. Net operating expenses – technical account

	2008	2007
	£'000	£'000
Acquisition costs	324,903	295,557
Change in net deferred acquisition costs	516	18,374
Administrative expenses	162,674	152,155
Reinsurance commissions	(214,197)	(213,215)
	<u>273,896</u>	<u>252,871</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 £245.6 million (2007: £232.5 million), and are included within acquisition costs.

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:

	2008	2007
	£'000	£'000
Audit fees		
Fees payable to the company's auditor for the audit of the annual accounts	346	332
Non audit fees		
Other services pursuant to legislation	495	483
Other services relating to taxation	406	168
	<u>1,247</u>	<u>983</u>

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

Notes to the Financial Statements

31 December 2008

7. Operating lease rentals

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

	2008	2007
	£'000	£'000
Leasehold property	3,417	3,580

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

	2008	2007
	£'000	£'000
Within 1 year	498	445
Between two and five years	3,012	2,338
More than five years	288	244
	3,798	3,027

8. Directors and employees

	2008	2007
	£'000	£'000
Cost of staff employed by the company		
Wages and salaries	39,386	30,749
Social security costs	10,761	8,457
Other pension costs	3,786	3,267
Other staff costs	4,180	4,039
	58,113	46,512

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

	2008	2007
	No.	No.
Underwriting	597	573
Claims	144	135
Other	129	100
	870	808

The disclosures above relate to staff based in the company's branches outside the UK who are directly employed by the company. As a significant element of staff costs are euro-denominated the strengthening of the euro during 2008 accounts for the majority of the apparent year on year movement. 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.

Notes to the Financial Statements

31 December 2008

8. Directors and employees – continued

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.

	2008	2007
	£'000	£'000
Aggregate emoluments and benefits	2,911	2,968
Company pension contributions to money purchase pension schemes	92	84
	<u>3,003</u>	<u>3,052</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 £718,926 (2007: £660,830) 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 £28,053 (2007: £28,053) and £44,718 (2007: £23,253) 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, two directors exercised options over the shares of ACE Limited. The highest paid director exercised share options during the year.

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

9. Profit on the sale of an operation

On 1 November 2008 the company sold the business of its Swiss branch to a fellow group company, ACE Insurance (Switzerland) Limited. The disposal included certain assets and liabilities of the Swiss branch along with the renewal rights for future business. The consideration received by the company was £16.8 million (CHF32.7 million) and the fair value of the assets and liabilities disposed of was £7.6 million (CHF13.9 million) resulting in a profit on disposal of £9.2 million (CHF18.8 million).

At the date of the sale, the company issued a guarantee to ACE Insurance (Switzerland) Limited and received a reciprocal guarantee from ACE Limited, the company's ultimate parent.

The loss after tax relating to the Swiss branch business included in the profit and loss account of the company up to the date of disposal was £5.8 million (CHF12.2 million).

Notes to the Financial Statements

31 December 2008

10. Investment return

	2008	2007
	£'000	£'000
Investment income		
Income from investments	109,283	93,854
Gains on the realisation of investments	77,967	34,708
	<u>187,250</u>	<u>128,562</u>
Investment expenses and charges		
Investment management expenses	(8,206)	(6,433)
Losses on the realisation of investments	(97,251)	(38,817)
	<u>(105,457)</u>	<u>(45,250)</u>
Net unrealised gains less losses on investments		
Unrealised gains on investments	70,398	31,016
Unrealised losses on investments	(240,284)	(51,981)
	<u>(169,886)</u>	<u>(20,965)</u>
Total investment return	<u>(88,093)</u>	<u>62,347</u>

Notes to the Financial Statements

31 December 2008

11. Taxation on profit on ordinary activities

Analysis of charge in period

	2008	2007
	£'000	£'000
UK corporation taxation at 28.5% (2007: 30%)		
Current taxation on income for the period	(891)	36,948
Adjustments in respect of previous periods	4,119	(2,222)
Taxation on exceptional item*	2,634	-
	<u>5,862</u>	<u>34,726</u>
Double taxation relief	(1,743)	(12,785)
	<u>4,119</u>	<u>21,941</u>
Foreign taxation		
Current taxation on income for the period	3,383	14,595
Adjustments in respect of previous periods	1,225	(771)
	<u>4,608</u>	<u>13,824</u>
Current taxation on income for the period	8,727	35,765
Deferred taxation (note 15):		
Origination and reversal of timing differences	(515)	(14,606)
Adjustments in respect of previous periods	792	(633)
	<u>277</u>	<u>(15,239)</u>
Taxation on profit on ordinary activities	<u>9,004</u>	<u>20,526</u>

Factors affecting taxation charge for period

The taxation assessed for the period is higher (2007: higher) than the standard rate of corporation taxation in the UK (28.5%). The differences are explained below:

	2008	2007
	£'000	£'000
Profit on ordinary activities before taxation	<u>2,755</u>	<u>73,997</u>
Profit on ordinary activities multiplied by standard rate of corporation taxation in the UK of 28.5% (2007: 30%)	785	22,199
Effects of:		
Restatement of prior year profits	-	14,613
Expenses not deductible for taxation purposes	1,483	243
Non-taxable losses	-	(89)
Higher taxation rates on overseas earnings	1,640	1,810
Adjustments in respect of previous periods	5,344	(2,993)
Other, including timing differences	(525)	(18)
Current taxation charge for period	<u>8,727</u>	<u>35,765</u>

* 'Taxation on exceptional item' represents taxation on the profit on disposal of the company's Swiss branch business (note 9).

Notes to the Financial Statements

31 December 2008

12. Dividends

During 2008 the company paid a dividend of 14.7p per share totalling £80.0 million (2007: 14.7p per share totalling £80.0 million).

13. Other financial investments

	Market Value 2008	Cost 2008	Market Value 2007	Cost 2007
	£'000	£'000	£'000	£'000
Shares and other variable yield securities and units in unit trusts	18,163	35,040	106,447	106,532
Debt securities and other fixed interest securities	2,029,615	2,221,907	1,720,975	1,758,311
Deposits with credit institutions*	283,663	283,663	238,352	238,352
	<u>2,331,441</u>	<u>2,540,610</u>	<u>2,065,774</u>	<u>2,103,195</u>

*Deposits with credit institutions includes £188.8 million (2007: £140.8 million) of collateral in respect of stock lending arrangements (note 22).

All investments held are listed.

Derivative financial instruments

	Assets 2008	Liabilities 2008	Assets 2007	Liabilities 2007
	£'000	£'000	£'000	£'000
Forward foreign currency contracts	5,020	5,846	2,656	1,505
Fixed income options and futures	1,252	1,332	2,689	1,215
	<u>6,272</u>	<u>7,178</u>	<u>5,345</u>	<u>2,720</u>

The cost of entering into derivative financial instruments was £193,360 (2007: £148,450).

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:

	2008	2007
	£'000	£'000
Forward foreign exchange contracts	<u>6,660</u>	<u>35</u>

At 31 December 2008, the fair value of the company's currency derivatives is a loss of £0.8 million (2007: gain of £1.2 million). These amounts are based on rates of exchange at the balance sheet date, comprising £5.0 million of assets (2007: £2.7 million) and £5.8 million of liabilities (2007: £1.5 million).

Amounts of £1.1 million (2007: £3.6 million) have been recognised in the profit and loss account in respect of contracts matured during the period.

Notes to the Financial Statements

31 December 2008

13. 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 2008, the fair value of the company's fixed income derivatives is a liability of £0.1 million (2007: assets of £1.5 million) comprising £1.3 million of assets (2007: £2.7 million) and £1.4 million of liabilities (2007: £1.2 million).

A gain of £1.4 million (2007: loss of £1.4 million) has been recognised in the profit and loss account in respect of contracts which matured in the period.

14. Other debtors

	2008	2007
	£'000	£'000
Amounts falling due within one year:		
Amounts due from group undertakings	43,796	70,335
Corporation tax receivable	–	1,866
Deferred taxation (note 15)	466	821
Receivable for sales of securities	47	3,800
Other debtors	95,774	11,995
	<u>140,083</u>	<u>88,817</u>

15. Deferred taxation

	2008	2007
	£'000	£'000
At 1 January	821	(14,624)
Foreign exchange differences	248	446
Movement relating to pension liability	(880)	(240)
Adjustment in respect of previous periods	792	633
Utilisation in year (note 11)	(515)	14,606
At 31 December	<u>466</u>	<u>821</u>
Analysis of asset at 31 December		
Other timing differences	466	821
Undiscounted deferred taxation asset as above	<u>466</u>	<u>821</u>

Notes to the Financial Statements

31 December 2008

16. Tangible assets

	Land and Buildings	Motor Vehicles	Leasehold improvements, fixtures and fittings	Computer, office equipment and software	Total
	£'000	£'000	£'000	£'000	£'000
Cost					
At 1 January 2008	1,250	1,126	10,914	8,111	21,401
Additions	–	1,262	773	531	2,566
Disposals	–	(356)	(528)	(1,246)	(2,130)
Foreign exchange differences	373	362	2,939	2,422	6,096
At 31 December 2008	1,623	2,394	14,098	9,818	27,933
Accumulated depreciation					
At 1 January 2008	603	979	6,074	5,652	13,308
Charge for the period	31	355	1,375	585	2,346
Disposals	–	(40)	(316)	(61)	(417)
Foreign exchange differences	185	351	2,063	1,630	4,229
At 31 December 2008	819	1,645	9,196	7,806	19,466
Net book value					
31 December 2008	804	749	4,902	2,012	8,467
31 December 2007	647	147	4,840	2,459	8,093

17. Called-up share capital

	2008	2007
	£'000	£'000
Allotted, issued and fully paid:		
376,567,035 'A' Ordinary £1 shares	376,567	376,567
168,174,109 'B' Ordinary £1 shares	168,174	168,174
	544,741	544,741
Authorised:		
500,000,000 'A' Ordinary £1 shares (2007: 500,000,000 Ordinary £1 shares)	500,000	500,000
250,000,000 'B' Ordinary £1 shares (2007: 250,000,000 Ordinary £1 shares)	250,000	250,000
	750,000	750,000

Notes to the Financial Statements

31 December 2008

18. Reserves

	Share capital	Profit and loss account	Merger reserve	Total
	£'000	£'000	£'000	£'000
At 1 January	544,741	145,711	25,653	716,105
Loss for the year	–	(6,249)	–	(6,249)
Currency translation differences	–	89,078	–	89,078
Actuarial gain recognised in relation to pension schemes	–	3,142	–	3,142
Movement of deferred taxation relating to pension liability	–	(880)	–	(880)
Dividend paid (note 12)	–	(80,000)	–	(80,000)
At 31 December	544,741	150,802	25,653	721,196

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.

19. Reconciliation of movements in shareholders' funds

	2008	2007
	£'000	£'000
(Loss) profit for the financial year	(6,249)	53,471
Currency translation differences	89,078	22,255
Actuarial gain recognised in relation to pension schemes	3,142	799
Movement on deferred taxation relating to pension liability	(880)	(240)
Dividend paid (note 12)	(80,000)	(80,000)
Net increase (decrease) in shareholders' funds	5,091	(3,715)
Opening shareholders' funds	716,105	719,820
At 31 December	721,196	716,105

20. 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 £59.9 million (2007: £76.8 million). The decrease during the year had the effect of increasing the balance on the technical account for general business and increasing the profit on ordinary activities before taxation by £16.9 million (2007: decrease of £13.6 million).

Notes to the Financial Statements

31 December 2008

21. Other creditors including taxation and social security

	2008	2007
	£'000	£'000
Corporation taxation payable	5,160	–
Payable for purchases of securities	46	10,649
Other creditors	29,540	23,620
Liability for stock lending collateral (note 22)	188,800	140,753
	<u>223,546</u>	<u>175,022</u>

22. Stock lending

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

	2008	2007
	£'000	£'000
Aggregate value of securities on loan at 31 December	<u>291,261</u>	<u>313,153</u>
Income from stock lending during the year	<u>1,310</u>	<u>620</u>

In respect of securities on loan at the year end, the company held £280.1 million (2007: £314.7 million) as collateral, the value of which fell below the value of the loan securities by 3.8% (2007: exceeded by 0.5%), 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 £280.1 million (2007: £314.7 million) of collateral held is £188.8 million (2007: £140.8 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'.

23. Letter of credit facilities

Under a facility with Citibank NA, the value of letters of credit outstanding was £22.7 million (2007: £16.5 million) with associated collateral of £87.6 million (2007: £35.3 million). Under a facility with Lloyds TSB Bank plc, there is a further letter of credit outstanding for £0.8 million (2007: £0.9 million), equally matched by collateral. Collateral is included within other financial investments and cash at bank and in hand on the face of the balance sheet.

24. Capital commitments

No capital expenditure was authorised at 31 December 2008 which has not been provided for in these financial statements.

25. Transactions with related parties

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

26. Ultimate parent company

The ultimate holding company is ACE Limited, a company which was registered in the Cayman Islands until 18 July 2008 when it redomesticated its place of incorporation to Zurich, Switzerland. ACE Limited's headquarters are 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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ace european group

AUSTRIA

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

BELGIUM

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

CZECH REPUBLIC

International Business Centre
Pobřežní 620/3
18600 Prague 8,
Czech Republic.
T: (420) 222 351 251
F: (420) 222 351 291

DENMARK

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

FINLAND

Mikonkatu 15B
FIN-00100 Helsinki
Finland
T: (358-0) 6969 2626
F: (358-0) 6969 2627

FRANCE

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

GERMANY

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

GIBRALTAR

Suite 837
Europort
Gibraltar
T: (350) 200 751 22
F: (350) 200 751 29

HUNGARY

Hegyalja út 7-13
Budapest 1016
Hungary
T: (36) 1 475 1230
F: (36) 1 475 1530

IRELAND

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

ITALY

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

NETHERLANDS

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

NORWAY

Fritjof Nansens plass 3
0121 Oslo
Norway
T: (47) 2331-5440
F: (47) 2331-5441

POLAND

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

PORTUGAL

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

SPAIN

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

SWEDEN

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

SWITZERLAND

Bärrengasse 32
Zurich CH-8001
Switzerland
T: (41-43) 456 7600
F: (41-43) 456 7601

TURKEY

Büyükdere Caddesi
No. 100-102 Maya Akar Center
B Blok 5
Kat Daire 23
34394 ESCNTEPE
Istanbul

ACE Building
100 Leadenhall Street
London
EC3A 3BP

Tel 020 7173 7000
Fax 020 7173 7800

www.aceeuropeangroup.com