Hiscox Ltd
Report and Accounts 2006

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ibc Glossary

The Hiscox ambition is to build a highly respected international specialist insurer, with a reputation for integrity and quality.

The photographs in this year's report and accounts were taken by Virginie Litzler. Virginie was the winner of a Hiscox commission at the Royal College of Art this year. Her photographs show her friends contorted into awkward looking positions – but they are in fact balanced. I think the twisted human forms with the stark architectural shapes make very fine works. It is a bonus that our basic strategy at Hiscox is to achieve balance in our business so there is a reason for the photographs over and above being good art.

Robert Hiscox

Highlights

Financial

Record profit before tax of £201.1 million.

Gross written premium income increased by 30.8 per cent to £1,126.2 million.

Dividend increased 43 per cent to 10.0 pence per share (2005: 7.0 pence per share).

Exceptional profit before tax of £116.6 million from Global Markets and £51.9 million from International business.

Outlook

Global Markets to capitalise on strong underwriting opportunities, particularly in US property catastrophe risks.

Hiscox Bermuda well positioned to take further advantage of favourable rates.

Continued expansion of Hiscox USA operation.

Sustained marketing activity for Hiscox UK in 2007.

Dividend of 12 pence per share targeted for 2007.

Operational

Established new Bermudian domiciled holding company for the Group.

Demand for UK household and commercial insurance increased following Hiscox's first TV advertising campaign.

Established first sidecar in the Lloyd's Market.

Opened nine new offices around the world.

Led process improvement for underwriting and claims in Lloyd's.

Group key performance indicators

	2006	2005
Gross written premium (£m)	**1,126.2**	861.2
Profit before tax (£m)	**201.1**	70.2
Combined ratio (%)	**88.3**	96.0
Earnings per share (p)	**41.7**	15.6
Dividend per share (p)	**10.0**	7.0
Shareholders' equity (£m)	**682.1**	578.0
Net unearned premiums (£m)	**428.1**	361.9
Net asset value per share (p)	**173.2**	147.7
Return on equity (%)	**28.9**	12.8

Chairman's statement

This is my first report as Chairman of Hiscox Ltd, the new Bermudian holding company of the Hiscox Group. It is pleasing to report a record profit for the Group, helped by a benign hurricane season (despite all the forecasts to the contrary) which contributed to an excellent result by our Global Markets division and our new insurance company in Bermuda. The timing was right to make a substantial investment in the future growth and prosperity of our regional businesses, which have shown a solid performance in 2006 after considerable marketing spend and start-up costs.

Results

The results for the year ending 31 December 2006 were a record profit before tax of £201.1 million (2005: £70.2 million). Gross written premium increased 30.8 per cent to £1,126.2 million (2005: £861.2 million) and net earned premium increased 28.2 per cent to £888.8 million (2005: £693.3 million). The combined ratio was 88.3 per cent (2005: 96.0 per cent). Earnings per share on profit after tax increased by 167 per cent to 41.7 pence (2005: 15.6 pence) and net assets per share increased by 17.3 per cent to 173.2 pence (2005: 147.7 pence). Return on equity increased to 28.9 per cent (2005: 12.8 per cent).

Dividend

In 2005, the Board proposed dividends totalling 9 pence for the year. The exceptional profit has led the Board to propose, subject to shareholders' approval, a final dividend of 7 pence (2005: 4.75 pence) making a total distribution for the year of 10 pence (2005: 7 pence), an increase of 43 per cent. This will be paid on 5 June 2007 to shareholders on the register on 4 May 2007. The Board also agreed that we would target a total dividend of not less than 12 pence for 2007, subject to adequate profitability and shareholders' approval.

We will maintain a policy of steady dividend growth if possible. I quite understand the desire of shareholders to get a tangible return from the business, especially as they have regularly provided money to us when required. But this is a capital hungry business. We have to have around 50 per cent of our turnover in readily realisable assets. When this is combined with our strategy of a wide spread of geographical distribution initiatives and the need to have a US admitted insurer, we currently have an obvious good use of capital as we expand. If in the future we contract and have surplus capital, we will of course consider buying back shares or other similar capital reduction initiatives.

The ambition

We want Hiscox to be a highly respected international specialist insurance and reinsurance company. The respect of our investors will be earned by the return on their investment; the respect of our customers will be earned by our intelligent covering of their risks backed by immaculate and cost-effective service; the respect of our peers will be earned by the overall quality of all parts of the business. All that will be achieved by employing the best people, admired for their energy, discipline, integrity and instinct. It will be achieved consistently by balancing the risks we take between volatile international catastrophe business with more steady local and regional business, and by focusing on specific areas in which we are expert.

Progress so far

As always I will highlight a few salient points leaving the detail to the Chief Executive's report which follows.

The major corporate event of 2006 was the successful re-domicile to Bermuda. Bermuda is a thriving commercial and intellectual insurance centre and it feels a natural progression for Hiscox, with over 70 per cent of its business emanating from outside the UK, to be headquartered there. During the year we also launched the first sidecar in Lloyd's for our Syndicate 33 giving it the ability to write $180 million more reinsurance premium. We also led the reform of the Lloyd's Market to electronic trading through the so-called G6 initiative.

Commercially, a key event was the non-event of catastrophic hurricanes which boosted our Global Markets and Hiscox Bermuda results. Our new ventures in Bermuda, writing catastrophe reinsurance, and in the USA writing regional business had very successful first years. In the UK regional arena we continued our major marketing drive to increase brand awareness and the flow of business from all sources. We also opened new offices in the UK and Continental Europe.

Hiscox Global Markets

It is easy to say that our great result was due to the lack of hurricane damage, but it took strong nerve at the time for the Global Markets team in London to write the same exposure as the previous year despite every weather forecaster prophesying another truly catastrophic year of storms. Feast followed famine. A substantial profit was made despite having to cover a considerable deficit from increased claims coming in during the year from the 2005 hurricanes. The multiple storms and the extraordinary damage in 2005 gave valid reasons for our not being able to forecast the arrival of those late claims. We have learnt from them and will factor them into future forecasting.

Rates have remained properly high for reinsurance and insurance exposed to natural catastrophes. Climate change is at the top of most agendas, and we are not assuming that last year's lack of catastrophes is the new norm. But most competitors want to balance their obviously risky exposure with less risky, so rates are under pressure elsewhere. The decision of the State of Florida to write a substantial proportion of the reinsurance of domestic insurers in the State may reduce income to us and other reinsurers. The Governor of Florida was appalled that the insurance industry had made an estimated $3 billion in Florida in 2006, ignoring the fact that it suffered losses in the State of $26 billion in the previous two years. It will be interesting to see who buys reinsurance from the State with the political conditions attached and with no Federal guarantee.

Global Markets also writes a good, steady book of regional business to balance in part their catastrophe account, giving a measure of stability within what is by its nature a volatile division.

Chairman's statement continued

Hiscox International
This section covers our operations in Bermuda, our new USA venture and Guernsey. Bermuda writes catastrophe exposed business, whereas Hiscox USA and Guernsey write non-catastrophe regional and retail business. A good balance.

Hiscox Bermuda had a perfect start. It wrote its budgeted income but did not have the budgeted claims. Again, it must be remembered that the forecasts for the year were very gloomy, but like the traditional naval officers of old, they sailed to the sound of gunfire to great benefit.

Our new venture in Armonk, New York which started in March 2006 completed a storming first year well ahead of original budget.

Hiscox Guernsey maintained its excellent record and truly is a jewel in our crown.

Hiscox UK and Europe
Our regional business in the UK and Europe made solid progress. In the UK, the prices weakened in several large books of business and our underwriters let our more optimistic competitors take them from us. Our core accounts have filled the gap and expanded, showing good growth where we want it most, and we expect further progress from the renewed marketing spend this year.

Competition is strong, but we have many years of experience and specialist expertise in our core products. We also have excellent relationships with brokers, especially with those who realise that the cheapest price is often the most expensive for the clients if it does not buy them the cover they need.

Our direct account almost doubled its income and obviously benefited from the advertising campaign. The campaign also greatly helped brokers sell our policies, with fewer customers asking "who is Hiscox?"

Our offices in Continental Europe achieved a profit for the third year running, and during the year additional country representative offices were opened in Portugal and Sweden.

We retain our focus on our specialist areas of business, but believe in a wide spread of distribution outlets as local business is placed locally, especially in Europe where regions within countries are like separate countries.

Investments
The investment return is an essential part of the underwriting business. We have had interest rates steadily reducing from 15 per cent in 1990 to 3 per cent recently which has been a constant squeeze on our profits. Interest rates of 15 per cent have a terrible effect on underwriting standards as the investment return swamps the losses from bad underwriting. (Insurance companies were regularly described as investment trusts with an expensive habit.) The squeeze has been good for underwriting standards as they have been fully exposed, so it is a healthier market as a result. However, the recent interest rate increases to over 5 per cent have given a steady and meaningful increase to our basic profitability, with the good underwriters doing better than the bad as the better you underwrite the more money you have to invest.

We need to preserve our capital. We have needed every penny of it and any fall would mean a reduction in our underwriting, so the investment of it has been conservative. We will continue to try to squeeze every drop of return within that prudent stance.

People
This business is only people, capital and computers. Computers do what people programme them to do, and capital is freely available to the best people. So the only way we will achieve our ambition is to employ the best people, train them thoroughly and keep them motivated. I think we have excellent people throughout the Group and I am truly grateful to them for taking Hiscox to where it is today.

I must make special mention of Bronek Masojada, the Chief Executive, who leads the Company with indefatigable energy and commercial acumen, and of Robert Childs, the Chief Underwriting Officer, who moved to Bermuda to help oversee the running of the Group from there, and is also CEO of the Bermudian company and Chairman of the US operation.

Finally
Change at Hiscox is constant – and vital. It is essential that we constantly adapt to the changing world outside our business, and keep ahead of our competitors.

This year we are running a bigger group of international businesses around the world from Bermuda. We have the same strategy of balance which has served us well in the last few years. If competition reduces rates on our international book, our investment in the long-term growth of our more steady regional businesses will truly come to the fore. It has been a year of wonderful profits. It has also been a year of investment in the future. The market looks as challenging as ever, but we have the people and the tools to achieve our ambition.

Robert Hiscox
Chairman
12 March 2007

Change at Hiscox is constant – and vital. It is essential that we constantly adapt to the changing world outside our business, and keep ahead of our competitors.

Chief Executive's report

In 2006 Hiscox focused on five initiatives to grow both the short and long-term profitability of the Group.

First, we commenced underwriting through our new Bermudian reinsurance business whilst simultaneously growing our existing reinsurance business in London. Second, we opened for business in the USA. Third, we launched a brand building campaign in the UK, including our first TV commercials. Fourth, we focused on the development of our sales skills in Europe. Finally, we moved our domicile to Bermuda.

Our tactics in reinsurance in Bermuda and London and the sales focus in Europe have paid off immediately. The creation of Hiscox USA and the UK marketing campaign have required an investment of almost £20 million which will pay dividends for the Group over a longer time period. All of these efforts propelled the Group to record revenue and profits – both on an absolute and a per share basis. Net assets per share have grown to record levels as well.

Looking forward we expect the market to get trickier during the course of this year – rates will be attractive in aggregate but discipline will be required to ensure we underwrite the right risks at the right price. We believe that our long-term strategy of balancing retail business with volatile risks will continue to serve us well in this environment. We see great opportunities in our retail activities in Europe, the UK and the USA. The investments we have made this year will help them in their drive to develop organically. If, however, we can find attractive businesses to acquire at the right price, we will do so.

Hiscox Bermuda will expand its underwriting this year, making the transition from a start-up to an established player on the Island. Hiscox Global Markets is seeking to widen its access to the market. It is developing hub offices in Paris and New York and working with competitors to launch peer to peer electronic trading initiatives.

We will be tested as we seek to do all of this but success in our endeavours will generate continued profits to the benefit of shareholders and staff.

Group performance

The pre-tax profit for the year was £201.1 million (2005: £70.2 million). This is a record performance for the Group. Total revenues controlled by the Group grew by 27.3 per cent to £1,407 million (2005: £1,105 million). Hiscox Ltd's share of this grew by 30.8 per cent to £1,126.2 million (2005: £861.2 million) which equals 286.9 pence per share (2005: 277.1 pence per share). Dividends for the year have been increased to 10 pence per share (2005: 7 pence per share).

Our record results are in part due to the good fortune of a low loss year, and in part due to our decision to expand our catastrophe reinsurance writings significantly. This was a brave decision when it was made in late 2005 and I would like to thank shareholders for supporting us in this course – both with their words and with their money. I hope that they feel adequately rewarded by these results.

£201.1m

Group pre-tax profit

Building a balanced business Gross written premium at 100% level (£m)

*London Market/Retail split estimated for these years

The amounts and ratios for all periods prior to 2004 are those previously published on a UK GAAP basis, the Group's primary reporting framework at that time. The figures reported for 2004 onwards are prepared in accordance with IFRS as adopted by the EU.

Chief Executive's report continued

Hiscox Global Markets

This business division uses the global licences, distribution network and credit rating available at Lloyd's to serve clients around the world. Seventy per cent of the business is more volatile big ticket reinsurance, marine, energy and other international property and liability business. The remainder is less volatile, smaller ticket business which provides the division with some balance.

Richard Watson took over as Managing Director of the division at the end of 2005. Under Richard's leadership the division has maximised its revenues to take advantage of the re-rating that occurred in some lines of business after the hurricanes of 2005. Gross written premiums increased 24.3 per cent to £689.9 million (2005: £555.2 million) and the division made a pre-tax profit of £116.6 million (2005: £20.7 million) with a combined ratio of 89.0 per cent (2005: 99.9 per cent). This record result has contributed materially to the Group's performance.

Looking at the major business units of the division in turn:

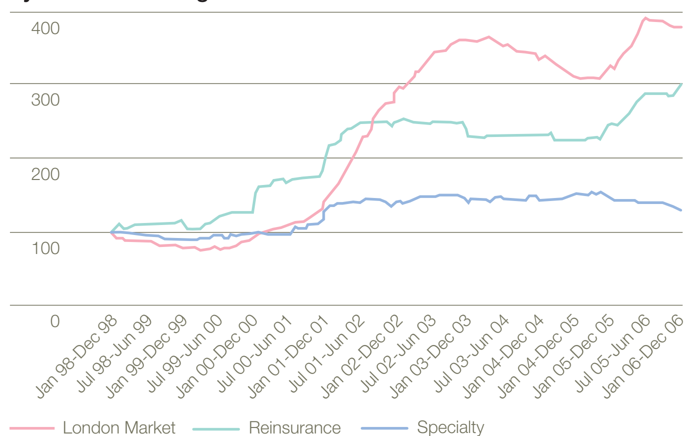
- Our London based reinsurance team took full advantage of the opportunity created by the strong rating environment. They expanded their business to £209.7 million (2005: £160.9 million), excluding inwards reinstatement premiums. During the course of the year we worked with W L Ross & Co to create a special purpose reinsurance vehicle, Panther Re, (the "sidecar") which will write a 40 per cent pro-rata share of this division's property catastrophe business in 2007. This was a first for the Lloyd's market. The team will benefit from the increased market presence the sidecar gives them and will receive a ceding commission and a profit commission based on actual performance. Rates in the reinsurance area remain attractive, despite the flow of underwriting capacity into this area over the past 12 months.
- The large property, terrorism, marine and offshore energy teams all had a good year. Aggregate income grew to £254.3 million (2005: £213.4 million). Rating trends vary across these lines of business. Energy rates are firm following losses in the Gulf of Mexico last year and we continue to have an appetite for this area – albeit supported by quota-share reinsurance. Marine hull rates are under some pressure and we do not anticipate growth in this area. Rates for large property risks continue to increase and we are doing more business. Terrorism rates are under pressure as new entrants look to expand into areas not affected by natural catastrophes.
- Technology, Media and Telecoms (TMT) has had another good year – with good profitability and increased distribution. Distribution initiatives include a focus on the Indian market and the recruitment and training of local underwriters in the USA, UK and European regional offices. At the end of the year the global professional indemnity account was brought under the management of the TMT leadership. We expect that this overlap will lead to shared underwriting discipline and better marketing.
- Our Specialty team includes personal accident, kidnap and ransom, bloodstock and cancellation and abandonment business. It also writes some high value household and other smaller property business in the USA. Other than the household and property area, rates in this business have remained steady and we have enjoyed another profitable year. The household and smaller property business saw much increased rates after the 2005 hurricanes. Again we kept our nerve in the face of the unprecedented market losses in 2005 and have prospered as a result of maintaining our involvement.

£116.6m
Hiscox Global Markets pre-tax profit

Hiscox Global Markets

	2006 £m	2005 £m
Gross premiums written	**689.9**	555.2
Net premiums earned	**549.3**	428.3
Profit before tax	**116.6**	20.7
Combined ratio	**89.0%**	99.9%

Syndicate 33 rating index Index level %



Looking forward, the Global Markets division is working on several related challenges which include broadening its access to worldwide insurance business and using technology to deliver better service. At the moment most of the division's business arrives in London via Lloyd's brokers, presenting risks in the form of paper proposal forms to underwriters at boxes at Lloyd's. The team is working on electronic peer to peer trading initiatives which will allow brokers around the world to submit business electronically. This will be supported by a trading floor which we are building in our London office. Global Markets has also widened its access to new business that has not always come into London by establishing two hub offices – one in Paris and the other
in New York. These hubs and the e-trading approaches have already contributed in excess of $75 million of revenue to Global Markets. We expect that this will grow materially in the years ahead.

Hiscox International

This business division was created during 2005 to cover our activities in the USA, Bermuda and Guernsey. It has had a great year – becoming a driver of both revenues and profits for the Group. Total revenues for the division were £151.3 million (2005: £43.7 million), profits were £51.9 million (2005: £6.2 million) with a combined ratio of 62.2 per cent (2005: 91.3 per cent). In 2005 all the revenues and profits came from Hiscox Guernsey, however during 2006 all the units were fully active.

- Hiscox Bermuda was capitalised with $500 million in December 2005. Around $300 million was raised by a Rights Issue, with the balance coming from debt facilities. Robert Childs, Chief Executive of Bermuda, set out to write $165 million of third party property catastrophe reinsurance business from a standing start sourced from Bermuda. He and his team surpassed this by writing $171 million. Balancing this business were the internal quota share arrangements which allowed the other businesses in the Group to expand their own activities. Bottom line results were outstanding, reflecting the absence of significant catastrophes and Hiscox Bermuda's attractive business mix. This strong start means that Hiscox Bermuda is well positioned to take advantage of the continuing favourable market environment.
- Hiscox USA opened for business in March 2006. Ed Donnelly, President of Hiscox USA, set out to underwrite $15 million of business in the first year of operation. The actual income achieved was $25 million. The significant investment we are making to equip this business properly has impacted on profitability but has provided solid foundations on which to grow going forwards. At the moment, Hiscox USA's business is placed on commercial third party terms with Syndicate 33. We would ideally like to acquire a carrier to allow Hiscox USA to develop as a separately capitalised entity.
- Hiscox Guernsey continues its excellent performance. Steve Camm, Underwriting Director in Guernsey, has worked to expand the office's core product lines of kidnap and ransom insurance and other related lines such as fine art, personal accident and terrorism insurance. Hiscox Insurance Company (Guernsey) Limited was awarded an A- rating this year by A.M. Best. This reflects both its excellent track record and the quota share reinsurance relationship it has with Hiscox Bermuda.

£51.9m

Hiscox International pre-tax profit

Hiscox International

	2006 £m	2005 £m
Gross premiums written	**151.3**	43.7
Net premiums earned	**93.5**	23.4
Profit before tax	**51.9**	6.2
Combined ratio	**62.2%**	91.3%

Chief Executive's report continued

Hiscox UK and Hiscox Europe

Hiscox UK and Hiscox Europe have expanded their revenues during the year. Their reduction in profitability reflects the outstanding year they had in 2005 and the decision to invest substantially in both businesses at a time when global big ticket and reinsurance rates were high – making a bigger investment than if they had been stand alone entities. The performance of each unit is reviewed below:

- Hiscox UK has seen its top line grow to £226.3 million (2005: £207.3 million) with profits down to £31.9 million (2005: £40.4 million). The combined ratio was 95.0 per cent (2005: 84.1 per cent). The fall in our combined ratio and profits is in part due to the large increase in marketing expenditure during the year. Steve Langan, Managing Director of Hiscox UK, joined us in October 2005 and has had a good first year. He has brought marketing skill and knowledge to the business, making sure that our £10 million increase in marketing budget was wisely used.

  The main focus to date of our marketing efforts has been on the Art and Private Client business. It remains a market leader, but we feel that we can expand our penetration, particularly through the direct and partnership channels. We are also working with some major brokers to help them reshape their ability to serve private client customers by using some of our direct capabilities.

  We saw strong growth in our Professions and Specialty Commercial area, particularly in our core target market of small and very small commercial businesses. Our confidence in the performance of these two areas has allowed us to resist some of the untenable requests put to us by intermediaries and we have walked away from business rather than write it on inappropriate terms.

  In 2007 we will continue with our marketing push, which we intend to broaden to ensure it supports both our commercial and our personal lines activities. The external environment is competitive, but we expect that our specialist focus will continue to insulate us in part from rate deteriorations.

- Hiscox Europe has enjoyed a third year of aggregate profitability. Revenues rose to £58.7 million (2005: £55.0 million) with profits of £0.7 million (2005: £3.0 million). The combined ratio reduced to 98.7 per cent (2005: 99.7 per cent), closer to our target range of 95 per cent to 98 per cent. Marc van der Veer, Managing Director of Hiscox Europe, has led a drive to build a sales focused culture which has reaped rewards. Aggregate revenues have grown despite the need to cancel and re-underwrite some business to deal with the problems of the past. Europe has reached critical mass in aggregate, but results in individual countries are still volatile reflecting their smaller individual scale. France deserves special mention for its consistent performance. It has shown us what we can expect when each country achieves appropriate scale. Looking forward we will continue to expand our business in the countries where we are currently active. We opened offices in Lyon and Cologne during the year, moving our strategy from a 'flag in capital cities' to deeper penetration in countries in which we are already present. We expect to open more regional offices in France and Germany during the course of 2007.

£31.9m

Hiscox UK pre-tax profit

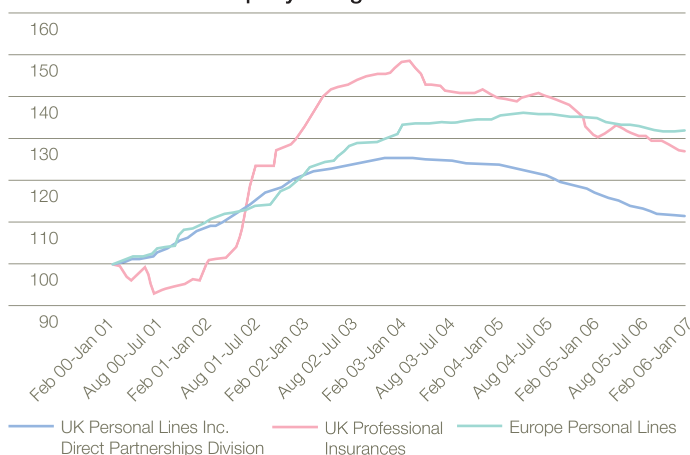
£0.7m

Hiscox Europe pre-tax profit

Hiscox UK and Hiscox Europe

	2006 (£m)		2005 (£m)	
	UK	Europe	UK	Europe
Gross premiums written	**226.3**	**58.7**	207.3	55.0
Net premiums earned	**196.5**	**49.5**	194.5	47.1
Profit before tax	**31.9**	**0.7**	40.4	3.0
Combined ratio	**95.0%**	**98.7%**	84.1%	99.7%

Hiscox Insurance Company rating index Index level %



Claims, Operations and IT

At Hiscox we aim to pay valid claims fast and with a smile. Client surveys suggest that to date we are achieving this reputation in their eyes. In order to ensure this continues as the Group grows we have appointed Jeremy Pinchin, previously Head of Claims at Lloyd's, to lead this area. Jeremy is leading a program of skill building amongst staff, segmentation of our approach to claims and further automation. These will ensure that claims attitude and payment continues to support the Hiscox brand.

Efficient operations are a cornerstone for any insurance business. We have begun a multi-year investment process to replace our core Global Markets systems, allowing for global product management and sharing of risks around the world. The Operations team are also the change agents in the move to e-trading. In our retail areas we continue to automate and eliminate waste. As pricing pressures continue, efficiency gains can offset, in part, some of the margin pressure we will face.

Investments

Invested assets in the Group grew to £1.74 billion (2005: £1.65 billion). During the year we retained our conservative stance on both equities and bonds as we wanted to ensure we preserved our available capital to support underwriting. The total return across the portfolio was £78.5 million (excluding derivative gains), equal to a 4.6 per cent return on average invested assets.

Our investments are supervised by the team at Hiscox Investment Management. They also look after £170 million of funds for third party investors. Our specialist financial funds had another good year, beating their benchmarks and earning performance fees.

Balance sheet

Net assets grew to 173.2 pence per share (2005: 147.7 pence) and tangible net assets grew to 164.8 pence per share (2005: 139.3 pence). For once we had a relatively quiet year on the financing front as we concentrated on making sure the capital we raised at the end of 2005 was put to good work. The most material financing activity was the arrangement of standby letters of credit so that Hiscox Bermuda could meet US funding requirements in the event of a large loss.

We hedged the net capital supporting our Bermudian activities so that we have not been affected by the weakness of the dollar. The gains on these derivatives have largely offset the non-cash losses we suffered in our accounts due to the obscure way in which deferred acquisition costs and unearned premiums are not re-valued under IFRS. We hope that in time the accounting standard-setters will listen to the practical views of those who manage businesses rather than the theoreticians in their think-tanks.

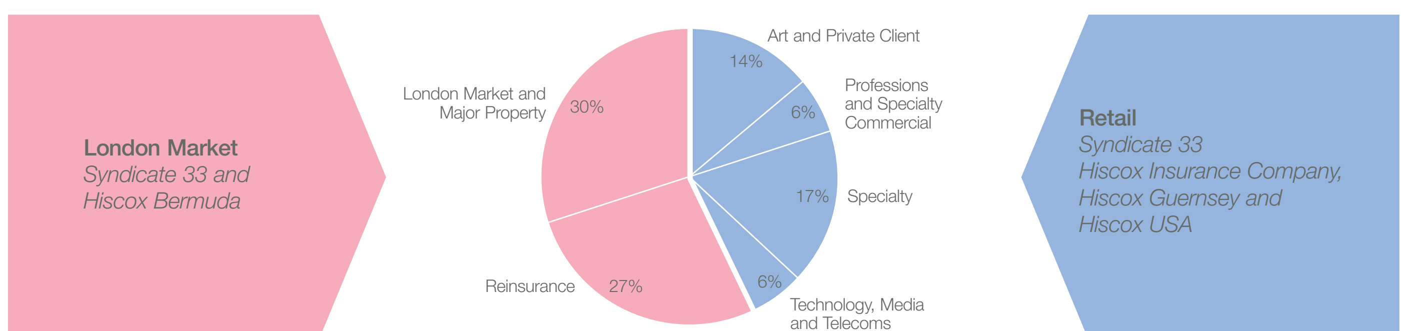
On 31 December 2006 we closed our final salary pension scheme to future accrual. This has resulted in a £7 million charge to this year's income statement. All active members who left the pension scheme joined the defined contribution scheme which has been in place for new joiners since 1 January 2001.

The business has generated, and we hope will continue to generate, a healthy cash flow. In the past our strategy has always been to reduce gearing as the insurance market softens. However financial markets are throwing up interesting financing tools which allow for longer-term debt than we have previously arranged. We will be working during 2007 to establish the optimal balance sheet mix for the market conditions
we expect to prevail over the next several years. In order to ensure we have sufficient flexibility we will be seeking shareholder approval to amend our Bye-Laws to allow us to buy back shares into treasury.

£78.5m
Investment management return

173.2p
Net assets per share

Hiscox Ltd product split 100% = £1,407 million total Group controlled income for 2006



Chief Executive's report continued

People

The delivery of our ambitious business plan has put stresses and strains on all our staff. As the business grows the leadership challenge is being shared by more and more people. During 2006 we launched management training initiatives which cover the needs of an individual from the time they begin to manage others to the time they lead a division of the Group. This will complement our existing programme for underwriting and professional training and personal development.

For the past four years Hiscox has been one of the 'Top 100' places to work in the UK Sunday Times survey. We were not in the final 100 this year – in part no doubt due to the pension changes. We remain committed to being a well regarded place to work and hope that we will receive this level of recognition again in the future.

Current trading

During January the insurance industry was impacted by two external events – Windstorm Kyrill and legislative changes in Florida.

Windstorm Kyrill blew through the UK and Continental Europe. This was a small net loss to our retail businesses in the UK and Europe. Our reinsurance account was also affected. Based on a market loss of $5 billion we expect the overall net cost of Windstorm Kyrill to the Group will be approximately £25 million.

In early February the State of Florida decided to double the amount of hurricane losses it will "nationalise" to $28 billion per event. The exact impact that this will have on the market is not yet clear, though the reduction of demand will inevitably put some pressure on prices elsewhere. We are fortunate that we have a broader book of business with Florida personal lines reinsurance business only comprising 1.69 per cent of our controlled premium income last year, so the proportionate impact on Hiscox will be less than others.

For the Hiscox book of business, rates in aggregate remain at attractive levels, though this disguises different trends in different parts of the account. Rates in catastrophe exposed lines have climbed to new peaks, whilst rates in non-catastrophe exposed lines are under pressure. We will therefore need to be more discriminatory in our underwriting, giving the good insured the reduction they deserve, but holding firm where the record is poor or exposure is growing.

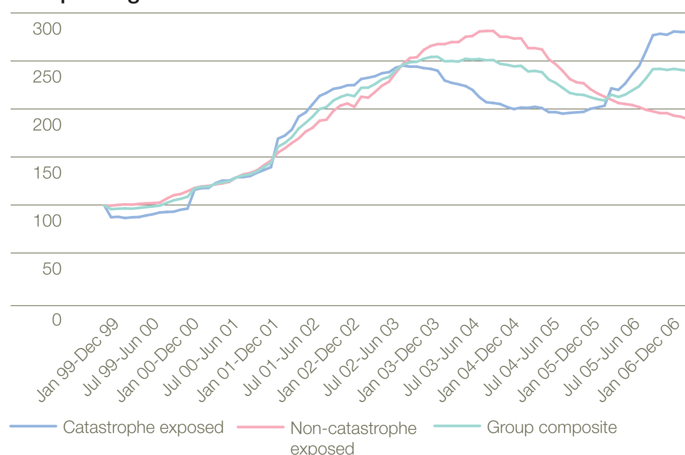
Conclusion

Over the past two years the Hiscox Group has changed from a London focused business to a specialist business with a substantial global reach, delivering record results. Reflecting this change it is now domiciled in Bermuda. This evolution has been achieved largely by organic growth with substantial investments in building new businesses, supported at critical times with capital from shareholders. The market outlook is attractive but will become more challenging. Strong discipline will be required in deciding which risks to underwrite and which business initiatives to pursue. We believe that our strategy of balancing retail and volatile risks will give us the flexibility to make the right choices for the benefit of the business and its owners.

Bronek Masojada
Chief Executive
12 March 2007

41.7p
Earnings per share

Group rating index Index level %



At a glance

Hiscox Global Markets

Hiscox Global Markets underwrites internationally traded business and other specialist business from around the world, via the Lloyd's insurance market and new bases within Paris and New York offices. The Lloyd's market and its licences gives Hiscox Syndicate 33 the ability to share large risks with other insurance vehicles and also to source specialist business such as technology, media, kidnap and ransom through an international network of brokers.

Richard Watson
Managing Director
Joined Hiscox in 1986 as a Political Risk Underwriter. Appointed Managing Director of Hiscox Global Markets in October 2005.

Highlights

Record pre-tax profit of £116.6 million

Successful launch of the first sidecar in Lloyd's – Panther Re

Global Markets opens in Paris and New York

Vehicle
Hiscox Global Markets uses Syndicate 33 as its primary insurance vehicle in the London Market.

Security
Syndicate 33 has an A+ (Excellent) from A.M. Best and uses Lloyd's security, A (Strong) from Standard & Poor's and A (Excellent) from A.M. Best.

Product split
Reinsurance 30%
Key product areas: marine, non-marine and aviation reinsurance; whole account reinsurance.

Property 19%
Key product areas: small residential and commercial property.

Marine and Energy 16%
Key product areas: marine hull; cargo; liability; upstream-midstream energy.

Professional Indemnity 13%
Key product areas: errors and omissions; directors and officers.

Specialty 19%
Key product areas: personal accident; kidnap and ransom; contingency; terrorism; political risks; aviation war; bloodstock; aerospace.

Technology, Media and Telecoms 3%
Key product areas: cyber liability; hacker damage; business interruption for technology, media and telecoms businesses.

Hiscox UK

Hiscox UK underwrites local specialty insurance from nine different regional centres. Business is sourced mainly through local brokers. Hiscox UK has three main product streams covering:

- the personal property of wealthy individuals, including fine art;
- the liability and property of professional or advisory and service-led businesses;
- executive household and small professional risks marketed direct to the consumer.

Steve Langan
Managing Director
Joined in 2005 as Managing Director of UK Retail and Group Marketing Director. Previously Managing Director of Diageo's Italian subsidiary.

Highlights

Strong result with a pre-tax profit of £31.9 million (2005: £40.4 million) and a combined ratio of 95.0%

Solid top line growth offset by reduced participation in Managing General Agents wholesale market and solicitors' professional indemnity market

Strong growth in direct household book driven by success of first-ever TV campaign

Vehicle
Hiscox UK uses Hiscox Insurance Company Limited and Syndicate 33 as its insurance vehicles.

Security
Hiscox Insurance Company Limited has an A- (Excellent) from A.M. Best and A- (Strong) from Standard & Poor's. Syndicate 33 has an A+ (Excellent) from A.M. Best and uses Lloyd's security, A (Strong) from Standard & Poor's and A (Excellent) from A.M. Best.

Product split
Art and Private Client 49%
Key product areas: higher value homes and possessions; fine art; specie.

Professional and Specialty Commercial 30%
Key product areas: industry specific professional indemnity; employment practices liability; directors and officers' liability; buildings, contents and business interruption for offices; contingency.

Direct and Partnerships 7%
Key product areas: executive home and contents insurance; professional indemnity.

Technology, Media and Telecoms 14%
Key product areas: business interruption for technology, media and telecoms businesses.

Hiscox Europe

Hiscox Europe underwrites local specialty insurance from offices in Amsterdam, Brussels, Cologne, Lisbon, Lyon, Madrid, Munich, Paris and Stockholm.

This business is sourced through local brokers and has two main product streams covering:

- the personal property of wealthy individuals, including fine art;
- the liabilities and property of professional or advisory and service-led businesses.

Marc van der Veer
Managing Director
Joined in May 2005. Previously headed up directors and officers' liability underwriting, Continental Europe for XL Capital.

Highlights

Improved combined ratio of 98.7%

Strong growth in fine art and TMT product lines

Cologne, Lisbon, Lyon and Stockholm were established as new branch offices

Vehicle
Hiscox Europe primarily uses Hiscox Insurance Company Limited as its insurance vehicle. Hiscox Insurance Company
Limited has a comprehensive set of licences allowing it to trade throughout the European Union. Hiscox Europe also uses Syndicate 33.

Security
Hiscox Insurance Company has an A- (Excellent) from A.M. Best and A- (Strong) from Standard & Poor's. Syndicate 33 has an A+ (Excellent) from A.M. Best, and uses Lloyd's security, A (Strong) from Standard & Poor's and A (Excellent) from A.M. Best.

Product split
Art and Private Client 79%
Key product areas: higher value homes and possessions; fine art.

Professional and Specialty Commercial 12%
Key product areas: industry specific professional indemnity; employment practices liability; directors and officers' liability; buildings, contents and business interruption for offices.

Technology, Media and Telecoms 9%
Key product areas: business interruption for technology, media and telecoms businesses.

Hiscox International

Hiscox International consists of Hiscox Guernsey, Hiscox Bermuda and Hiscox USA.

Highlights

£51.9 million pre-tax profit and a combined ratio of 62.2%

$25 million premium income for USA, exceeding its $15 million target

Hiscox Bermuda wrote £171.1 million of external reinsurance, exceeding its target

Robert Childs
Chief Underwriting Officer
Chief Executive Officer of Hiscox Bermuda
Chairman of Hiscox USA
Joined Hiscox in 1986. Active Underwriter of Syndicate 33 from 1993 to 2005. Chief Underwriting Officer of the Group for seven years.

Hiscox Bermuda
Hiscox Bermuda opened in 2005 and underwrites a significant property reinsurance account, predominantly catastrophe and risk excess of loss business and some internal reinsurances.

Vehicle
Hiscox Bermuda uses Hiscox Insurance Company (Bermuda) Limited as its insurance vehicle.

Security
A- (Excellent) from A.M. Best.

Steve Camm
Managing Director
Joined Hiscox in 1994 as a Kidnap and Ransom Underwriter. Appointed Underwriting Director of Hiscox Guernsey in December 1998.

Hiscox Guernsey
Hiscox Guernsey has been operating since 1998 and offers a range of products including fine art insurance and kidnap and ransom protection.

Vehicle
Hiscox Guernsey uses Hiscox Insurance Company (Guernsey) Limited as its insurance vehicle.

Security
A- (Excellent) from A.M. Best.

Ed Donnelly
President
Joined Hiscox in 2005. Previously Senior Vice President at Professional Indemnity Agency, a subsidiary of HCC Insurance Company.

Hiscox USA
Hiscox USA opened in March 2006, targeting smaller to medium sized business via its Armonk (New York) office and satellite offices in Manhattan and San Francisco. Hiscox USA offers the following insurance products: architects and engineers and miscellaneous professional indemnity, allied healthcare (professional indemnity for select healthcare professionals), non-profit directors and officers' and public officials liability, media liability coverage, technology errors and omissions, fine art and terrorism. Hiscox USA allows the Group to capture business too small to be traded at Lloyd's and to channel larger business back to Hiscox Global Markets.

Vehicle
Hiscox USA uses Syndicate 33 as its primary insurance vehicle.

Security
Syndicate 33 has an A+ (Excellent) rating from A.M. Best and uses Lloyd's security, A (Strong) from Standard & Poor's and A (Excellent) from A.M. Best.

Hiscox Investment Management

Hiscox Investment Management Limited is an investment management subsidiary responsible for supervising the investment of Group funds which total £1.74 billion. Hiscox Investment Management also manages a number of specialist funds, in the insurance and banking sector, for third party investors.

Alec Foster
Managing Director
Joined Hiscox in 1976 and was Group Investment Officer until 2005. He became Managing Director of Hiscox Investment Management Limited in 1995 and is fund manager of the Hiscox Insurance Fund. He is Non Executive Chairman of Universal Salvage plc.

Product split
Hiscox Investment Management manages insurance and financials funds:

Insurance 39%
Hiscox Insurance Portfolio Fund.

Financials 61%
Hiscox US Financial Fund
Hiscox European Financial Fund
Hiscox Far Eastern Financial Fund
Hiscox Global Financials Fund
Aramus Financial Fund.

Investing in the business

Investing in global reach

The Group's strategy is to balance insurance and reinsurance business traded in international markets with retail business written locally.

Hiscox's presence in the international market was reinforced through a new parent company in Bermuda. Nine new offices were opened for business around the world, extending Hiscox's global reach.

Hiscox offices

1901	London
1993	Paris
1994	Munich
1998	Harrogate (relocated to Leeds in 2001) and Guernsey
1999	Amsterdam
2000	Birmingham and Glasgow
2001	Brussels and Dublin
2002	Maidenhead
2003	Colchester
2004	Madrid
2005	Bermuda and Tunbridge Wells
2006	Armonk, Bristol, Cologne, Lisbon, Lyon, Manhattan, San Francisco and Stockholm
2007	Manchester

"We're succeeding by sticking to our strategy. We understand what we sell – we just want to sell more of it in more places around the world."

Robert Childs, Chief Underwriting Officer

Investing in distribution

Hiscox's products are distributed globally, almost exclusively through insurance brokers. In the UK however, some household and commercial products are also offered direct to customers via the internet and telephone.

Reducing costs and improving the efficiency of the distribution channels are vital. A number of initiatives were put in place in 2006 to achieve this:

The Hiscox Underwriting Centre (HUC)
HUC was launched in Colchester, UK, to improve customer service for smaller brokers and speed up responses to straightforward broker enquiries. This enables the regional UK offices to concentrate on more complex retail risks and business development.

Schemes and Affiliate Solutions (SAS)
Launched in Colchester, SAS is a think-tank for new business ideas and for 'hot housing' broker and affinity schemes. It is low-cost, fast and flexible and has proved popular with brokers.

Peer to peer
Hiscox is part of the G6, a group of six Lloyd's insurers working towards simplifying processes within the London Market. The group is chaired by Hiscox Chief Operating Officer, Sue Langley.

Simplifying London Market processes: **Sue Langley,** Hiscox Chief Operating Officer and G6 Chair.

In 2006, G6 introduced a new form of electronic trading, known as peer to peer, to streamline business with brokers and start to reduce costs at Lloyd's to deliver a better service to clients.

Peer to peer also has the potential to give Hiscox access to business not currently available in the London Market by providing an easy, cost effective way for brokers to reach Global Markets underwriters.

Additional G6 projects in 2006 included:

- work on a new policy wordings database for the London Market (to assist with contract certainty);
- simplifying the process for checking and issuing a contract;
- research into streamlining accounting and settlement processes.

Investing in the business continued

Investing in the brand

Hiscox believes that a strong brand will help sell its products throughout the world.

The brand is built on the behaviour and performance of employees. It is only highlighted by marketing and sponsorship.

Linking into the brand are Hiscox's values. Regularly appraised by staff, these values are constantly evolving.

Challenge convention
There is always a better way.

Integrity
True to our word.

Respect
Decisive in decision, considerate in execution.

Courage
Dare to be different.

Quality
Good enough is not enough.

Excellence in execution
See it through, thoroughly.

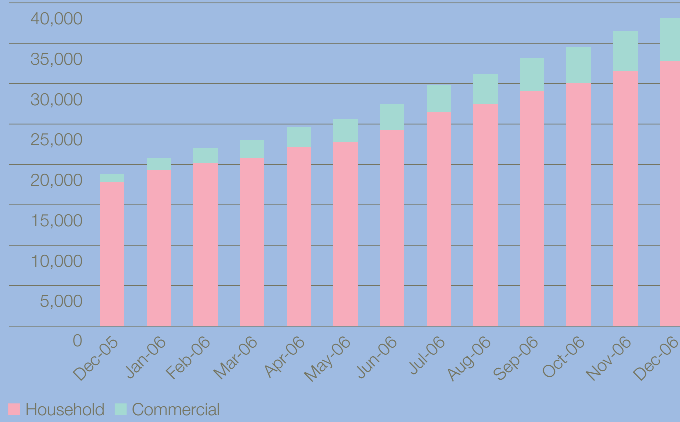
"Our mission is simple: develop the Hiscox brand through a powerful combination of flexible underwriting and superb service, backed by innovative marketing."

Steve Langan, Managing Director, Hiscox UK

Making the first TV advert, which was launched in May 2006.

The biggest challenge was getting cats to run in a straight line.

Direct division – live policy count



Marketing

Hiscox invested heavily in marketing during 2006 to:

- reinforce and emphasise the brand in key markets; and
- increase demand for its products across both the direct and broker channels.

The UK was the focus of Hiscox's marketing efforts and a campaign combining national TV, press, online and direct mail advertising was launched, targeting mid to high net worth individuals.

The results of the campaign were:

- brand awareness increased substantially in the target market;
- online searches for Hiscox grew by 189%;
- customer numbers through the direct channel grew by 100%;
- household broker channel sales rose by 6.8%.

Themes of quality and confidence underpinned the campaign and the concept of superstitions was used to execute it. The campaign differentiated on quality, not price, setting it apart from the advertisements of other insurers.

The marketing campaign will continue in 2007, with a new concept to be launched later in the year.

Sponsorship

Hiscox's sponsorships in 2006 included:

- Damien Hirst's exhibition at the Serpentine Gallery, London;
- the Bermudian cricket team's 2007 world cup campaign;
- a media and entertainment law conference, hosted by the TMT division;
- equestrian sponsorships such as Richard Davison (British international dressage rider) and UK regional Point to Point events;
- Ecole Nationale Supérieure des Beaux-Arts de Paris.

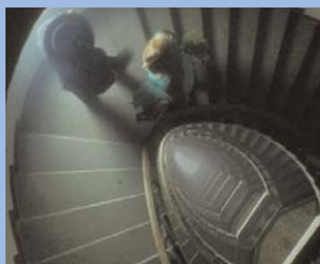
Members of the Bermuda world cup cricket team with Lady Vereker, the wife of the Island's Governor, Sir John Vereker.

Recognition

Hiscox was awarded the British Insurance Awards 2006 Underwriter of the Year.

Syndicate 33 was awarded the Insurance Times Lloyd's Syndicate of the year.

Brokers participating in the 2006 British Insurance Brokers' Association (BIBA) survey placed Hiscox in the top three insurers for overall service satisfaction. In addition, Hiscox was rated first in the survey for service in personal and commercial lines.



It was part of an overall campaign designed to leave an impression of confidence and quality and to create demand across all distribution channels.

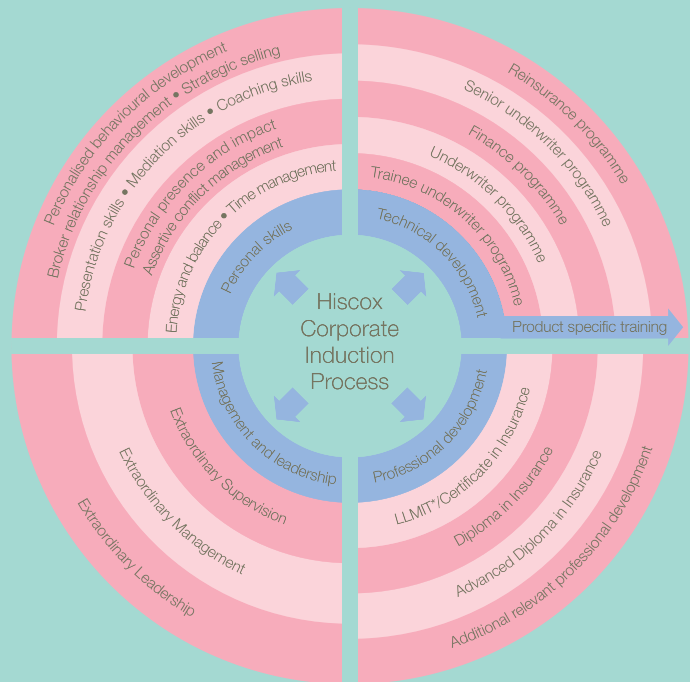
The concept was superstitions, with the voiceover: "There is no need to be superstitious when you have Hiscox home insurance. Nearly half the claims we pay would not have been covered by a standard insurance policy."

Investing in people

Hiscox's employees deliver its vision and culture.

The Group aims to find the best people, keep, train and motivate them. Significant investment was made during the year to achieve this.

Learning and development at Hiscox



The new approach to learning and development, launched in 2006.

*Lloyd's and London Market Insurance Test.

"Our achievements so far have been driven by the quality of our people, the responsibility we give to them and the loyalty created by our very distinctive culture. Our people do not work for an insurance company – they work for Hiscox."

Amanda Brown, Group Human Resources Director

Recruiting the best

The Group operates in highly specialised areas where brains make a difference – reflected in the intelligent, independent, accountable and ambitious people Hiscox recruits.

The Group is growing; 741 people in 13 countries work for Hiscox, an increase of 23 per cent on the number of employees in 2005.

New perspectives gained from new employees are balanced by the knowledge of existing staff. This is important, especially for the underwriting side of the business where thorough knowledge of clients and market issues is required.

Maximising performance and potential

A new approach to training and development was launched in 2006. The approach targets four areas: leadership, personal, professional and technical skills (see illustration on page 22).

Leadership

Over eighty per cent of senior managers completed the leadership programme during the year.

The programme is tailored to different levels: directors and senior managers ('Extraordinary Leadership'), managers ('Extraordinary Management') and project leaders ('Extraordinary Supervision'). Training supports the Group's growth, including the need for senior executives to devolve more decision-making as the business expands.

Technical skills

Over 100 underwriters undertook technical skills training in 2006 as part of the Group's in-house Underwriter Passport programme. The passport provides ongoing training for underwriters throughout their career at Hiscox.

Professional skills

Professional skills training addresses the skills needed to increase effectiveness and confidence on the job. All Hiscox underwriters completed broker relationship management training in 2006, a course all new underwriters are now required to attend. Other examples of professional skills training include mediation skills for claims staff, strategic selling skills, financial and marketing training.

Personal skills

Training is based on individual needs and career goals. This can include organisation and time management or personal impact and performance training.

Engaging and motivating

Financial reward, personal wellbeing and robust communications contribute to an exciting and motivating workplace.

Financial reward

Hiscox links personal reward to individual performance and business results. More information can be found in the Remuneration report on page 42.

Additional benefits:

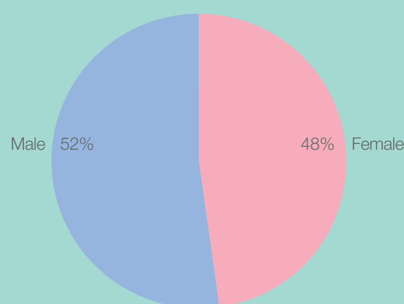
- a fully paid eight week sabbatical for employees once they have worked at the Company for ten years; 31 eligible employees have taken sabbaticals since the benefit was introduced in 2003;
- sports membership allowance;
- subsidised alternative therapy consultations – including massage, acupuncture and hypnotherapy.

Communication

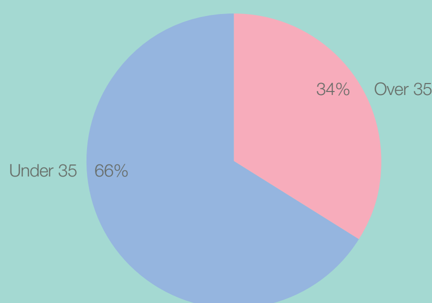
Regular communication between staff and senior executives remains important as the Group grows internationally. This includes:

- video conferencing – video conferencing facilities are installed in the majority of Hiscox's offices and are used for regular updates and Group-wide announcements or briefings;
- regular group face-to-face meetings are held by senior management to cover subjects from the Group's results announcements to online trading updates and survey results;
- staff magazines;
- staff intranet.

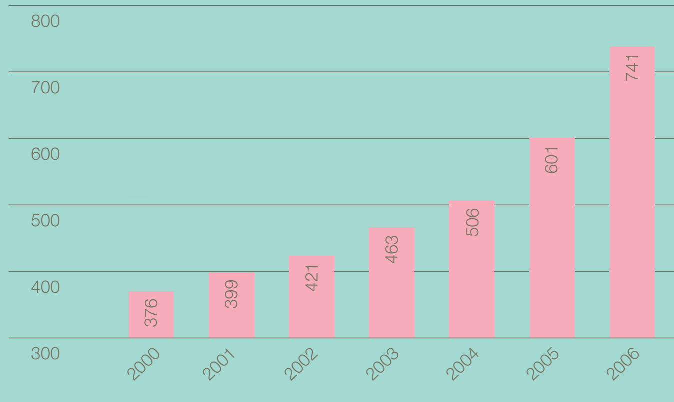
Snapshot of Hiscox people by gender*



Snapshot of Hiscox people by age*



Head count growth* Total number of staff



*Figures as at 31 January 2007.

Insurance vehicles

Syndicate 33

Hiscox can trace its origins in the Lloyd's Market to 1901. Today, Hiscox Syndicate 33 is one of the largest composite syndicates at Lloyd's, and has an A.M. Best syndicate rating of A+ (Excellent). Syndicate 33 underwrites a mixture of reinsurance, major property and energy business, as well as a range of specialty lines including contingency, technology and media risks. The business is mainly property-related short-tail business; there is little exposure to aviation or motor business. Syndicate 33 trades through the Lloyd's worldwide licences and rating. It also benefits from the Lloyd's brand. Lloyd's has an A (Excellent) rating from A.M. Best and A (Strong) from Standard & Poor's. The geographical and currency splits are shown below.

One of the main advantages of trading through Lloyd's is the considerably lower capital ratios that are available due to the diversification of business written in Syndicate 33 and in Lloyd's as a whole. Syndicate 33 has a capital requirement ratio of approximately 40 per cent of Syndicate capacity. The size of the Syndicate is increased or reduced according to the strength of the insurance environment in its main classes. At present, Hiscox owns 72.5 per cent of the Syndicate,
with 27.5 per cent being owned by third party Lloyd's Names. Hiscox receives a fee and a profit commission of approximately 17.5 per cent on the element it does not own.

The charts below show the performance of Syndicate 33 for the last six years.

Panther Re

In December 2006, Hiscox announced a market leading sidecar transaction, which broke new ground within the Lloyd's Market.

Hiscox, in conjunction with WL Ross as lead investor, and Goldman Sachs as financial adviser and lead arranger, created the sidecar, Panther Re Bermuda Limited, which was a first for the Lloyd's market.

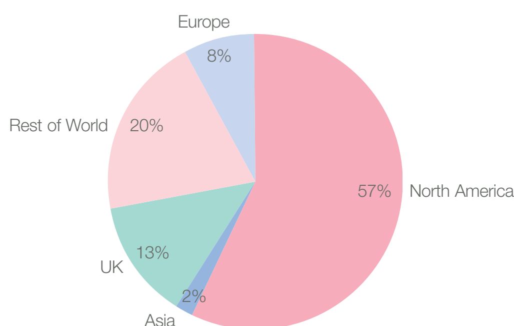
A 'sidecar' is a limited-life insurance company, formed to give its investors access to the insurance market, and its cedants access to capital. The quota share arrangement that Syndicate 33 has entered into with Panther Re will enable Syndicate 33 to write more of the favourably rated business currently available.

Panther Re's sole activity is the quota share arrangement it entered into with Syndicate 33 for 2007, under which it takes a 40 per cent pro-rata share of the Syndicate's property catastrophe reinsurance business. In return Syndicate 33 will receive a ceding commission and a profit commission.

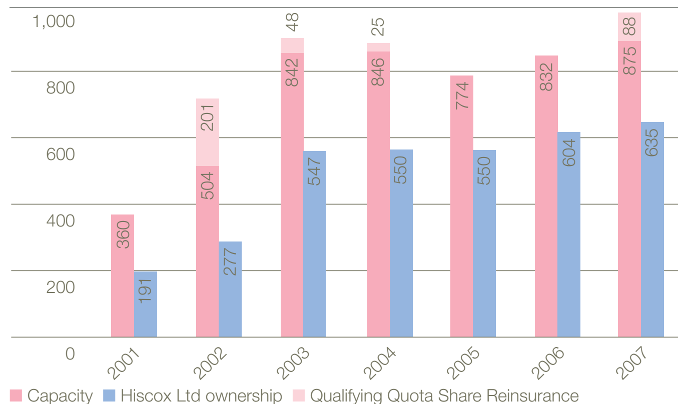
Panther Re Bermuda Limited was structured by Hiscox and $360 million was raised in conjunction with Goldman Sachs and WL Ross to capitalise it. Hiscox has no equity interest in Panther Re. Panther Re anticipates writing gross premiums of up to $180 million in 2007 and will write business in 2007 and 2008 only.

Charles Dupplin, Head of Special Projects, led the Hiscox team in the Panther Re transaction.

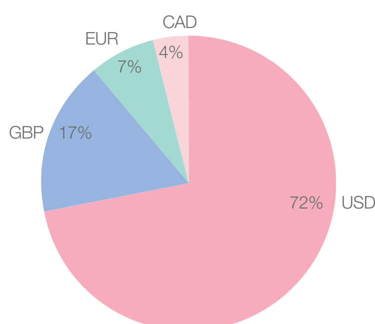
Syndicate 33 2006 Gross written premium geographical split (%)



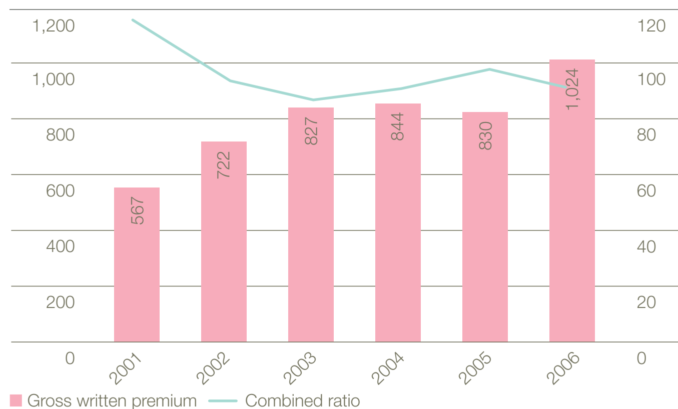
Syndicate 33 Capacity and Hiscox ownership (£m)



Syndicate 33 2006 Gross written premium currency split (%)



Syndicate 33 Gross written premium (£m) and combined ratio (%)



Hiscox Insurance Company

Hiscox purchased Hiscox Insurance Company Limited in 1996, in keeping with its aim of diversifying its activities outside of Lloyd's and writing a focused book of regional specialist risks. The Group has reshaped the Company's original portfolio to concentrate on high value household and smaller premium professional indemnity business. Hiscox Insurance Company has licences throughout Europe. It is the primary insurance vehicle used by the UK and mainland Europe offices for their business.

The success of the reshaped portfolio can be seen in the chart below. Hiscox Insurance Company Limited has achieved average compound growth in gross written premium of 13.2 per cent since its purchase, despite discontinuing almost all of its original business. It has also significantly improved its combined ratio.

Hiscox Insurance Company Limited continues to be rated A- (Excellent) by A.M. Best and A- (Strong) by Standard & Poor's. At the end of 2006, net assets were £133.5 million.

Hiscox Insurance Company (Guernsey)

Formed by Hiscox in 1998, Hiscox Insurance Company (Guernsey) Limited writes mainly kidnap and ransom and fine art insurance. Its gross written premium and combined ratio since inception are shown in the chart below. Hiscox Guernsey retains an A- (Excellent) rating from A.M. Best.

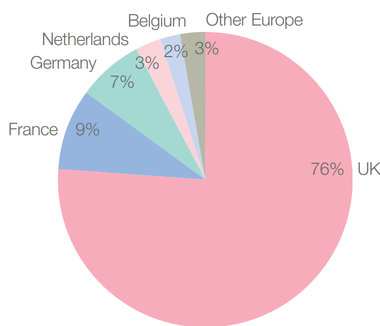
Hiscox Insurance Company (Bermuda)

Formed by Hiscox in late 2005, Hiscox Insurance Company (Bermuda) Limited completed its first full year of business in 2006. Initially capitalised at $500 million, it has access to reinsurance business shown to the growing Bermudian market and has also become a vehicle for certain other Group reinsurance. Hiscox Bermuda has an A- (Excellent) rating from A.M. Best. At the end of 2006, net assets were $607 million.

Future insurance vehicles

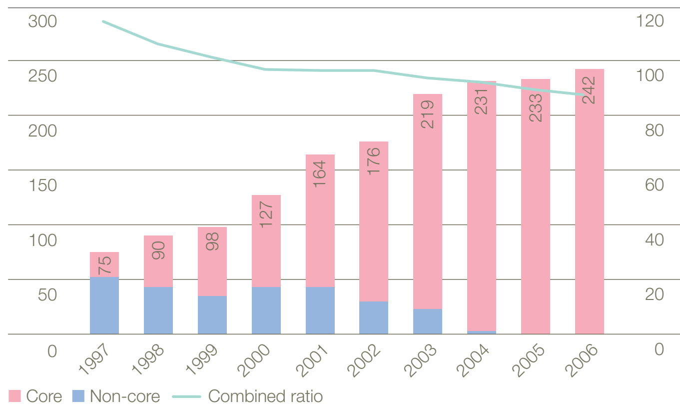
Hiscox Inc. commenced business in March 2006 as an underwriting agency focused on rolling out Hiscox's specialist products for small and medium commercial business that is normally insured in the US domestic market. The Group is exploring opportunities to obtain surplus lines and admitted lines licenced businesses in the USA.

Hiscox Insurance Company Limited
Gross written premium geographical split by origin (%)

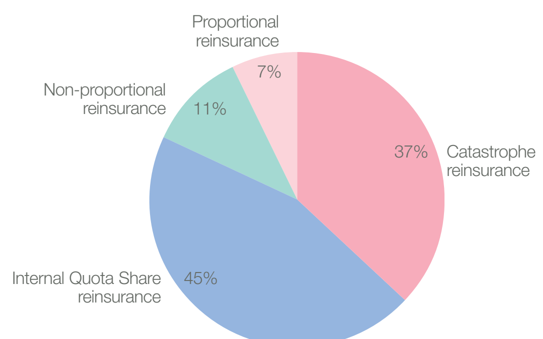


Hiscox Insurance Company (Guernsey) Limited
Gross written premium ($m) and combined ratio (%)

Hiscox Insurance Company Limited
Gross written premium (£m) and combined ratio (%)



Hiscox Insurance Company (Bermuda) Limited
Gross written premium by class (%)



Managing the Group's assets

The management of the Group's funds is undertaken by specialist fund managers overseen by Hiscox Investment Management Limited (HIM), a wholly owned subsidiary of the Group. These funds totalled £1.74 billion at 31 December 2006 (£1.65 billion: 2005).

The investment returns grew steadily in the last year due in part to rising interest rates in the US and the UK.

The HIM team also manages funds for external investors which includes six mutual funds investing in the financial sector. This active involvement in the financial markets contributes to the effective management of the Group's own funds.

Investment policy

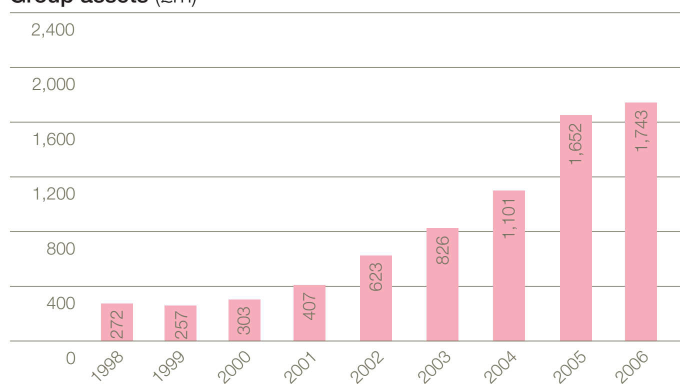
The investment policy is designed to maximise returns within the overall risk appetite of the Group. The overriding philosophy with the Group's assets is not to lose money or to put at risk the Group's capacity to underwrite.

Technical funds, the investments held for the payment of future claims, are primarily invested in high quality bonds and cash. The high liquidity of these funds allows the Group to meet its aim of paying valid claims quickly. These funds are maintained in the currency of the insurance policy to reduce foreign exchange risk.

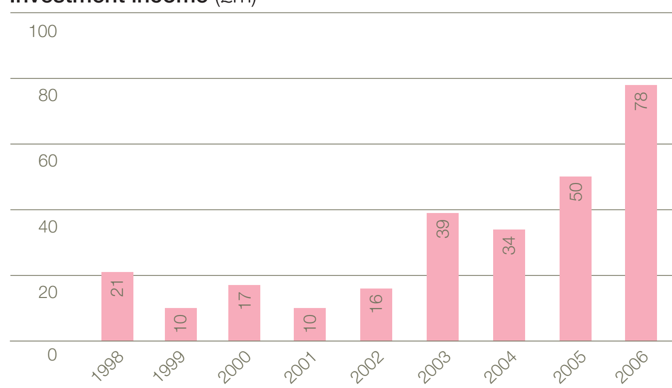
Due to the short tail nature of the Group's insurance liabilities, the aim is not to match the duration of the assets and liabilities precisely. Benchmarks are instead set for the fixed income fund managers which approximate the payment profile of the claims as well as providing the managers with some flexibility to enhance returns.

A proportion of the Group's assets are allocated to riskier assets, principally equities. Here, it is the Group's philosophy to take a long-term view in search of acceptable risk adjusted returns. The HIM team leverages its knowledge and experience to seek out fund managers with proven performance, sound judgement and integrity. The proportion of the Group's funds invested in risk assets will depend on the outlook for investment markets and the requirement within the Group for underwriting capital. An allocation within the risk assets is made to less volatile, absolute return strategies. This balances the desire to enhance returns against the need to ensure capital is available to support underwriting throughout any downturn in financial markets.

Group assets (£m)



Investment income (£m)



Group financial performance

The Group achieved a profit before tax of £201.1 million in 2006 (2005: £70.2 million). Earnings per share were 41.7 pence (2005: 15.6 pence). The post-tax return on shareholders' equity was 28.9 per cent (2005: 12.8 per cent).

The underwriting performance of each reporting segment is detailed below. The net asset value grew to £682.1 million from £578.0 million driven by profitable contributions from each of the segments. Net asset value per share grew to 173.2 pence from 147.7 pence.

Underwriting performance – Hiscox Global Markets

Hiscox Global Markets comprises the results of Syndicate 33, excluding Syndicate 33's specie, fine art, UK regional events coverage, non-US household business and the underwriting result of Hiscox Inc. It also includes the investment return and administrative costs associated with the parent Company and other Group management activities.

- Gross written premium increased in the year driven by high rates achieved on catastrophe exposed risks together with increased ownership of the Syndicate which rose to 72.6 per cent for the 2006 year of account (2005: 71.1 per cent). The capacity of Syndicate 33 also increased to £832 million from £774 million.
- Net written premium increased to £587.3 million from £417.1 million after lower reinsurance reinstatement costs.
- Investment income increased to £68.5 million (2005: £20.9 million), driven by increased funds under management, more favourable US interest rate environment together with a significant derivatives contribution of £27.0 million in the year.
- Profit before tax increased to £116.6 million (2005: £20.7 million) following the benign hurricane season experienced this year. A charge of approximately £7 million was incurred following the closure of the defined benefit pension scheme to future accrual.
- The net claims ratio decreased from 70.8 per cent to 54.6 per cent in the absence of significant catastrophe losses in 2006, despite strengthening of 2005 hurricane reserves.
- The expense ratio deteriorated to 34.4 per cent from 29.1 per cent primarily as a result of foreign exchange movements from a weaker US Dollar.
- The combined ratio fell to 89.0 per cent (2005: 99.9 per cent) predominantly driven by a benign 2006 hurricane season.

Group financial performance

	Global Markets and Corporate Centre 2006	UK and Europe 2006	International 2006	Consolidated Group Total 2006	Global Markets and Corporate Centre 2005	UK and Europe 2005	International 2005	Consolidated Group Total 2005
Gross premiums written (£m)	**689.9**	**285.0**	**151.3**	**1,126.2**	555.2	262.3	43.7	861.2
Net premiums written (£m)	**587.3**	**250.7**	**137.4**	**975.4**	417.1	235.3	28.8	681.2
Net premiums earned (£m)	**549.3**	**246.0**	**93.5**	**888.8**	428.3	241.6	23.4	693.3
Investment income (£m)	**68.5**	**20.6**	**16.4**	**105.5**	20.9	20.4	1.6	42.9
Profit before tax (£m)	**116.6**	**32.6**	**51.9**	**201.1**	20.7	43.4	6.1	70.2
Claims ratio (%)	**54.6**	**45.5**	**17.5**	**49.3**	70.8	45.1	2.8	61.8
Expense ratio (%)	**34.4**	**50.2**	**44.7**	**39.0**	29.1	41.8	88.5	34.2
Combined ratio (%)	**89.0**	**95.7**	**62.2**	**88.3**	99.9	86.9	91.3	96.0

	2006	2005
Financial assets and cash excluding derivative assets (£m)	**1,743.1**	1,651.5
Other assets (£m)	**914.9**	1,095.4
Total assets (£m)	**2,658.0**	2,746.9
Net assets (£m)	**682.1**	578.0
Net asset value per share (pence)	**173.2**	147.7
Net tangible asset value per share (pence)	**164.8**	139.3
Adjusted number of shares in issue (m)	**393.7**	391.2

Group financial performance continued

Hiscox UK performance

Hiscox UK comprises business written by the Hiscox Insurance Company in the UK and Ireland, excluding Irish surety business. It also includes the results of Syndicate 33's specie, fine art, UK regional events coverage and non-US household business, together with income and expenses arising from the Group's retail agency activities in the UK.

- Gross written premium increased by 9.2 per cent due to increased income from all core lines of business, offset in part by further reduction of the solicitors' account and Managing General Agents account.
- Net written premium increased by 7.3 per cent from £185.6 million to £199.1 million.
- Investment income remained steady at £16.7 million (2005: £16.0 million) as interest rates remained high and the equity weighting was maintained.
- Profit before tax of £31.9 million (2005: £40.4 million) was reduced following the additional marketing expenses despite generally favourable claims experience in the retail business.
- The net claims ratio increased to 44.4 per cent (2005: 43.6 per cent) following a year of significant losses on the specie account, offset by the fact that there were no major catastrophes and the remaining retail business experienced benign loss conditions.
- The expense ratio increased to 50.6 per cent (2005: 40.5 per cent) following significantly increased marketing spend.
- The combined ratio increased to 95.0 per cent (2005: 84.1 per cent).

Hiscox Europe performance

Hiscox Europe comprises business written in mainland Europe by Hiscox Insurance Company and the Irish surety company, together with the income and expenses arising from the Group's retail agency activities in Continental Europe.

- Gross written premium increased by 6.7 per cent following the launch of a number of new products across Europe. France achieved growth in gross written premium of 15.3 per cent while Germany remained flat. The Group's operations in other European countries achieved 2.3 per cent growth in gross written premium, with the continued development of European business from the opening of new offices in France, Germany, Portugal and Sweden during the year.
- Net written premium increased by 3.8 per cent from £49.7 million to £51.6 million.
- Investment income remained steady at £3.9 million (2005: £4.4 million).
- The Irish surety business continued its excellent performance in the year.
- Profit before tax decreased to £0.7 million (2005: £3.0 million) following increased expenditure on expanding European operations during the year.
- The net claims ratio reduced to 50.2 per cent (2005: 51.5 per cent). Both France and the Netherlands had another outstanding year but this was offset to some extent by a number of large claims in Germany and Belgium. The new areas of European development also experienced a favourable claims environment in the year.
- The expense ratio remained steady at 48.5 per cent (2005: 48.2 per cent).
- The combined ratio improved to 98.7 per cent (2005: 99.7 per cent), primarily driven by favourable loss ratios in France and the Netherlands as well as in the new areas of European development.

Hiscox UK and Hiscox Europe

	UK 2006	Europe 2006	Total 2006	UK 2005	Europe 2005	Total 2005
Gross premiums written (£m)	**226.3**	**58.7**	**285.0**	207.3	55.0	262.3
Net premiums written (£m)	**199.1**	**51.6**	**250.7**	185.6	49.7	235.3
Net premiums earned (£m)	**196.5**	**49.5**	**246.0**	194.5	47.1	241.6
Investment income (£m)	**16.7**	**3.9**	**20.6**	16.0	4.4	20.4
Profit before tax (£m)	**31.9**	**0.7**	**32.6**	40.4	3.0	43.4
Claims ratio (%)	**44.4**	**50.2**	**45.5**	43.6	51.5	45.1
Expense ratio (%)	**50.6**	**48.5**	**50.2**	40.5	48.2	41.8
Combined ratio (%)	**95.0**	**98.7**	**95.7**	84.1	99.7	86.9

Hiscox International performance

International comprises the results of Hiscox Insurance Company (Guernsey) Limited, Hiscox Insurance Company (Bermuda) Limited and Hiscox Inc.

- Gross written premium increased by 246 per cent to £151.3 million primarily driven by Bermuda in its first year of operation, together with Hiscox Inc. which commenced trading in March 2006.
- Net written premium increased by 377 per cent, driven by growth in gross written premiums.
- Investment income increased to £16.4 million (2005: £1.6 million) as investments and cash grew to £349.5 million from £313.9 million due to the commencement of trading by Hiscox Bermuda in December 2005 and Hiscox Inc. during 2006.
- Profit before tax significantly increased to £51.9 million (2005: £6.2 million) with strong profits from Hiscox Bermuda and Guernsey due to a favourable claims environment.
- The claims ratio was excellent at 17.5 per cent (2005: 2.8 per cent) following a benign hurricane season.
- The expense ratio improved to 44.7 per cent (2005: 88.5 per cent) with Bermuda trading for the full year, despite approximately £7 million of set up costs in Hiscox Inc.
- The combined ratio improved to 62.2 per cent from 91.3 per cent.

Group investment performance

The investment return benefited from the increase in funds under management together with rising US interest rates, though the rates in Europe remained relatively low.

The Group retained almost one third in cash during the year as bond markets proved uncertain. Bond portfolios in all currencies had short durations to protect the underlying assets against the rising interest rates in the US and UK. The Group's bond managers out-performed their benchmarks, delivering a good return. The equity weighting was increased to eight per cent, with a defensive and more globally diversified portfolio which included some absolute return funds.

Group investment performance

		31 December 2006			31 December 2005		
		Asset allocation %	Return %	Return £000	Asset allocation %	Return %	Return £000
Bonds	£	**17.7**	**4.0**		16.1	4.9	
	US$	**31.7**	**4.4**		36.3	2.4	
	Other	**10.5**	**2.2**		9.9	2.2	
Bonds total		**59.9**	**4.0**	**42,095**	62.3	3.1	26,733
Equities		**8.1**	**10.6**	**13,517**	7.2	13.1	12,278
Deposits and cash equivalents		**32.0**	**4.6**	**22,904**	30.5	3.7	11,276
Actual return			**4.6**	**78,516**		4.0	50,287
Group invested assets				**£1,743.1m**			£1,651.5m

Cash flow and liquidity

The Group's cash flows originate from multiple sources. Core cash inflows include insurance premium remittances, losses recovered from reinsurance partners and net investment returns. After allowing for the payment of acquisition costs and other short-term expense requirements, surplus cash balances are invested in an optimal mix of assets, concentrated mainly on high quality debt and fixed income securities of short duration.

In general, the investment portfolio produces relatively steady cash returns during periods of interest rate stability. Where interest rates are lower for sustained periods, investment income typically reduces, as the proceeds from higher-yielding securities are reinvested in securities offering coupon payments at lower prevailing market rates. However, it is still possible to realise a partial cash flow benefit in a low interest rate environment, since the underlying market value of the investments tends to increase, leading to higher realised cash gains from their eventual sale.

Other cash inflows result from the sale and redemption of investments, investment management fees and underwriting agency commissions.

Aside from investing activities and the payment of acquisition and operating costs, the Group's principal cash requirements are primarily for the settlement of insurance claims, to pay for reinsurance cover, to settle fiscal tax liabilities, to service and reduce borrowings and to distribute dividends to shareholders.

The Group's cash flow is impacted to a large extent by the results of Syndicate 33. Until 2005, the Group had in general only received cash from the Syndicate following the closure of a year of account at the end of three years, except when Lloyd's allowed early profit distributions subject to solvency requirements. However, from 2006 onwards, Syndicate cash distribution was determined on a one-year accounting basis, although still subject to solvency requirements.

Cash flows for 2006

The Group's cash and cash equivalent holdings increased by £89.1 million to £502.9 million at 31 December 2006.

Net cash inflow from operating activities during the year was £181.9 million (2005: £18.9 million), demonstrating excellent underlying cash generation in addition to increased business volume. This result was achieved notwithstanding substantial payouts being made during 2006 in relation to large catastrophe losses suffered in 2005.

Investment income receipts, inclusive of derivative cashflows, increased by 91 per cent or £43.5 million on the prior year, partially as a result of the larger portfolio and higher interest rates and also driven by significant cash inflows totalling £21.4 million in respect of the Group's US Dollar hedging programme.

The net cash used in investment activities during 2006 was £5.8 million (2005: £2.4 million) reflecting modest needs for capital investment to realise growth during the year. The prior year comparative includes a non recurring receipt of £3.8 million in relation to the disposal of the Group's interest in an associate.

The net cash outflow from financing activities was £41.5 million in contrast to the net cash inflow of £276.3 million reported for 2005. This prior year comparative includes £170.0 million of proceeds raised from the Rights Issue in November 2005 which were applied as capital to support Hiscox's underwriting operations in Bermuda. Dividend payments have risen during 2006, partially as a consequence of the Group's enlarged share capital base following that Rights Issue and the increased dividend per share. Total dividend payments made during 2006 amounted to £30.4 million which represents an increase of 80 per cent on 2005.

Net debt, including finance lease obligations, reduced at the year end by £32.3 million and is now £93.9 million. Approximately £14.1 million of this decrease is attributable to currency depreciation of the US Dollar. However the interest payments and related finance charges on the Group's borrowings have increased by £6.1 million on the previous year as the facilities concerned were only entered into in November 2005. Steeper prevailing market rates, particularly in respect of the LIBOR benchmark, have also increased the outflow. In economic terms, investment income generated on the proceeds of borrowings largely offsets the interest obligations.

Current tax payments were some £26.1 million higher than 2005 due to the utilisation of losses in the prior year and also higher attributable profits falling to be taxed and paid in the current year.

Relationship between cash flow statement and income statement

The Group's premium income can only be earned as the risk coverage period to which it relates elapses. Consequently, whilst the cash flow statement reports on actual funds received in the year from premiums written, the income statement is influenced by older premiums falling to be earned in the current year as well as the exclusion of newer premium inflows relating to future risk coverage periods. Likewise much of the cash outflows made during 2006 relate to claim liabilities recognised in prior income statements.

Liquidity of debt and fixed income securities

The availability of funds at short notice is a prerequisite for any insurance business with short tail exposure to catastrophic events. As indicated in the table below, the Group retains a deliberate level of debt and fixed income securities in instruments with imminent maturity dates which can be liquidated rapidly for cash as required. Notwithstanding the contractual maturity profile of these securities, the Group is able to realise the value of its investment portfolios for cash in a prompt and reasonable manner as and when required.

Cash flow

	2006 £000	2005 £000
Net cash flows from operating activities	**181,860**	18,917
Net cash flows from investing activities	**(5,752)**	(2,421)
Net cash flows from financing activities	**(41,495)**	276,289
Net increase in cash and cash equivalents before foreign exchange effects	**134,613**	292,785

Maturity of debt and fixed income securities

	2006 £000	2005 £000
Less than one year	**225,283**	167,175
Between one and two years	**257,883**	295,897
Between three and five years	**307,325**	327,522
Over five years	**192,890**	174,660
Sub-total	**983,381**	965,254
Perpetual notes and other non-dated instruments	**60,288**	63,541
Total debt and fixed income securities	**1,043,669**	1,028,795

Capital

Overview

Hiscox is strongly capitalised with a stable asset and shareholder base. Its activities are funded by a mixture of equity, retained earnings, letters of credit, bank debt and other third party insurance capital. Group assets are invested predominantly in bonds with high credit ratings to ensure a high liquidity and to limit investment risk in the capital base.

The Directors ensure that the use and allocation of capital are given a primary focus in all significant operational actions. Over the last five years, the Group has developed and embedded sophisticated capital modelling tools within its business. These join together short-term and long-term business plans and link divisional aspirations with the Group's overall strategy. The models provide the basis of the allocation of capital to different businesses and business lines, as well as the regulatory and rating agency capital processes.

Gearing

The Group's ability to increase or decrease the volumes of business that it can underwrite relates directly to its level of capital. Hiscox currently utilises short to medium-term gearing as an additional source of funds to maximise the opportunities from strong markets and to reduce the risk profile of the business when the rating environment shows a weaker model for the more volatile business.

The Group's gearing is obtained from a number of sources, including:

- letters of credit – in November 2005, the Group secured a £137.5 million facility from a syndicate of banks at a margin of 1.1 per cent;
- term and revolving loan facility – also in November 2005, the Group secured a $225 million facility at 1.3 per cent margin of which $182 million remains available;
- external Names – 27.5 per cent of Syndicate 33's capacity is capitalised by third parties paying a profit share of approximately 17.5 per cent;
- sidecar – in December 2006, Syndicate 33 entered into a quota share reinsurance arrangement with Panther Re Bermuda Limited, whose sole activity is to participate in the property catastrophe reinsurance business of its only client, Syndicate 33. Panther Re is capitalised at $360 million and all risks underwritten are fully collateralised;
- gearing quota shares – historically the Group has used reinsurance capital to fund its capital requirement for short-term expansions in the volume of business underwritten by the Syndicate;
- qualifying quota shares – these are reinsurance arrangements that allow the Group to increase the amount of premium it writes in hard markets.

The funds raised through letters of credit and loan facilities have been applied to support both the 2007 year of account for Syndicate 33 and the capital requirements of Hiscox Insurance Company (Bermuda) Limited, formed in 2005.

Financial strength

Standard & Poor's and A.M. Best's ratings of the financial strength of the UK insurance company remained at A- during the year. Similarly Hiscox Insurance Company (Bermuda) Limited and Hiscox Insurance Company (Guernsey) Limited retained their A- (Excellent) ratings from A.M. Best. Syndicate 33 benefits from an A.M. Best rating of A+ (Excellent) and the Lloyd's A global rating. The Group is confident of maintaining these excellent ratings.

Capital performance

The Group's main capital performance measure is the achieved Return on Equity (ROE). This marker best aligns the aspirations of employees and shareholders. As variable remuneration, the vesting of options and longer-term investment plans all relate directly to ROE. This concept is embedded in the workings and culture of Hiscox.

Capital modelling and regulation

The capital requirements of an insurance group are determined by its exposure to risk and the solvency criteria established by management and statutory regulations. Hiscox is compliant by a significant margin on every prescribed capital test.

In 2005, the Financial Services Authority (FSA) and Lloyd's introduced a new capital regime that gives insurance companies the chance to calculate their own capital requirements through Individual Capital Assessments (ICA). Hiscox Insurance Company and Syndicate 33 maintain ICA models in accordance with this regime.

The models are concentrated specifically on the particular product lines, market conditions and risk appetite of each entity. If the FSA considers an ICA to be inadequate, it can require the entity to maintain an increased capital safeguard. The Directors are also required to certify that the Group has complied, in all material aspects, with the provisions of the Interim Prudential Sourcebook: Insurers (IPRU(INS)), the Integrated Prudential Sourcebook for Insurers (INSPRU) and General Prudential Sourcebook (GENPRU) when completing the ICA return.

Hiscox used its own integrated modelling expertise to produce the ICA calculations. The results mirrored those driving the existing internal capital setting process.

The assessed capital requirement for the business placed through Hiscox Insurance Company Limited is driven by the level of resources necessary to hold an A rating. The Group's internal work on the ICA of Hiscox Insurance Company has produced results that support the level of capital required by the rating agencies.

For Syndicate 33, the ICA process produces a result that is uplifted by Lloyd's to identify the capital required to hold the A rating. The strong control and risk management environment, together with the sophistication of the modelling, have produced a capital ratio below that suggested under the previous risk-based capital regime.

Another key area of capital modelling for Hiscox is to identify which insurance vehicle produces the best return on capital employed for the Group, given certain restraints from licences, reinsurance and the regulatory environment. This modelling takes into account transactional costs and tax, in addition to the necessary capital ratios. It proves the capital efficiency of Lloyd's, despite a tax disadvantage against offshore entities, and the cost advantage of processing smaller premium business outside of Lloyd's.

In addition to the ICA modelling process, the EU Insurance Group's Directive of 1998, as amended by the Finance Group's Directive (FGD), compels insurance companies that are members of a group to consider the solvency margin of their ultimate parent company. This consideration must refer to the surplus assets of the ultimate parent's related insurers, reinsurers, intermediate holding companies and other regulated entities.

The FGD has been applied in the UK through INSPRU and GENPRU. In accordance with these provisions, the parent company's solvency margin consideration will become a minimum capital requirement for the Group from 31 December 2006. The estimated regulatory capital position of the Group under FGD at 31 December 2006 was a surplus of £435 million (2005: surplus of £343 million), which is calculated as below. The final audited regulatory capital position will be submitted to the FSA before 30 April 2007 in accordance with the required regulatory timetable.

In the Group's other geographical territories, including the USA, it is required to operate within broadly similar risk-based capital requirements when accepting business.

Capital position (Unaudited)

At 31 December	2006 £m	2005 £m
Group capital resources	617	494
Group capital resources requirement	(182)	(151)
Surplus	**435**	343

Risk management

Risk management framework

The risk management framework extends to all aspects of risk including insurance risk, market risk, credit risk, operational risk, liquidity, social, environmental and ethical risk.

The core business of Hiscox is dealing with risk. The understanding of risk is intrinsic to every level of decision-making in the Group.

The risks associated with the core business represent some of the greater exposures, however the Group is exposed to a number of other risks and has developed systems and procedures to identify and manage them.

Risk appetite is set by the main Board and cascaded down into the Group's operations through management and specialist committees. These latter committees have terms of reference that assign specific areas of focus, and oversee activities such as underwriting, loss modelling, reinsurance purchase and security, overdue debt, investments, claims reserving and business continuity.

Senior management responsibilities are clearly identified together with their reporting lines and the execution of delegated responsibility is closely monitored by reporting to the Board and its committees. This monitoring, supported by financial and non-financial management information, covers performance against agreed targets and objectives, as well as the risks to achieving these objectives and the effectiveness of the measures in place to manage these risks.

In parallel with these direct risk management processes, there is a dedicated risk management function which, in conjunction with Internal Audit, monitors and reviews the effectiveness of risk management throughout the organisation and reports to the Board.

These functions are organised centrally to assist in the integration of best practice throughout the Group. Risk management tools allow individual Group businesses to assess their own risks locally whilst feeding into weighted global reports at Group level.

Major risks

The major risks that the Group faces are presented below. A number of these factors are common to all insurance businesses, while others are relevant to Hiscox specifically. For a discussion of the major risks and uncertainties impacting the Group's financial statements, see note 3 to the financial statements.

Catastrophe and systemic insurance losses

Like other insurers, the Group's earnings can be affected by unpredictable events and circumstances. These may include, but are not limited to, conditions such as natural and other catastrophes, legal developments, social change and the emergence of latent risks. Such events could create significant levels of losses if the Group's underwriting models, aggregation tools and policy wordings do not prevent unplanned concentrations of risk, both in geographical regions and types of policy.

The failure to manage concentrations of exposure is therefore the single greatest risk to Hiscox.

The Group continues to underwrite significant risks in geographical regions that are prone to natural peril. This book of business remains a compelling proposition for the Group, since it is capable of returning impressive margins over the medium- to long-term as the occurrence of catastrophes averages out.

By its nature, this business requires that underwriting staff exercise the greatest levels of foresight. The Group has developed robust risk management and mitigation techniques in preparation for the challenges that these risks present. These techniques are designed to shield the core capital base of the Group against unexpected, repeat clusters of all but the most destructive of events.

The portfolio of risks is actively managed to maintain a balanced and diversified book. This is supported by the use of exposure aggregation and scenario modelling tools and by the purchase of a reinsurance programme designed to cap losses from concentrations of risks. Policy wordings are reviewed regularly in the light of legal developments to ensure that the Group's exposure is restricted, where possible, to those risks identified at the time of policy issuance.

The modelling and monitoring tools are used both in the underwriting process and by independent risk specialists. They are used to design the insurance and reinsurance programmes and control the business underwritten to ensure that the risk profiles of contracts match the exposures for which the programmes were devised.

Aggregation and modelling resources are shared across the Group. Management at Hiscox insurance subsidiaries worldwide are therefore able to adopt the Group's existing methodologies and models, albeit tailored to the intricacies of that particular market.

Hiscox also runs realistic disaster scenario projections for each Group entity and for the Group as a whole. The Group's maximum net retentions based on the estimated losses from these scenarios are outlined in note 3.1 to the financial statements.

The Group's performance relative to the unprecedented impact of catastrophes on the industry in recent years highlights the ability of its models to suggest precise and logical reinsurance placements. It also shows the distinctive benefits that Hiscox derives from its diversification in coverage and geography. By writing a well diversified book with a large focus on uncorrelated retail business, Hiscox is able to offset losses on its more volatile accounts.

Competition and the insurance cycle

The principal markets for the Group's products continue to grow. Hiscox companies are expanding further into the USA and Bermuda and extending their regional presence in the UK and Europe.

In all of these markets around the world, Hiscox competes against major international groups with very similar offerings. At times, a minority of these groups may choose to underwrite for cash flow or market share purposes and at prices that sometimes fall short of the suggested breakeven technical price.

The Group is firm in its resolve to reject business that is unlikely to generate underwriting profits. Accepting insurance risk below the technical price is detrimental to the industry's prospects, since it drives the prevailing rates in the market lower to the point where business failures occur, insurers' capital is destroyed, customers receive sub-optimal service and the industry suffers from negative publicity. As capacity levels in the market fall, prices inevitably rise until the point where the cycle of irrational pricing may begin again.

In common with all insurers, the Group is exposed to this price volatility. Prolonged periods of low premium rating levels or high levels of competition in the insurance markets are likely to have a negative impact on the Group's financial performance. Pricing levels are monitored on a continuous basis with monthly reports showing both current levels and trends over the past 12 months throughout a wide range of products.

To counter this, Hiscox alters its appetite for the lines of business and the layers it writes within them in response to market conditions and the risk appetite of the Group. The Group's cycle management strategy and related modelling and monitoring are essential to ensure that it controls any accumulating adverse effects of changes. As the Group frequently acts as the lead insurer in the complex co-insurance programmes required to cover significant high value assets, it has some ability to set market rates rather than follow them.

Mutualisation is a related risk arising from the phenomenon of pricing cycles in the industry. The Group is required to contribute towards obligations arising from poorly priced risks accepted by other insurers who subsequently fail. Syndicate 33 contributes to the New Central Fund operated by the Council of Lloyd's and in the UK, certain Hiscox entities contribute to the Financial Services Compensation Scheme (FSCS). Should the level of failures escalate, the Group could be subject to additional or special levies by Lloyd's or the FSCS.

The Group participates in many industry bodies, associations and task-force initiatives in order to monitor developments and influence their strategic direction. In particular, the involvement of the Group's executives in the reshaping of the Lloyd's market over the last decade underscores that commitment.

Binding authorities and other outsourcing
Hiscox writes a considerable amount of premium income through agents to whom binding authority is given to accept risks on behalf of Hiscox Group insurance vehicles. Binder management exists as a separate discipline outside of the underwriting process at Hiscox. All delegations are strictly controlled through tight underwriting guidelines and limits and extensive monitoring, review and auditing of the agencies. However, as there is no absolute guarantee that an agent will comply with the terms of its authority, Hiscox could be exposed to unanticipated losses.

Other business areas where the Group is to some extent reliant on the timely and effective supply of services from third parties include back office policy processing, data entry and cash collection. Although the Group manages these relationships to ensure continuity and quality of service, events could occur beyond its control that could affect these third parties and in turn impact on the Group's performance.

The Group selects its agents and business partners carefully. Significant areas of outsourcing undergo a rigorous tendering process, where numerous attributes other than just price competitiveness are given due consideration. All third parties operate within the terms of formal service level agreements, with repercussions for underperformance.

Credit risk with reinsurance counterparties
The Group purchases reinsurance protection to contain exposure against its capital from single claims and the aggregation of claims from catastrophic events.

The Group places reinsurance with companies that it believes are strong financially and operationally. The limits on reinsurance counterparty risk are recommended by the Reinsurance Security Committee, which meets regularly under the chairmanship of the Group Finance Director. Evaluation criteria include financial strength, trading record, payment history, outlook and organisational structures. Information is drawn from the following sources: public information produced by the company; the Group's experience with the reinsurer and knowledge of their behaviour in the marketplace; analysis from a reinsurance consultant; rating agency commentary and gradings.

Recently there has been a development of so-called 'sidecars', reinsurance vehicles which participate in the business of another insurer, but which are separately capitalised or offer security or both. These companies may offer very high levels of reinsurance but are often vehicles of only a limited and very short-term duration and their attractiveness is highly dependent upon the amount and quality of collateralisation offered. Some reinsurance transactions have been entered into with these vehicles but each has been individually approved. There remains a risk that in the event of this shorter-term capacity being withdrawn following large losses it may be more difficult to replace in the conventional market. In addition the Group is the sole client of Panther Re Bermuda Limited, a Bermudian reinsurer that takes a 40 per cent share of certain property catastrophe reinsurance lines written by Syndicate 33.

An analysis of the insurance assets receivable from the Group's major reinsurance partners, by reference to their underlying Standard & Poor's or equivalent ratings, at 31 December is as follows:

	31 December 2006 £000	31 December 2005 £000
AAA	**20,892**	27,784
AA	**130,155**	150,896
A	**121,261**	311,370
Other/not rated	**30,464**	16,326
	302,772	506,376

The Group's experience of bad debt losses arising from its reinsurance arrangements has been minimal.

Risk management continued

Claims volatility
The Group establishes provisions for unpaid claims, defence costs and related expenses to cover its ultimate liability in respect of both reported claims and incurred but not reported (IBNR) claims. These provisions take into account both the Group's and the industry's experience of similar business, historical trends in reserving patterns, loss payments and pending levels of unpaid claims and awards.

Reserve estimates are subject to regular monthly reviews. Adjustments are made to take into account management's latest view of the probable ultimate liability, based on claims and other developments and new data. Yet there can be no absolute guarantee that the ultimate losses will not differ materially from the provisions the Group has established. It is particularly difficult to estimate IBNR claims and those arising from large catastrophes.

Note 24 to the financial statements provides information on the Group's estimation of ultimate claim costs over recent years. Additional information is provided in note 3 to the financial statements.

Business continuity
It is critical for Hiscox that the key resources required to support insurance underwriting and other essential business activities continue to be available. The Group has taken significant steps to mitigate the impact of business interruptions that may result from a variety of events, including the loss of key individuals and facilities such as premises, computer networks and communications.

The Group's business could be affected adversely if staff were to be prevented from using its major premises for any reason. The Group's staff are now widely distributed with offices around the UK, Europe, USA, Bermuda and Guernsey. Less than half of the Group's personnel are based in London. This geographical dispersion reduces the Group's exposure to natural, operational and terrorist events that could prevent access to its premises.

The business also relies on IT and telecommunications systems. Whilst the Group considers its systems to be resilient, their failure or impairment, or the inability to transfer data onto any new systems introduced, could cause a loss of business and/or damage to the reputation of the Hiscox Group, as well as remedial costs.

The most difficult continuity risk for Hiscox to manage is the loss of key staff. The recruitment and retention of high quality people is of fundamental importance to Hiscox and the Group takes the risk of losing such assets very seriously. To maintain the loyalty of staff, the Group provides competitive remuneration packages and benefits as well as extensive training and support and a unique culture that embraces the individual and their aspirations. More information about Hiscox's investment in its people can be found on pages 22 and 23.

In the event that key staff do leave, the Group's contingency plans ensure continuity of service both internally and to policyholders. These include cross-training and rotation of duties to ensure that staff can perform multiple roles. Most staff work in teams rather than in isolation, which lessens the impact of normal staff turnover on the business.

Hiscox has a formal disaster recovery plan that addresses its premises and technology related risks. Robust contingency strategies are in place for both workspace recovery and back up of data-centres and communications. In the event of an outage, these procedures will enable the Group to move operations to alternative facilities within very short periods of time. The alternative facilities are supplied by separate localised utility grids and telecommunications carriers.

The disaster recovery plan is tested regularly and the Group also performs disaster simulations.

Currency fluctuations
The US Dollar is the Group's largest underwriting currency. A significant proportion of the Group's US Dollar insurance liabilities are supported by investments held in the same currency. However, as a significant proportion of the Group's operational cost base is located in the UK and Europe, movements in foreign exchange rates may have a material adverse effect on its financial performance and position.

Further details of the Group's investment profile and its management of currency risks are provided in notes 3, 18 and 20 to the financial statements.

Investment returns
The Group's entities hold significant portfolios of investments to support their obligations, including their insurance liabilities, and their profits depend in part upon the returns that these achieve. Changes in interest rates, equity returns and other economic variables can therefore affect the Group's financial performance substantially.

A fall in the capital value of their investments could result in a reduction in the level of business that each entity is able to underwrite. In addition, a major insurance loss or unexpected sequence of attritional losses could result in a sustained cash outflow that might require the early realisation of investments on unfavourable terms.

The Group has a detailed investment strategy that seeks to minimise the concentration of investment risk in any one particular sector or issuer.

Regulation
The Group's entities are incorporated and transact business in a variety of countries and states, all of which require strong levels of accountability to the local regulatory authorities.

The various Hiscox businesses operating in the UK are subject to high levels of regulation from the FSA and the Council of Lloyd's. The numerous regulatory bodies that oversee the Group's international operations include the Guernsey Financial Services Commission, the Bermuda Monetary Authority and individual state insurance departments in the USA. These bodies all have significant powers of intervention including the ultimate sanction of removing the authorisation to carry on insurance business.

Regulatory action could affect the Group's results and position in numerous ways. For example, it could be required to allocate inefficient levels of capital around the Group in order to overcome minimum regulatory hurdles, or bear the costs of implementing new compliance or sophisticated computer modelling systems. Continual changes in, or inappropriate levels of, regulation in the Group's markets could also result in their becoming uncompetitive or unattractive to customers, which might lead them to place their insurance business in other alternative markets in which the Group has no presence.

Hiscox devotes considerable resources throughout the Group to meet its regulatory obligations. The senior management of each Hiscox business maintains constructive, productive and valuable relationships with all of the regulatory bodies in their respective territories. Furthermore, the Group debates all current regulatory issues and encourages the development of new initiatives in areas such as risk management and reporting that will help safeguard the future of the industry.

Rating agencies
The ability of the Group's insurance operations to write certain classes of business, including reinsurance, may be affected by a change in the financial strength or credit rating issued by an accredited rating agency such as A.M. Best, Moody's or Standard & Poor's.

Syndicate 33 has its own rating and also benefits from the Lloyd's global rating. The Lloyd's rating could be affected by matters outside of the Group's influence or control. Hiscox Insurance Company Limited, Hiscox Insurance Company (Guernsey) Limited and Hiscox Insurance Company (Bermuda) Limited have their own separate ratings from accredited agencies.

A downgrading of any of the rated entities could have a material adverse impact. The Group might cease to meet the security criteria of brokers, resulting in a loss of new business, policy cancellations and non-renewals. The Group's borrowing facilities might also be subject to review.

The Group maintains an excellent relationship with the agencies that rate its entities. Group senior management holds several meetings with representatives from the agencies each year and give due consideration to the likelihood of rating consequences before executing any significant strategic action.

Corporate responsibility

Fundamental to corporate and social responsibility is honest and fair dealing in all activities of the Company. Hiscox has always been extremely conscious of its reputation. Management has always believed that a reputation for integrity and decent behaviour in all dealings, be they within the Group or with those from outside who come in contact with the Group, will be good for morale and for the results of the business.

Robert Hiscox

Hiscox's commitment to responsible business practices is reflected:

In the marketplace

Dealing with customers

Hiscox is dedicated to advising customers on risk management to prevent burglary and fire in the home and other distressing losses. Should a loss occur, the Hiscox philosophy is that insurance is a promise to pay, and the Group's claims service aims to support customers and make them whole as soon as possible. Hiscox also provides high quality risk management advice for commercial customers and again should a loss occur, its claims service aims to restore business continuity with minimum disruption. The Group pioneered the use of clear wordings on insurance policies, especially those intended for private customers. In addition, policies are normally inclusive, which means that risks are covered unless excluded specifically.

Customer feedback is considered carefully and used to enhance future products and services.

Dealing with business partners

Insurance brokers are an important Hiscox stakeholder, and Hiscox endeavours to have good relationships with them to create a competitive advantage in the marketplace. Clear communication is key to good relations and a quarterly Hiscox broker magazine keeps brokers informed of developments at Hiscox and in the insurance industry. In 2006, the Group ran an extensive regional programme of presentations by Hiscox senior management to local brokers to explain the Group's business strategy and understand how the Group can further improve its service.

Dealing with investors

In keeping with its policy of open and transparent communication, Hiscox reports both its half and full year results to its investors via a series of presentations as well as ensuring all relevant Group financial information is available from its website. In addition, senior management and key performers meet investors and analysts to explain and take questions on the Group financial performance and business strategy.

In the workplace
Hiscox wants to employ the best people and provide them with the means and the motivation to excel. This is achieved with fair rewards and by providing staff with an environment in which they can enjoy their work and reach their full potential. Hiscox recognises how important it is for employees to maintain a healthy work-life balance and gives staff the option of flexible and home working wherever possible. More information can be found on pages 22 to 23.

Equal opportunities
Hiscox is committed to providing equal opportunities to all employees and potential employees in all aspects of employment regardless of disability, sex, race, religion, sexual inclination or background.

Rewards and benefits
Hiscox encourages employees to identify with the success of the Group through performance-related pay and bonus schemes, savings-related share option schemes and executive share option schemes. Competitive benefits packages contain health, fitness, flexible working and career break opportunities. Salary packages are benchmarked by Watson Wyatt against the financial services industry as a whole and against the Lloyd's market specifically, when applicable.

Training and development
Hiscox is committed to training and developing its employees to help them maximise their potential. Each permanent member of staff is provided with a tailored personal development programme. Training and development needs are reviewed twice a year, along with performance, against clearly set objectives.

Communication and participation
Employees are kept informed of business developments through formal briefings, team meetings, intranet bulletins, video conferences and informal routes. Management takes these opportunities to listen to staff and involve them in taking the business forward. A monthly staff magazine provides updates on issues and social events.

Culture
The Hiscox culture is underpinned by a set of core values that determine the standard of behaviour expected of employees. These core values – challenge convention, integrity, respect, courage, quality and excellence in execution – guide everything that Hiscox does in its business (for more information on Hiscox's values see page 20). By conducting its business with these core values in mind, the Group recognises that it is more likely to achieve business success and create value for its shareholders. Hiscox strives for the highest standards of corporate governance while being in essence a non-bureaucratic organisation. An effective and firm system of internal controls ensures that risks are managed within acceptable limits, but not at the expense of innovation or speed of response. The Group believes that it has got this balance right and that it is one of its greatest strengths. The Group's policies ensure that it continues to follow a best practice approach to managing its people and remains a fair and professional employer. In the unlikely event of an employee having a material concern relating to the operations of the business, a whistleblowing policy explains to staff how they can confidentially raise their misgivings.

Hiscox also subscribes to Public Concern at Work, which provides free legal advice to any employee with a concern about possible danger or malpractice in the workplace.

In the community
In total, Hiscox donated £567,000 to charities in 2006. As the Group expands throughout the world, it aims to recruit local staff wherever possible to help develop a rapport with the local community and make a direct contribution to the local economy.

The Group has maintained its involvement in its local communities with the strong support of its employees. Hiscox is a member of the Lloyd's Community programme, which supports local initiatives concerning education, training, enterprise and regeneration. In London for example, the Reading Partners scheme has continued, through which staff assist pupils at the Elizabeth Selby Infants School in Tower Hamlets. Employees also mentor students at Morpeth School in Tower Hamlets. In Bermuda, Hiscox supports the Bermuda Sunshine League which is a transitional living facility for children removed from unstable living environments and gives employees the opportunity to contribute their time and effort to children who require adult role models and a semblance of stability.

Supporting the arts
Hiscox Art Projects, a contemporary exhibition space situated in the London office with free entry to the public, continues to provide artists with an opportunity to exhibit their talents. In 2006 the exhibition included work from five graduates from the prestigious Ecole Nationale Supérieure des Beaux-Arts in Paris as well as work from Stephen Cornell, and a first solo exhibition from Matthew Wilkinson. The Group has also committed to a multi-year donation towards the Bermuda Masterworks Foundation, which aims to repatriate artworks by Bermudian artists or featuring Bermuda landscapes/seascapes.

The Hiscox Foundation
The Hiscox Foundation, a charity funded by an annual donation from Hiscox, has been set up to give donations to deserving causes. It gives priority to any charity in which a member of staff is involved with the aim of encouraging and developing such activity.

Hiscox staff also continued their five year long support of the Richard House Hospice, raising over £19,000 through various initiatives during 2007. One such initiative was the annual Three Peaks Challenge. Twenty people took part in a climb of the UK's highest peaks – Snowdon, Ben Nevis and Scafell Pike, raising over £9,000 for the charity.

In the environment
The way customers conduct their business is of paramount importance to the Group. Hiscox's approach to underwriting their risks will take into account customers' attitudes to all aspects of their business, including care of the environment.

The Group's direct environmental impact is mainly from the energy it uses and the emissions and waste it generates from its premises. In accordance with the Group's Environmental Policy, consumables are recycled and reused wherever possible. The Group is taking steps to reduce the amount of raw materials used in business processes and by staff particularly through the extensive use of computerisation and communications technology. During 2006, Hiscox began to upgrade its computer printers to multi-function devices capable of scanning, photocopying and double-sided printing. This will reduce the cost of consumables and waste volumes and increase the efficiency of document storage, search and retrieval. Programmes for recycling batteries, mobile phones, lamps and CDs continued during the year.

The Group's efforts were rewarded by a Gold Clean City Award from the City of London Corporation, which aims to promote good waste management practices and encourage waste minimisation, reuse and recycling. A Hiscox representative attends meetings organised by the City of London Corporation to keep abreast of environmental best practice and exchange ideas with other like-minded companies.

Board of Directors

Executive Directors

1 Robert Ralph Scrymgeour Hiscox
Chairman (Aged 64)
Robert Hiscox joined Hiscox in 1965 and has been Chairman of the main holding company of Hiscox since 1970. He was Deputy Chairman of Lloyd's between 1993 and 1995. He is a Non Executive Director of Grainger Trust plc.

2 Bronislaw Edmund Masojada
Chief Executive (Aged 45)
Bronek Masojada joined Hiscox in 1993. From 1989 to 1993 he was employed by McKinsey and Co. Bronek served as a Deputy Chairman of Lloyd's from 2001 to 2007 and as Chairman of the Lloyd's Underwriting Agents Association from 1998 to 2001. He was a Non Executive Director of Ins-sure Holdings Limited from 2002 to 31 December 2006 and is a past president of The Insurance Institute of London.

3 Stuart John Bridges
Group Finance Director (Aged 46)
Stuart Bridges joined Hiscox in 1999. He is a chartered accountant and has held posts in various financial service companies in the UK and US, including Henderson Global Investors. He was a member of the Financial Reporting Council's review group on The Turnbull Guidance on Internal Control.

4 Robert Simon Childs
Chief Underwriting Officer
Chief Executive Officer of Hiscox Bermuda
Chairman of Hiscox USA (Aged 55)
Robert Childs joined Hiscox in 1986, served as the Active Underwriter of the Hiscox Lloyd's Syndicate 33 between 1993 and 2005, and is the Group's Chief Underwriting Officer. Robert was Chairman of the Lloyd's Market Association from January 2003 to May 2005.

▲ Member of the Audit Committee
● Member of the Conflict Committee
■ Member of the Remuneration and Nomination Committee
Chairman of Committee highlighted in red

Independent Non Executive Directors

5 Carol Franklin Engler▲●■
Non Executive Director (Aged 55)
Carol Franklin Engler joined Hiscox in 1999. She is the Ombudsman for the Swiss telecommunication industry and the Executive Chairman of Forests for Friends Ltd in Switzerland. Carol was the Chief Executive Officer of the World Wide Fund for Nature in Switzerland from 1999 to 2002. From 1979 to 1999 she was employed by Swiss Re in a variety of roles including Head of the Aviation Department and Head of Human Resources.

6 Daniel Maurice Healy▲●■
Non Executive Director and Chairman of the Audit Committee (Aged 64)
Daniel Healy joined Hiscox in 2006. He was appointed Executive Vice President and Chief Financial Officer of North Fork Bancorporation in 1992 and a member of its Board of Directors in 2000. He was a partner with KPMG LLP before joining North Fork. He was the Managing Partner of the San José, California and Long Island, New York offices and held other positions in that firm during his tenure. He holds Board positions with KBW, Inc. and Harlem RBI, a not for profit organisation.

7 Dr James Austin Charles King▲●■
Non Executive Director and Chairman of the Conflict Committee (Aged 67)
Dr James King joined Hiscox in 2006. He chairs Keytech Limited, The Bermuda Telephone Company Ltd, the Argus Group of Companies, Grotto Bay Properties Ltd and the Establishment Investment Trust, a UK listed company. He was chairman of the Bank of N.T. Butterfield & Son Limited until 19 April 2007. He is a Trustee of the Bermuda Institute of Ocean Sciences and a Director of Castle Harbour Limited. Dr King is a fellow of the Royal College of Surgeons, Canada and the American College of Surgeons.

8 Sir Mervyn Pedelty●■
Senior Independent Director and Chairman of the Remuneration and Nomination Committee (Aged 58)
Sir Mervyn Pedelty joined Hiscox in 2005. He was previously the Chief Executive and an Executive Director of The Co-operative Bank plc (from 1997 until his retirement in 2004) and also of Co-operative Financial Services Limited and the Co-operative Insurance Society Limited (from 2002 to 2004). He was a Director of the Association of British Insurers (from 2002 to 2004) and is a former Council Member of the British Bankers' Association. Sir Mervyn is a Chartered Accountant and a Chartered Banker. His other current appointments include: independent Director of Friends Provident plc, Chairman of the FTSE4Good Policy Committee, a Director of Business in the Community Limited and Symphony Hall (Birmingham) Limited and a Senior Adviser to Permira Advisers LLP.

9 Andrea Sarah Rosen▲●■
Non Executive Director (Aged 52)
Andrea Rosen joined Hiscox in 2006. She was appointed as a Director of Emera Inc. on 24 January 2007. She was previously Vice Chair of TD Financial Group and President of the TD Canada Trust from 2002 to 2005. Prior to this she held various positions within the TD Financial Group from 1994 to 2002, including Executive Vice President of TD Commercial Banking and Vice Chair of TD Securities. She was Vice President of Varity Corporation from 1991 to 1994 and held various positions with Wood Gundy Inc. from 1981 to 1990.

10 Dirk Arie Stuurop▲●■
Non Executive Director (Aged 58)
Dirk Stuurop joined Hiscox in 2006. He is managing partner of Lighthouse Holdings LLC. In 2004 he was appointed Vice Chairman of the Board of RAM Holdings Limited, a Bermudian domiciled financial guaranty reinsurance operation. From 1999 to 2006, Dirk was President of Stuurop & Company, a privately owned firm providing strategic advice to executive managements and boards of directors. In 1999 he retired as Chairman of Global Financial Institutions at Merrill Lynch where he worked from 1982. He served as Chairman of Worldinsure Ltd, from 2000 to 2002 and as Senior Executive Director to Banc of America Securities in 2003.

Secretary
Robin Mehta

Registered office
Canon's Court
22 Victoria Street
Hamilton HM 12
Bermuda

Registered number
38877

Auditors
KPMG
Crown House
4 Par-la-Ville Road
Hamilton HM 08
Bermuda

Solicitors
Appleby Hunter Bailhache
Canon's Court
22 Victoria Street
PO Box HM1179
Hamilton
HMEX Bermuda

Bankers
Bank of Bermuda – HSBC
6 Front Street
Hamilton HM 11
Bermuda

Stockbrokers
UBS Limited
1 Finsbury Avenue
London EC2M 2PP

Registrars
Capita Registrars (Jersey) Limited
Victoria Chambers
Liberation Square
1-3 The Esplanade
St Helier
Jersey JE4 0FF

Corporate governance

Overview and basis of reporting

Up until 12 December 2006 responsibility for the corporate governance of the Hiscox Group resided in Hiscox plc. With the introduction of Hiscox Ltd as a Bermudian domiciled holding company for the Group, this responsibility transferred to Hiscox Ltd ('the Company'). On 12 December 2006, Hiscox plc was delisted and Hiscox Ltd was admitted to the Official List of the UK Listing Authority and to trading on the London Stock Exchange's main market for listed securities in its place.

Bermuda does not have a corporate governance regime and as the Company is incorporated in Bermuda it is not bound by the Combined Code. However, Hiscox remains committed to high standards of corporate governance and has therefore undertaken to comply voluntarily with the Combined Code.

The corporate governance report covers Hiscox plc up until 12 December 2006 and Hiscox Ltd from that date until year end. References to the Board are to the Board of Hiscox Ltd, unless otherwise stated.

During 2006, and up to the date of this report and accounts, the Group has complied with the provisions of the Combined Code in all material respects.

The Board of Directors

The Board comprises four Executive Directors and six independent Non Executive Directors, including a Senior Independent Director.

Brief biographical details for each member of the Board are provided on page 39.

The roles and activities of the Chairman and Chief Executive are distinct and separate. The Chairman is responsible for running an effective Board and overall strategy, and the Chief Executive has responsibility for running the Group's business.

In accordance with the Company's Bye-Laws, all Directors are required to submit themselves for re-election by the shareholders at this year's Annual General Meeting (AGM) as it is the first AGM of the Company. At the second, third and fourth AGM a third of all Directors shall submit themselves for re-election, so that all Directors shall have been re-elected during this period. Thereafter all Directors are required to submit themselves for re-election at least every three years.

All Directors are entitled to seek independent professional advice at the Company's expense. A copy of the advice is provided to the Company Secretary who will circulate it to all Directors. No such advice was sought during the year.

The Board meets at least four times a year and operates within established terms of reference. It is supplied with appropriate and timely information to enable it to review business strategy, trading performance, business risks and opportunities.

The Board of Hiscox plc met four times in the period from 1 January 2006 to 12 December 2006. All Directors attended the AGM in 2006. The Board had met and established an appropriate corporate governance structure and committees prior to the transfer of the listing on the London Stock Exchange from Hiscox plc, but did not meet between 12 December 2006 and year end.

The Board has an agreed Schedule of Matters Reserved for the Board, a copy of which can be found on the Group's website: www.hiscox.com. The Board retains ultimate authority for high level strategic and management decisions including: setting Group strategy, approving significant mergers or acquisitions, approving the financial statements, declaration of the interim dividend and recommendation of the final dividend, approving Group business plans and budgets, approving major new areas of business, approving capital raising, approving any bonus or rights issues of share capital, setting Group investment guidelines, approving the Directors' remuneration, approving significant expenditure or projects, and approving the issue of share options. The Board has however authorised the boards of the trading entities and business divisions to manage their respective operational affairs, to the extent that Company Board level approval is not required.

The Board's committees

The Board has appointed and authorised a number of committees to manage aspects of the Group's affairs. Each committee operates within established written terms of reference and each committee Chairman reports directly to the Board.

The Group Executive Committee

The Group Executive Committee, comprised of the Executive Directors, meets monthly to raise and discuss topics such as Group strategy (subject always to Board approval), approval of senior appointments and remuneration (other than Board appointments), management of the Group's trading performance, mergers and acquisitions (which are not significant to the Group), significant issues raised by the London and International executive committees and approval of exceptional spend within the limits established by the Board. The London Executive Committee considers day-to-day issues arising from the Group's UK and mainland Europe businesses. The International Executive Committee considers issues arising from the Group's Bermuda, Guernsey and US businesses.

The Audit Committee

The Audit Committee of Hiscox plc comprised Adrian Auer as Chairman of the Committee together with Anthony Howland Jackson, Derek Netherton and Carol Franklin Engler until 12 December 2006. Following the re-domicile, the Audit Committee of the Company comprises Daniel Healy as Chairman of the Committee together with Carol Franklin Engler, Dirk Stuurop, Andrea Rosen and Dr James King.

The Audit Committee meets at least four times a year to assist the Board on matters of financial reporting, risk management and internal control. The internal and external auditors have unrestricted access to the Audit Committee, which monitors the scope, results and cost effectiveness of the internal and external audit functions, the independence and objectivity of the external auditors, and the nature and extent of non-audit work undertaken by the external auditors together with the level of related fees. All non-audit work undertaken by the Group's external auditors with fees greater than £50,000 must be pre-approved by the Audit Committee. KPMG has confirmed to the Audit Committee that in its opinion it remains independent. The Committee is satisfied that this is the case.

The Remuneration and Nomination Committee

Following the Group re-organisation the Remuneration and Nomination Committees have been merged into a single committee.

Between 1 January and 12 December 2006, the Remuneration Committee comprised Anthony Howland Jackson as Committee Chairman, Derek Netherton, Adrian Auer, Sir Mervyn Pedelty and Carol Franklin Engler.

Between 1 January and 12 December 2006, the Nomination Committee was chaired by Carol Franklin Engler and comprised Robert Hiscox, Anthony Howland Jackson, Derek Netherton, Adrian Auer and Sir Mervyn Pedelty.

The Remuneration and Nomination Committee is chaired by Sir Mervyn Pedelty and comprises Carol Franklin Engler, Dirk Stuurop, Daniel Healy, Andrea Rosen and Dr James King. It meets a minimum of two times a year to deal with appointments to the Board and to recommend a framework of executive remuneration. The Committee employs external search and recruitment agencies when considering new appointments. The Directors' remuneration report is presented on pages 42 to 47.

Prior to 12 December 2006, the Remuneration Committee met twice, however the new Combined Committee did not meet between 12 December 2006 and year end.

Due to the re-organisation the Nomination Committee did not meet in either company during 2006, however, the Board of Hiscox plc approved the newly constituted Hiscox Ltd Board prior to the handover. An intensive process using a combination of headhunting companies and known contacts was implemented to locate suitable Non Executive Directors for Hiscox Ltd.

The Conflicts Committee

The Group has a Conflicts Committee which is comprised of independent Non Executive Directors from within the Group, and chaired by Dr James King. It meets as and when required. Should a potential conflict of interest arise, there is a formal procedure to refer the matter to this Committee. Conflicts of interest arise from time to time because Syndicate 33 is managed by a Hiscox-owned Lloyd's Managing Agency. 27.5 per cent of the Names in the Syndicate are third parties; 72.5 per cent of the Syndicate is owned by a Hiscox Group company. The Conflicts Committee serves to protect the interests of the third party Syndicate Names.

Risk Committees

There are a number of committees within the Group which have been established to deal with key risk areas, including committees covering reinsurance risk, liquidity risk, credit risk, business continuity risk and market risk. These committees are comprised of Directors within the Group companies and relevant senior employees.

Performance evaluation

As part of the move to Bermuda, the Board was reconstituted during the year. Prior to this reconstitution, the mix of skills and experience of all directors was evaluated and balanced against the need to have directors who had experience of running Bermudian companies.

Following the evaluation, the Executive Directors of Hiscox plc were retained in their existing roles by the Company. Sir Mervyn Pedelty and Carol Franklin Engler were retained as Non Executive Directors and four new appointments were made to complete the Board: Daniel Healy, Dr James King, Andrea Rosen and Dirk Stuurop. As part of the handover, the Board of Hiscox plc approved the newly constituted Board.

During the year, the Non Executive Directors met with the Chairman to discuss a wide range of issues, including the performance of the Executive Directors of the Board and senior management. No major issues regarding the performance of the Board were raised.

The Non Executives met without the Chairman and the Executive Directors during the year. The main issue arising from those meetings was the requirement for a dedicated Company Secretarial function and this has been implemented.

The Chief Executive held one-to-one meetings with each of the Executive Directors to discuss their performance over the year and to set targets for the year ahead. Similarly, the Chairman evaluated the performance of the Chief Executive and of the Non Executive Directors.

Shareholder communications

The Executive Directors communicate and meet directly with shareholders and analysts throughout each year, and do not limit this to the period following the release of financial results or other significant announcements.

All Directors endeavour to attend the Annual General Meeting.

In addition to the Executive Directors, the Senior Independent Director attends the six-monthly analysts' meeting. The Company also commissions independent research on feedback from shareholders and analysts on a regular basis following the Company's results announcements. This research together with the analysts' research notes are copied to the Non Executive Directors in full. The Chairman attends a number of meetings with shareholders as well as speaking at the analysts' presentations. In addition, any specific items covered in letters received from major shareholders are reported to the Board. Major shareholders are invited to request meetings with the Senior Independent Director and/or the other Non Executive Directors, and they have been given the contact details of the Senior Independent Director.

An alert service is available on www.hiscox.com to notify any stakeholder of new stock exchange announcements.

Accountability and internal control

The Directors are responsible for maintaining a sound system of internal control to safeguard shareholders' investment and the Company's assets, and for reviewing its effectiveness.

The risk management systems are set out in detail in the risk management report on pages 32 to 35.

The Board has reviewed the effectiveness of internal controls during 2006, including financial, operational and compliance controls. The Board confirms there is an ongoing process for identifying, evaluating and managing the significant risks faced by the Company, which has been in place throughout the year and up to the date of approval of the Annual Report and Accounts and accords with the guidance in the document, *"Internal Control: Guidance for Directors on the Combined Code"*. The head of each business area is responsible for implementing the risk management programme in their area of operations. The Risk Management team collates risk management information and the Head of Risk and the risk committees monitor significant risks and any movement in risk, and review the relevant control procedures. The Board receives reports on these issues at least bi-annually, and more frequently if necessary. Action will be taken whenever the need for additional controls and mitigation is identified.

The Group also has an Internal Audit function which has direct access to the Audit Committee and reports to it regularly.

The Board acknowledges that it is neither possible, nor desirable, to eliminate risk completely. The system is designed to manage rather than eliminate the risk of failure to achieve business objectives, and can only provide reasonable and not absolute assurance against material misstatement or loss. The constant aim is to be fully aware of the risks to which the business is exposed and to manage these risks to acceptable levels.

Meetings and attendance table

	plc Board		Audit Committee		Nomination Committee		Remuneration Committee	
Director	Meetings	Attended	Meetings	Attended	Meetings	Attended	Meetings	Attended
RRS Hiscox	4	4	n/a	n/a	0	0	n/a	n/a
BE Masojada	4	4	n/a	n/a	n/a	n/a	n/a	n/a
SJ Bridges	4	4	n/a	n/a	n/a	n/a	n/a	n/a
RS Childs	4	4	n/a	n/a	n/a	n/a	n/a	n/a
AR Auer	4	4	3	3	0	0	2	2
C Franklin Engler	4	3	3	1	0	0	2	1
DM Healy	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
AGC Howland Jackson	4	3	3	3	0	0	2	2
Dr J King	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
DND Netherton	4	4	3	3	0	0	2	1
Sir Mervyn Pedelty	4	4	n/a	n/a	0	0	2	2
AS Rosen	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
DA Stuurop	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a

This table shows meetings held by Hiscox plc up until 12 December 2006. The Board and Committees of HIscox Ltd did not meet between 12 December 2006 and year end.

Directors' remuneration report

This report sets out the remuneration policy for the Group's senior executives. This policy is consistent with the overall reward approach across the Group. The sections of this report entitled 'Remuneration of Executive Directors', 'Annual cash incentives', 'Share incentive schemes' and 'Pensions' have been audited by KPMG. The remainder of the report is unaudited.

Remuneration Committee
The Remuneration Committee meets at least twice a year. Details of the members can be found on page 39.

The Remuneration Committee makes recommendations to the Board on the overall framework and cost of remuneration for Hiscox and determines the specific remuneration packages for the Executive Directors.

None of the committee has any personal financial interest (other than as shareholders) or conflicts of interest arising from cross-directorships or day-to-day involvement in running the business. No Director plays any part in any discussion about his or her own remuneration.

Remuneration policy
The remuneration philosophy within Hiscox is to provide rewards which attract and retain quality staff and encourage and reward superior performance.

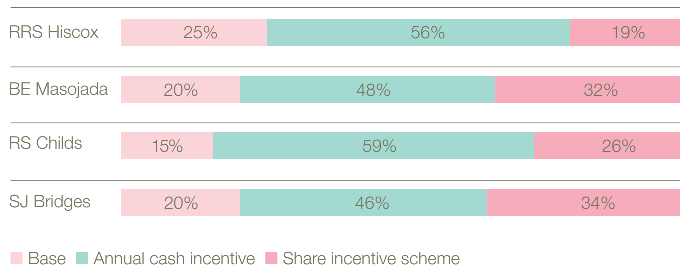
The Remuneration Committee believes that pay should be competitive but that superior reward should be driven by superior business results.

Remuneration of Executive Directors
The remuneration received by each person who served as an Executive Director during the year is set out in the table below.

Remuneration elements
There are four main elements of the remuneration packages in Hiscox: base salary and benefits, annual cash incentives (bonuses), share incentives and pensions.

The proportions of salary, cash incentives and share schemes in the overall reward for Executive Directors are detailed below:

Executive Directors' remuneration elements 2006



'Base' refers to base salary for the year.
'Annual cash incentive' is the annual amount allocated from the profit bonus pool.
'Share incentive scheme' is the estimated value at award of the Performance Share Plan awards made during the year.

Base salary and benefits
Base salaries within the Group are reviewed annually. The Remuneration Committee considers the overall budget and approach for the review, taking into account economic and operational conditions. Individual salaries are then reviewed using the Watson Wyatt Financial Services Salary Survey as a benchmark. Individual skills, experience and performance are also taken into account when setting salaries.

The Remuneration Committee applies this approach, alongside consideration of other publicly available reports and comparable companies' pay structures, to its review of Executive Directors' salaries.

Watson Wyatt are independent remuneration consultants who provide ad hoc information to the Remuneration Committee and do not provide any other services to the Company.

Annual cash incentives (bonuses)
Hiscox's remuneration policy is underpinned by the belief that a significant portion of total remuneration should be attained through incentive awards, therefore linking rewards directly with performance. The expectation is that successful performance should enable individuals to achieve upper quartile total remuneration. The table on page 43 shows the payment of annual cash incentives to Executive Directors over the past 10 years and illustrates the alignment between business performance and reward.

Incentives are awarded by setting an overall bonus pool and then allocating individual awards from that pool based on personal performance ratings. Two bonus pools are operated: the Personal Performance Bonus (PPB) and the Profit Related Bonus (PRB). The PPB is only available to junior and mid-level staff and is based on individual performance. It is designed to ensure that staff in these roles continue to be motivated to perform and the cost is up to ten per cent of relevant salaries.

Remuneration of Executive Directors

	2006 Basic salary £000	2006 Benefits £000	2006 Bonus £000	2006 Total £000	2005 Basic salary £000	2005 Benefits £000	2005 Bonus £000	2005 Total £000
RRS Hiscox	268	17	600	885	258	16	125	399
BE Masojada	326	15	800	1,141	309	15	175	499
RS Childs	308	13	1,200	1,521	291	18	150	459
SJ Bridges	268	14	600	882	249	14	150	413

All employees are eligible for the Profit Related Bonus. The PRB scheme is triggered when the business profits of the Group, based on the year's pre-tax operating result, exceed a Return on Equity (ROE) linked to the longer term rate of return ('Hurdle Rate'). The minimum Hurdle Rate has previously been set at a ten per cent pre-tax return on allocated equity with the bonus pool comprising 15 per cent of profits in excess of that. Bonus pools are then calculated for each major business division based on the performance of that division against the Hurdle Rate of return for the division's allocated equity.

Once the overall bonus pool has been established, individual bonuses, including those for Executive Directors, are calculated based on the results of each business area and individual performance. The Remuneration Committee determines the bonuses to be paid to the Executive Directors based on the performance of the Group and an assessment of individual performance. In this way, the bonus scheme aligns the interests of Executive Directors and employees with shareholders.

The payment of larger bonuses is deferred over a three year period as follows.

Bonus of £50,000/$100,000 and below	Entire bonus taken in cash year one
Bonus above £50,000/$100,000 and below £100,000/$200,000	£50,000/$100,000 taken in cash year one Remainder of bonus split 25% in year two, 25% in year three
Bonus above £100,000/$200,000	50% of bonus taken in year one 25% taken in year two 25% taken in year three

Share ownership is encouraged amongst senior personnel by allowing the deferred element of the annual bonus to be used, without deferral, for:

- exercise of share options;
- payment of tax on the exercise of share options;
- purchase of shares;
- payment of debt due on share purchase.

Share incentive schemes
The Remuneration Committee believes strongly in the value of employee participation in long-term share schemes in order to further align employee interests with those of the shareholder.

The following share incentive schemes are operated by Hiscox: the Hiscox Approved Share Option Scheme, the Hiscox Unapproved Share Option Scheme (the 'Share Option Schemes'), the Performance Share Plan and a Save as You Earn (SAYE) scheme.

Performance conditions
In order to ensure that these schemes are aligned with shareholders' interests, the Remuneration Committee regularly reviews the terms and conditions of the grants. The 2003 review resulted in the Remuneration Committee proposing changes to the terms and conditions applying to future grants of options under the Share Option Schemes and awards under the Performance Share Plan. These amendments were approved and adopted on 22 June 2004. Consequently, awards earned under these schemes are currently running with two sets of terms and conditions.

The most important change was a move from measuring performance on Earnings per Share (EPS) to performance based on ROE.

The Remuneration Committee believes that using ROE as the long-term performance condition better aligns the interests of employees with shareholders because:

- ROE captures the efficiency with which the Company is using shareholder funds to generate earnings, whereas EPS growth gives no indication of the level of return on the investment required to generate those additional earnings;
- the Company operates in a highly cyclical business where earnings can fluctuate considerably, which can have a distorting effect on EPS growth. Where EPS is used as a performance condition this can introduce an element of luck as to when in the cycle share grants are made which can operate to the disadvantage of both employees and shareholders. The Remuneration Committee believes that an average ROE performance requirement over the three year period smoothes out the cyclical fluctuations in earnings and ensures that over any given period shareholders will receive a minimum return on equity before share grants to employees will vest.

With the exception of Special Awards, the ROE for awards granted since June 2004 has been calculated as profit before tax and goodwill amortisation divided by shareholders' funds at the beginning of each year. The ROE will be calculated for each of the three financial years constituting the performance period and then averaged.

The Remuneration Committee will review the ROE target attached to grants on an annual basis in light of the prevailing bond yields. Adjustments may be made to the target, provided that in the opinion of the Remuneration Committee, the adjusted target shall be no easier to satisfy than the original target when imposed and provided that shareholders will be consulted in advance in respect of any material change.

Executive Directors' cash incentives and ROE

	Pre-tax return on equity %	Bonus as a percentage of salary %
1997	18	82
1998	16	73
1999	0	0
2000	3	0
2001	(24)	0
2002	13	90
2003	30	202
2004	28	173
2005	19	54
2006	35	274

Directors' remuneration report continued

Share Option Schemes
Awards are made to Executive Directors, senior managers and other staff at the discretion of the Remuneration Committee. No grants were made during 2006, or up until the date of these report and accounts.

Exercise of option grants made since 22 June 2004 are subject to the following performance conditions:

- participants receive 100 per cent of their share grant if the Group's ROE average is ten per cent over the three year performance period (the 'maximum target');
- no grants will vest unless the Group's ROE average over the period equals or exceeds eight per cent, at which point 40 per cent of the grant will vest (the 'minimum target');
- a grant will vest on a straight line basis if the Group's ROE average is between the minimum target and the maximum target.

Exercise of option grants made prior to 22 June 2004 under the Share Options Schemes is dependent upon the basic earnings per share of the Group increasing at two per cent more than the rate of inflation over a period of three years.

Following the re-domicile, new share option schemes, both approved and non-approved, have been established for Hiscox Ltd on essentially the same terms as the existing share options. All subsequent share option grants will be made under the new share option schemes.

Performance Share Plan
Restricted share awards are made to Executive Directors, senior managers and all other staff under the Performance Share Plan at the discretion of the Remuneration Committee. No grants (other than under the special award disclosed below) were made during 2006. However, the Remuneration Committee has agreed that awards will be made during 2007, although these will be subject to the same testing conditions that were applied to the special awards granted last year.

In 2005, following the Rights Issue, we received shareholder approval for a special award to grant individuals within the Company rights over up to five million restricted shares, of which a maximum of 20 per cent are available for Executive Directors ('Special Award'). Options were granted over 4,235,000 restricted shares on 12 January 2006 pursuant to the Special Award. These shares vest after three years; 25 per cent of the award vests if the Company achieves an average ROE of ten per cent post-tax for each of the three years and 100 per cent if the average return exceeds 17.5 per cent post-tax.

Subsequent grants pursuant to the Special Award were made over 25,000 restricted shares on 13 March 2006 and 190,000 restricted shares on 5 October 2006.

Exercise of restricted share awards granted since 22 June 2004, other than those made under the Special Award, are subject to the following performance conditions:

- participants receive 100 per cent of their share grant if the Group's ROE average is ten per cent over the three year performance period (the 'maximum target');
- no grants will vest unless the Group's ROE average over the period equals or exceeds eight per cent, at which point 40 per cent of the grant will vest (the 'minimum target');
- a grant will vest on a straight line basis if the Group's ROE average is between the minimum target and the maximum target.

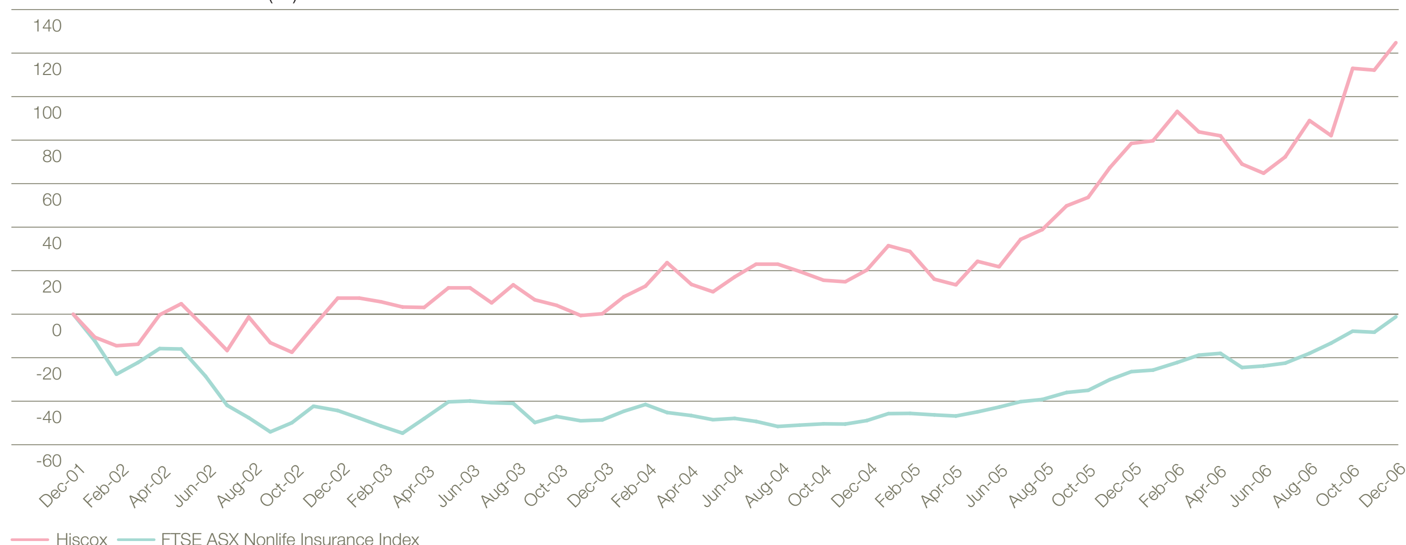
Exercise of restricted share awards granted prior to 22 June 2004 under the Performance Share Plan are subject to the following terms:

- participants receive 100 per cent of the award if the Group's operating EPS over a fixed three year period has increased by 35 per cent (the 'maximum target');
- no award will vest unless the increase in the Group's operating EPS over the period equals or exceeds 15 per cent (the 'minimum target');
- an award will vest on a straight line basis if the operating EPS growth is between the minimum target and the maximum target.

Save as You Earn
The sharesave scheme and international sharesave scheme are offered to all employees and currently have a 43 per cent participation.

Please see the table at the end of the Remuneration report which details Directors' interests in the long-term incentive plans.

Total shareholder return (%)



Source: Bloomberg

The above graph shows the Company's performance, measured by cumulative total shareholder return, compared with the performance of the FTSE All-Share Nonlife Insurance Index which also measures by cumulative total shareholder return. The FTSE All-Share Nonlife Insurance Index has been selected for this comparison because it is the most representative index for measuring the performance of the insurance market in which Hiscox participates.

Pensions
On 14 August 2006, Hiscox announced its intention to close the final salary pension scheme to future accrual. It had been closed to new members since 1 January 2001. After a thorough consultation process, this scheme was closed with effect from 31 December 2006. All active members, including SJ Bridges and BE Masojada, transferred to the Group Personal Pension plan (GPP), a defined contribution scheme. RRS Hiscox being an existing pensioner member, retiring on 3 January 2003 and RS Childs who left the Scheme on 31 December 2005, being a deferred member already, were unaffected by the Scheme closure (details of these were as set out in last year's report).

The pension entitlement shown in the table below is that which would be paid annually on retirement based on service to either the date of leaving the Scheme (increased from date of deferment to 31 December 2006) or the date of Scheme closure. The increase in accrued pension for the year excludes any increase for inflation. However, figures for RRS Hiscox are based on his actual pension in payment. The transfer value has been calculated on the basis of actuarial advice in accordance with version 9 Actuarial Guidance Note GN 11: Retirement Benefit Schemes – Transfer Values. No contractual contributions were due or have been paid by the Directors during the year.

Executive Directors' service contracts
Directors' service contracts are on a rolling basis and the unexpired term shown in the following table is therefore the same as the notice period.

The Remuneration Committee believes that these notice periods provide an appropriate balance and provide sufficient protection to the Company, having regard to prevailing market conditions and current practice amongst public companies.

None of the contracts include any provision for compensation payments on early termination.

Service contract table

Director	Effective date of Hiscox Ltd contract	Unexpired term and notice period
RRS Hiscox	12 Dec 2006	12 months
BE Masojada	12 Dec 2006	6 months
RS Childs	12 Dec 2006	6 months
SJ Bridges	12 Dec 2006	6 months
C Franklin Engler	11 Oct 2006	3 months
D Healy	11 Oct 2006	3 months
Dr J King	11 Oct 2006	3 months
Sir Mervyn Pedelty	11 Oct 2006	3 months
A Rosen	11 Oct 2006	3 months
D Stuurop	11 Oct 2006	3 months

External Non Executive Directorships
No external appointment may be accepted by an Executive Director where such appointment may give rise to a conflict of interest. The consent of the Chairman is required in any event.

During the year RRS Hiscox has been a Non Executive Director of Grainger Trust plc and was paid £30,000 for his services. BE Masojada was Deputy Chairman of Lloyd's during the year. BE Masojada was also a Non Executive Director of Ins-sure Holdings Limited and its subsidiaries during the year, resigning on 31 December 2006. The fees for his services are remitted to the Group, as disclosed in note 34.

Neither SJ Bridges nor RS Childs held Non Executive Director positions during the year.

Remuneration of Non Executive Directors
Non Executive Directors receive an annual fee in respect of their Board appointments together with additional compensation for their further duties in relation to Board committees. The structure of this and the fees paid are detailed below:

The fees in relation to Hiscox plc for the year were:

	Hiscox plc Board £	Subsidiary Board and Committees £	**Total 2006 £**	Total 2005 £
AR Auer	28,500	10,750	**39,250**	19,625
C Franklin Engler	28,500	8,250	**36,750**	36,750
AGC Howland Jackson	28,500	18,750	**47,250**	47,250
DND Netherton	28,500	13,250	**41,750**	41,750
Sir Mervyn Pedelty	28,500	11,250	**39,750**	19,875

The fees in relation to Hiscox Ltd from 11 October 2006 to 31 December 2006 were:

	Hiscox Ltd Board $	Committees $	**Total 2006 $**
C Franklin Engler	6,000	–	**6,000**
D Healy	16,438	7,671	**24,109**
Dr J King	16,438	6,575	**23,013**
Sir Mervyn Pedelty	10,000	–	**10,000**
A Rosen	16,438	5,479	**21,917**
D Stuurop	16,438	5,479	**21,917**

Sir Mervyn Pedelty's and C Franklin Engler's fees for their participation on committees during 2006 were paid by Hiscox plc.

The fees are reviewed annually but not necessarily increased. Fees are set at a level to attract individuals with a broad range of relevant skills and experience. The Non Executive Directors receive no other benefits.

Pensions

	Increase in accrued pension during the year £000	Total accrued pension at 31 Dec 06 £000	Transfer value of increase in accrued pension £000	Transfer value of accrued pension at 1 Jan 06 £000	Transfer value of accrued pension at 31 Dec 06 £000	Increase/ (decrease) in transfer value of accrued benefit during the year £000
RRS Hiscox	9	186	190	4,388	4,213	(175)
BE Masojada	3	34	37	482	479	(3)
RS Childs	12	200	199	3,834	3,867	33
SJ Bridges	4	27	42	311	337	26

Share options

The conditions of exercise of the Approved and Unapproved share options are described on pages 43 and 44.

	Number of options at 1 January 2006	Effect of modification on 12 January 2006	Number of options granted	Number of options lapsed	Number of options exercised	**Number of options at 31 December 2006**	Modified exercise price £	Market price at date of exercise £	Date from which exercisable	Expiry date
SJ Bridges	82,092	2,505	–	–	–	**84,597**	1.281	–	13 Oct 02	12 Oct 09
	109,457	3,340	–	–	–	**112,797**	1.020	–	15 Jun 03	14 Jun 10
	54,728	1,670	–	–	–	**56,398**	1.755	–	03 May 04	02 May 11
	136,821	4,176	–	–	–	**140,997**	0.806	–	27 Sep 04	26 Sep 11
	175,000	5,341	–	–	–	**180,341**	1.252	–	19 Nov 05	18 Nov 12
	150,000	4,578	–	–	–	**154,578**	1.465	–	02 Apr 06	01 Apr 13
	150,000	4,578	–	–	–	**154,578**	1.514	–	13 Jul 07	12 Jul 14
	150,000	4,578	–	–	–	**154,578**	1.499	–	06 Apr 08	05 Apr 15
	1,008,098	30,766	–	–	–	**1,038,864**				
RS Childs	87,566	2,672	–	–	–	**90,238**	1.574	–	20 Oct 01	19 Oct 08
	109,457	3,340	–	–	–	**112,797**	1.281	–	13 Oct 02	12 Oct 09
	164,186	5,011	–	–	–	**169,197**	1.020	–	15 Jun 03	14 Jun 10
	76,620	2,338	–	–	–	**78,958**	1.755	–	03 May 04	02 May 11
	136,821	4,176	–	–	–	**140,997**	0.806	–	27 Sep 04	26 Sep 11
	200,000	6,104	–	–	–	**206,104**	1.252	–	19 Nov 05	18 Nov 12
	200,000	6,104	–	–	–	**206,104**	1.465	–	02 Apr 06	01 Apr 13
	200,000	6,103	–	–	–	**206,103**	1.514	–	13 Jul 07	12 Jul 14
	200,000	6,104	–	–	–	**206,104**	1.499	–	06 Apr 08	05 Apr 15
	1,374,650	41,952	–	–	–	**1,416,602**				
RRS Hiscox	87,565	2,672	–	–	–	**90,237**	1.574	–	20 Oct 01	19 Oct 08
	54,727	1,669	–	–	–	**56,396**	1.020	–	15 Jun 03	14 Jun 10
	54,728	1,670	–	–	–	**56,398**	1.755	–	03 May 04	02 May 11
	50,000	1,526	–	–	–	**51,526**	1.465	–	02 Apr 06	01 Apr 13
	50,000	1,526	–	–	–	**51,526**	1.514	–	13 Jul 07	12 Jul 14
	50,000	1,526	–	–	–	**51,526**	1.499	–	06 Apr 08	05 Apr 15
	347,020	10,589	–	–	–	**357,609**				
BE Masojada	87,565	2,672	–	–	–	**90,237**	1.574	–	20 Oct 01	19 Oct 08
	109,457	3,340	–	–	–	**112,797**	1.281	–	13 Oct 02	12 Oct 09
	164,185	5,010	–	–	–	**169,195**	1.020	–	15 Jun 03	14 Jun 10
	76,620	2,338	–	–	–	**78,958**	1.755	–	03 May 04	02 May 11
	136,821	4,176	–	–	–	**140,997**	0.806	–	27 Sep 04	26 Sep 11
	200,000	6,104	–	–	–	**206,104**	1.252	–	19 Nov 05	18 Nov 12
	200,000	6,104	–	–	–	**206,104**	1.465	–	02 Apr 06	01 Apr 13
	200,000	6,104	–	–	–	**206,104**	1.514	–	13 Jul 07	12 Jul 14
	200,000	6,104	–	–	–	**206,104**	1.499	–	06 Apr 08	05 Apr 15
	1,374,648	41,952	–	–	–	**1,416,600**				
Other employees	151,042	4,608	–	–	(28,198)	**127,452**	1.702	2.09-2.61	17 Dec 00	16 Dec 07
	472,714	14,423	–	–	(169,189)	**317,948**	1.574	2.29-2.72	20 Oct 01	19 Oct 08
	495,825	15,115	–	–	(162,417)	**348,523**	1.281	2.23-2.72	13 Oct 02	12 Oct 09
	940,761	28,682	–	–	(241,203)	**728,240**	1.020	1.96-2.76	15 Jun 03	14 Jun 10
	114,929	3,507	–	–	–	**118,436**	1.001	–	09 Nov 03	08 Nov 10
	109,456	3,339	–	–	(17,756)	**95,039**	1.685	2.37	14 Feb 04	13 Feb 11
	661,089	19,410	–	–	(188,731)	**491,768**	1.755	2.16-2.76	03 May 04	02 May 11
	1,127,397	34,400	–	–	(214,310)	**947,487**	0.806	1.96-2.76	27 Sep 04	26 Sep 11
	2,022,500	59,569	–	(30,915)	(595,783)	**1,455,371**	1.252	2.10-2.76	19 Nov 05	18 Nov 12
	2,152,500	65,662	–	(41,220)	(462,142)	**1,714,800**	1.465	2.09-2.76	02 Apr 06	01 Apr 13
	2,240,000	68,336	–	–	–	**2,308,336**	1.514	–	13 Jul 07	12 Jul 14
	2,385,000	72,753	–	–	–	**2,457,753**	1.499	–	06 Apr 08	05 Apr 15
	12,873,213	389,804	–	(72,135)	(2,079,729)	**11,111,153**				
Total	16,977,629	515,063	–	(72,135)	(2,079,729)	**15,340,828**				

Share option schemes continued

The interests of the Directors and employees under the UK and International Sharesave Schemes of the Group are set out below:

	Number of options at 1 January 2006	Effect of modification on 12 January 2006	Number of options granted	Number of options lapsed	Number of options exercised	**Number of options at 31 December 2006**	Modified exercise price* £/€	Market price at date of exercise £	Date from which exercisable	Expiry date
UK Sharesave Scheme										
SJ Bridges	7,321	223	–	–	(7,544)	**–**	1.223	2.72	01 Dec 06	31 May 07
RS Childs	7,321	223	–	–	–	**7,544**	1.223	–	01 Dec 06	31 May 07
RRS Hiscox	9,282	283	–	–	(9,565)	**–**	0.988	2.48	01 Dec 05	31 May 06
	5,757	175	–	–	–	**5,932**	0.988	–	01 Dec 08	31 May 09
BE Masojada	6,956	212	–	–	–	**7,168**	1.322	–	01 Dec 07	31 May 08
Other employees	136,247	4,131	–	(73)	(140,305)	**–**	0.988	2.07-2.60	01 Dec 05	31 May 06
	281,105	8,530	–	(17,716)	(187,591)	**84,328**	1.223	2.50-2.84	01 Dec 06	31 May 07
	588,460	17,681	–	(52,077)	(28,514)	**525,550**	1.322	2.12-2.83	01 Dec 07	31 May 08
	376,457	11,435	–	(60,818)	(9,171)	**317,903**	1.576	2.22-2.79	01 Dec 08	31 May 09
	1,418,906	42,893	–	(130,684)	(382,690)	**948,425**				
International Sharesave Scheme										
Other employees	30,690	931	–	(599)	(31,022)	**–**	1.573	2.16-2.39	01 Dec 05	31 May 06
	19,286	544	–	(4,271)	(7,423)	**8,136**	1.758	2.73	01 Dec 06	31 May 07
	41,020	1,237	–	(11,670)	(6,566)	**24,021**	1.941	2.73	01 Dec 07	31 May 08
	42,013	1,287	–	(3,760)	(1,672)	**37,868**	2.317	2.28-2.73	01 Dec 08	31 May 09
	133,009	3,999	–	(20,300)	(46,683)	**70,025**				

*International Sharesave Scheme prices are denominated in Euros.

The aggregate gains made by the Directors on exercise of the above options (based on market price at date of exercise less the exercise price) was £25,568 (2005: £nil). The market price of Hiscox Ltd shares at 31 December 2006 was 280.25 pence (2005: 231.00 pence). The highest and lowest prices of Hiscox shares during 2006 were 280.25 pence and 193.75 pence (2005: 234.5 pence and 152.25 pence).

In January 2006 approval was received from HM Revenue & Customs to adjust the entitlement of participants in the Employee Share Schemes in respect of both the number of shares under option and the option exercise price to counter the depreciatory effect of the Rights Issue on the implied value of the options. The adjustments have been calculated in accordance with a formula set out by HM Revenue & Customs and have the effect that the number of options that each option holder is entitled to has increased by three per cent and the exercise price of each option has decreased by three per cent. The effect of these modifications was to increase the fair value of the options granted such that the charge recognised in the current year's consolidated income statement under IFRS 2 is £930,000 higher than it would otherwise have been had no modification occurred.

Performance share plan

	Number of awards at 1 January 2006	Effect of modification on 12 January 2006	Number of awards granted	Number of awards lapsed	Number of awards exercised	**Number of awards at 31 December 2006**	Modified exercise price £	Market price at date of exercise £	Date from which released
SJ Bridges	–	–	215,000	–	–	**215,000**	2.363	–	12 Jan 09
RS Childs	–	–	250,000	–	–	**250,000**	2.363	–	12 Jan 09
RRS Hiscox	–	–	100,000	–	–	**100,000**	2.363	–	12 Jan 09
BE Masojada	–	–	260,000	–	–	**260,000**	2.363	–	12 Jan 09
Other employees	3,283	100	–	–	–	**3,383**	1.037	–	01 Apr 05
	–	–	3,410,000	(72,500)	–	**3,337,500**	2.363	–	12 Jan 09
	–	–	25,000	–	–	**25,000**	2.363	–	13 Mar 09
	–	–	190,000	–	–	**190,000**	2.363	–	05 Oct 09
Total	3,283	100	4,450,000	(72,500)	–	**4,380,883**			

By order of the Board

Sir Mervyn Pedelty
Chairman of the Remuneration and Nomination Committee
Canon's Court, 22 Victoria Street, Hamilton HM 12, Bermuda
12 March 2007

Directors' report

The Directors have pleasure in submitting their Annual Report and financial statements for the year ended 31 December 2006.

Principal activity and business review
The Company is a holding company for subsidiaries involved in the business of insurance in Bermuda, the US, the UK and Europe.

An analysis of the development and performance of the business can be found within the Chief Executive's report on pages 9 to 14. A description of the major risks can be found in the Risk management section on pages 32 to 35.

Financial results
The Group achieved a pre-tax profit for the year of £201.1 million (2005: £70.2 million). Detailed results for the year are shown in the consolidated income statement on page 50, and also within the Group financial performance section on pages 27 to 29.

Going concern
After making enquiries, the Directors have a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future. For this reason they continue to adopt the going concern basis in preparing the accounts.

Dividends
An interim dividend of 3 pence (net) per share (2005: 2.25 pence (net)) was paid on 23 October 2006 by Hiscox plc in respect of the year ended 31 December 2006.

The Directors recommend the payment of a final dividend of 7 pence (net) per share (2005: 4.75 pence (net)). If approved this will be paid on 5 June 2007 to shareholders on the register at the close of business on 4 May 2007, provided that, such dividend will not be paid to those shareholders who, prior to 4 May 2007, have made an election to participate in the Company's Dividend Access Plan if Hiscox plc subsequently declares a dividend for the purposes of such Dividend Access Plan prior to the payment date of such dividend.

If Hiscox plc has declared a dividend, those shareholders who have elected to participate in the Dividend Access Plan will receive payments of that dividend on 5 June 2007.

Directors
The names and details of the individuals who served as Directors of the Company during the year are set out on page 39.

Anthony Howland Jackson was the Senior Independent Director until his retirement from Hiscox plc on 12 December 2006. Derek Netherton and Adrian Auer also retired from the Hiscox plc Board on 12 December 2006. The Board is grateful for the significant contribution that these Directors have made to the Group's development.

Robert Hiscox, Bronek Masojada and Stuart Bridges, were appointed as Executive Directors of the Company on 11 October 2006, joining Robert Childs who was appointed on 13 September 2006. Carol Franklin Engler, Daniel Healy, Sir Mervyn Pedelty, Andrea Rosen and Dirk Stuurop were appointed as Non Executive Directors of the Company on 11 October 2006, joining Dr James King who was appointed on 13 September 2006.

In accordance with the Bye-Laws of the Company, all Directors have submitted themselves for re-election at the first Annual General Meeting of the Company.

A copy of the Company's Bye-Laws is available for inspection at the Company's registered office.

Political and charitable contributions
The Group made no political contributions during the year (2005: £nil).

Charitable donations totalled £567,000 (2005: £78,650) of which £500,000 (2005: £50,000) was donated to the Hiscox Foundation, a UK registered charity. The policy of the Hiscox Foundation is to assist and improve education, the arts and independent living for disabled and disadvantaged members of society. Further information concerning the Group's charitable activities is contained in the report on Corporate responsibility on pages 36 to 37.

Major interests in shares
The Company has been notified of the following shareholdings of five per cent or more in the ordinary shares of the Company as at 12 March 2007:

	Number of shares	% of total
Amvescap plc	58,939,381	14.95
Fidelity International Ltd	34,556,323	8.77
Jupiter Asset Management	25,210,566	6.40
JP Morgan Chase & Co.	20,548,378	5.21

Annual General Meeting
The notice of Annual General Meeting, to be held at 4th floor, Wessex House, 45 Reid Street, Hamilton, HM 12 Bermuda on 23 May 2007 at 10am (2pm BST), is contained in a separate circular to shareholders enclosed with this report.

By order of the Board

Robin Mehta
Secretary
Canon's Court, 22 Victoria Street, Hamilton HM 12, Bermuda
12 March 2007

Directors' interests

	31 December 2006 5p Ordinary Shares number of shares beneficial	31 December 2006 5p Ordinary Shares number of shares non-beneficial	31 December 2005 5p Ordinary Shares number of shares beneficial	31 December 2005 5p Ordinary Shares number of shares non-beneficial
Executive Directors				
RRS Hiscox	**9,395,065**	**570,237**	9,382,500	580,237
BE Masojada	**2,702,902**	**–**	2,702,902	–
RS Childs	**1,386,067**	**–**	1,382,067	–
SJ Bridges	**468,421**	**–**	460,877	–
Non Executive Directors				
C Franklin Engler	**23,288**	**–**	17,550	–
D Healy	**50,000**	**–**	n/a	n/a
Dr J King	**–**	**–**	n/a	n/a
Sir Mervyn Pedelty[2]	**–**	**–**	–	–
A Rosen	**–**	**–**	n/a	n/a
D Stuurop[1]	**–**	**–**	n/a	n/a

[1]On 3 January 2007 D Stuurop purchased 50,000 Shares.

[2]On 12 March 2007 Sir Mervyn Pedelty purchased 18,000 Shares.

[3]The Executive Directors of Hiscox are potential beneficiaries of the Hiscox employees' share ownership plan trust (the "ESOP") and are therefore each deemed to have an interest in 135,782 Shares owned by Hiscox Trustees Limited, the trustee of the ESOP.

Report of the independent registered public accounting firm to the Board of Directors and the shareholders of Hiscox Ltd

We have audited the accompanying consolidated financial statements of Hiscox Ltd ('the Company') on pages 50 to 87, which comprise the consolidated balance sheet as at 31 December 2006, and the consolidated income statement, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

In addition to our audit of the consolidated financial statements, the Directors have engaged us to audit the information in the Directors' remuneration report that is described as having been audited, which the Directors have decided to prepare as if the Company were required to comply with the requirements of Schedule 7A to the UK Companies Act 1985.

Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditors' responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit and, under the terms of our engagement letter, to audit the part of the Directors' remuneration report that is described as having been audited.

We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements and the part of the Directors' remuneration report to be audited are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements and the part of the Directors' remuneration report to be audited. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements and the part of the Directors' remuneration report to be audited, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the financial statements and the part of the Directors' remuneration report to be audited in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting principles used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements and the part of the Directors' remuneration report to be audited.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

In addition to our audit of the financial statements, the Directors have engaged us to review their Corporate Governance Statement as if the Company were required to comply with the Listing Rules of the Financial Services Authority in relation to those matters. We review whether the Corporate Governance Statement reflects the Company's compliance with the nine provisions of the 2003 Combined Code specified for our review by those rules, and we report if it does not. We are not required by the terms of our engagement to consider whether the Board's statements on internal control cover all risks and controls, or to form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

Opinion

In our opinion:

- the consolidated financial statements give a true and fair view of the consolidated financial position of the Company as at 31 December 2006, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards; and
- the part of the Directors' remuneration report which we were engaged to audit has been properly prepared in accordance with Schedule 7A to the UK Companies Act 1985, as if those requirements were to apply to the Company.

KPMG
Hamilton
Bermuda
12 March 2007

Consolidated income statement

For the year ended 31 December 2006

	Notes	2006 £000	2005 £000
Income			
Gross premiums written	4	**1,126,164**	861,174
Outward reinsurance premiums		**(150,767)**	(179,938)
Net premiums written	4	**975,397**	681,236
Gross premiums earned		**1,033,585**	879,344
Premiums ceded to reinsurers		**(144,757)**	(186,045)
Net premiums earned	4	**888,828**	693,299
Investment result	6	**105,550**	43,883
Other income	9	**15,858**	81,297
Net revenue		**1,010,236**	818,479
Expenses			
Claims and claim adjustment expenses, net of reinsurance	24.2	**(382,341)**	(457,025)
Expenses for the acquisition of insurance contracts	8	**(225,849)**	(199,979)
Administration expenses		**(76,533)**	(41,197)
Other expenses	9	**(115,057)**	(46,973)
Total expenses		**(799,780)**	(745,174)
Results of operating activities		**210,456**	73,305
Finance costs	11	**(9,404)**	(3,334)
Share of profit of associates after tax	16	**10**	250
Profit before tax		**201,062**	70,221
Tax expense	26	**(37,216)**	(21,591)
Profit for the year (all attributable to equity shareholders of the Company)		**163,846**	48,630
Earnings per share on profit attributable to equity shareholders of the Company			
Basic	29	**41.7p**	15.6p
Diluted	29	**40.5p**	15.1p

The notes on pages 54 to 87 are an integral part of these consolidated financial statements.

Consolidated balance sheet
At 31 December 2006

	Notes	2006 £000	2005 £000
Assets			
Intangible assets	14	**33,212**	33,099
Property, plant and equipment	15	**13,821**	12,128
Investments in associates	16	**28**	18
Deferred acquisition costs	8	**117,115**	106,747
Financial assets carried at fair value	18	**1,241,910**	1,237,778
Loans and receivables including insurance receivables	19	**446,272**	436,981
Reinsurance assets	17, 24	**302,772**	506,376
Cash and cash equivalents	21	**502,871**	413,759
Total assets		**2,658,001**	2,746,886
Equity and liabilities			
Shareholders' equity			
Share capital	22	**19,694**	19,570
Share premium	22	**–**	401,365
Contributed surplus	22	**442,425**	–
Other reserves	23	**(40,396)**	38,789
Retained earnings	23	**260,362**	118,289
Total equity		**682,085**	578,013
Employee retirement benefit obligations	28	**3,801**	16,677
Deferred tax	27	**8,467**	15,193
Insurance liabilities	24	**1,594,101**	1,723,000
Financial liabilities carried at fair value	18	**93,929**	126,246
Current tax		**20,793**	16,581
Trade and other payables	25	**254,825**	271,176
Total liabilities		**1,975,916**	2,168,873
Total equity and liabilities		**2,658,001**	2,746,886

The notes on pages 54 to 87 are an integral part of these consolidated financial statements.

The consolidated Group financial statements were approved by the Board of Directors on 12 March 2007 and signed on its behalf by:

RRS Hiscox
Chairman

SJ Bridges
Group Finance Director

Consolidated statement of changes in equity

	Notes	Share capital £000	Share premium £000	Contributed surplus £000	Merger reserve £000	Currency translation reserve £000	Capital redemption reserve £000	Retained earnings £000	Total £000
Balance at 1 January 2005		14,685	234,267	–	4,723	(468)	33,244	82,375	368,826
Currency translation differences	13	–	–	–	–	1,290	–	–	1,290
Net income/(expense) recognised directly in equity		–	–	–	–	1,290	–	–	1,290
Profit for the year		–	–	–	–	–	–	48,630	48,630
Total recognised income/(expense) for year		–	–	–	–	1,290	–	48,630	49,920
Employee share options:									
Equity settled share based payments		–	–	–	–	–	–	2,059	2,059
Deferred tax release on share based payments		–	–	–	–	–	–	1,950	1,950
Proceeds from shares issued	22	67	1,522	–	–	–	–	–	1,589
Rights Issue of equity shares	22	4,818	171,550	–	–	–	–	–	176,368
Expenses related to Rights Issue of equity shares	22	–	(5,974)	–	–	–	–	–	(5,974)
Change in own shares		–	–	–	–	–	–	192	192
Dividends to shareholders	30	–	–	–	–	–	–	(16,917)	(16,917)
Balance at 31 December 2005		19,570	401,365	–	4,723	822	33,244	118,289	578,013
Currency translation differences	13	**–**	**–**	**–**	**–**	**(41,218)**	**–**	**–**	**(41,218)**
Net income/(expense) recognised directly in equity		**–**	**–**	**–**	**–**	**(41,218)**	**–**	**–**	**(41,218)**
Profit for the year		**–**	**–**	**–**	**–**	**–**	**–**	**163,846**	**163,846**
Total recognised income/(expense) for year		**–**	**–**	**–**	**–**	**(41,218)**	**–**	**163,846**	**122,628**
Employee share options:									
Equity settled share based payments		**–**	**–**	**–**	**–**	**–**	**–**	**5,238**	**5,238**
Deferred tax release on share based payments		**–**	**–**	**–**	**–**	**–**	**–**	**3,367**	**3,367**
Proceeds from shares issued	22	**124**	**2,829**	**264**	**–**	**–**	**–**	**–**	**3,217**
Transfer on reverse acquisition	22	**–**	**(404,194)**	**442,161**	**(4,723)**	**–**	**(33,244)**	**–**	**–**
Change in own shares		**–**	**–**	**–**	**–**	**–**	**–**	**50**	**50**
Dividends to shareholders	30	**–**	**–**	**–**	**–**	**–**	**–**	**(30,428)**	**(30,428)**
Balance at 31 December 2006		**19,694**	**–**	**442,425**	**–**	**(40,396)**	**–**	**260,362**	**682,085**

The notes on pages 54 to 87 are an integral part of these consolidated financial statements.

Consolidated cash flow statement

For the year ended 31 December 2006

	Notes	2006 £000	2005 £000
Profit before tax		**201,062**	70,221
Adjustments for:			
Interest and equity dividend income		**(70,243)**	(48,072)
Net (gains)/losses on financial assets		**(9,422)**	4,289
Retirement benefit contributions paid in excess of charges		**(12,876)**	(18,041)
Depreciation	15	**3,898**	3,281
Charges in respect of share based payments	10	**5,238**	2,059
Other charges		**10,955**	690
Changes in operational assets and liabilities:			
Insurance and reinsurance contracts		**45,426**	212,462
Financial assets		**1,311**	(256,280)
Other assets and liabilities		**(17,953)**	13,048
Cash flows from operations		**157,396**	(16,343)
Interest received		**68,644**	46,844
Equity dividends received		**1,599**	1,228
Interest paid		**(9,416)**	(2,573)
Current tax paid		**(36,363)**	(10,239)
Net cash flows from operating activities		**181,860**	18,917
Cash flows from the acquisition and sale of subsidiaries and associates		**–**	3,750
Cash flows from the purchase of property, plant and equipment		**(5,452)**	(4,474)
Cash flows from the purchase of intangible assets	14	**(300)**	(3,277)
Loans repaid by related parties		**–**	1,580
Net cash flows from investing activities		**(5,752)**	(2,421)
Proceeds from the issue of ordinary shares		**3,217**	171,983
Net cash flows from transactions in own shares		**50**	192
Dividends paid to Company's shareholders	30	**(30,428)**	(16,917)
Proceeds from borrowings		**–**	121,133
Repayments of borrowings and financial liabilities		**(14,334)**	(102)
Net cash flows from financing activities		**(41,495)**	276,289
Net increase in cash and cash equivalents		**134,613**	292,785
Cash and cash equivalents at 1 January		**413,759**	119,563
Net increase in cash and cash equivalents		**134,613**	292,785
Effect of exchange rate fluctuations on cash and cash equivalents		**(45,501)**	1,411
Cash and cash equivalents at 31 December	21	**502,871**	413,759

The purchase, maturity and disposal of financial assets is part of the Group's insurance activities and is therefore classified as an operating cash flow. The purchase, maturity and disposal of derivative contracts is also classified as an operating cash flow.

Included within cash and cash equivalents held by the Group are balances totalling £41,304,000 (2005: £50,313,000) not available for use by the Group which are held within the Lloyd's Syndicate.

The notes on pages 54 to 87 are an integral part of these consolidated financial statements.

Notes to the financial statements

1 General information

The Hiscox Group, which is headquartered in Hamilton, Bermuda, comprises Hiscox Ltd (the parent Company, referred to herein as the 'Company') and its subsidiaries (collectively, the 'Hiscox Group' or the 'Group'). The Group relocated its parent Company domicile during the year from the United Kingdom to Bermuda. The Group provides insurance, reinsurance and investment management services to its clients worldwide. It has operations in Bermuda, the UK, Europe, and USA and employs over 700 people worldwide.

The Company is registered and domiciled in Bermuda and on 12 December 2006, its ordinary shares were listed on the London Stock Exchange. As such it is required to prepare financial information in accordance with the Bermuda Companies Act 1981, which permits the Group to prepare financial statements which comprise the consolidated income statement, the consolidated balance sheet, the consolidated statement of changes in equity, the consolidated cash flow statement and the related notes 1 to 34 in accordance with International Financial Reporting Standards ('IFRS'). Accordingly, the financial information has been prepared in accordance with Bermuda Law.

The consolidated financial statements for the year ended 31 December 2006 comprise all of the Group's subsidiary companies and the Group's interest in associates. All amounts relate to continuing operations.

The financial statements were approved for issue by the Board of Directors on 12 March 2007.

2 Significant accounting policies

The principal accounting policies applied in the preparation of these consolidated Group financial statements are set out below.

2.1 Statement of compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards and in accordance with the provisions of the Bermuda Companies Act 1981. The Group's consolidated financial statements for the prior financial year were published in accordance with those International Financial Reporting Standards adopted for use in the European Union. No adjustments are necessary to the amounts measured previously therein, for their inclusion as comparatives in these consolidated financial statements.

Since 2002, the standards adopted by the IASB have been referred to as 'International Financial Reporting Standards' (IFRS). The standards from prior years continue to bear the title 'International Accounting Standards' (IAS). Insofar as a particular standard is not explicitly referred to, the two terms are used in these financial statements synonymously. Compliance with IFRS includes the adoption of interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC).

In March 2004, the IASB issued IFRS 4 *Insurance Contracts* which specifies the financial reporting for insurance contracts by an insurer. The standard is only the first phase in the IASB's insurance contract project and as such is only a stepping stone to phase II, introducing limited improvements to accounting for insurance contracts. Accordingly, to the extent that IFRS 4 does not specify the recognition or measurement of insurance contracts, transactions reported in these consolidated financial statements have been prepared in accordance with another comprehensive body of accounting principles for insurance contracts, namely accounting principles generally accepted in the UK at the date of transition to IFRS.

2.2 Basis of preparation

The financial statements are presented in Pounds Sterling and are rounded to the nearest thousand unless otherwise stated. They are compiled on a going concern basis and prepared on the historical cost basis except that pension scheme plan assets included in the measurement of the employee retirement benefit obligation and financial instruments at fair value through profit or loss are measured at fair value. Employee retirement benefit obligations are determined using actuarial analysis. The balance sheet of the Group is presented in order of increasing liquidity.

The accounting policies have been applied consistently by all Group entities, to all periods presented, solely for the purpose of producing the consolidated Group financial statements.

The Group elected to apply the transitional arrangements contained in IFRS 4 that permitted the disclosure of only five years of data in claims development tables, in the year ended 31 December 2005 which was the year of adoption. The number of years of data presented was increased to six in the current financial year, and will be increased in each succeeding additional year, up to a maximum of ten years, if material outstanding claims exist for such periods.

The Directors have considered recently published IFRS, new interpretations and amendments to existing standards that are mandatory to the Group's accounting periods commencing on or after 1 January 2007 and which have not been subject to early adoption. The main developments that are expected to be of relevance to forthcoming financial years are:

- IFRS 7 *Financial Instruments: Disclosures*, and a complementary amendment to IAS 1 *Presentation of Financial Statements – Capital Disclosures (effective for accounting periods beginning on or after 1 January 2007*). IFRS 7 introduces additional minimum disclosure requirements regarding exposures to risk arising from financial instruments. The amendment to IAS 1 introduces minimum disclosures about the level of an entity's capital and how it manages that capital. The Directors' current assessment is that the main additional disclosures arising from the application of these developments from 1 January 2007 will be more detailed sensitivity analysis to market risk, and additional capital management disclosures.
- IFRS 8 *Operating Segments* (*effective for accounting periods beginning on or after 1 January 2009*). IFRS 8 will result in a number of amendments to the Group's presentation of segmental reporting such that users will be able to appraise summary segment results on an operational basis consistent with that used by management.
- IFRIC 10 *Interim Financial Reporting and Impairment* (*effective for accounting periods beginning on or after 1 November 2006*). IFRIC 10 prohibits the impairment losses recognised in an interim period on goodwill and investments in equity instruments and in financial assets carried at cost to be reversed at a subsequent balance sheet date. The Group will apply IFRIC 10 from 1 January 2007 but it is not expected to have any significant impact on the Group's financial statements.

2.3 New holding company

Hiscox Ltd was incorporated under the laws of Bermuda on 6 September 2006. With effect from 12 December 2006, under a scheme of arrangement involving a share exchange with the members of Hiscox plc, the Company became the new holding company of the Hiscox Group. Details of the transaction and its effects are disclosed in notes 22 and 29.

Throughout the period from incorporation to 12 December 2006, Hiscox Ltd was a shell company with no material revenues or assets and did not constitute a 'business' as defined by IFRS 3 *Business Combinations*. Consequently, due to the relative values of both Companies, the shareholders of Hiscox plc immediately before the share exchange acquired, in effect, 100 per cent of the enlarged share capital of Hiscox Ltd on completion of the transaction.

In order to appropriately reflect the substance of the transaction outlined above, the new holding Company has been accounted for using the reverse acquisition principles outlined in IFRS 3. Consequently, Hiscox plc is deemed to be the acquirer for accounting purposes and the legal parent Company, Hiscox Ltd, is treated as a subsidiary whose identifiable assets and liabilities are incorporated into the Group at fair value.

2 Significant accounting policies continued

2.3 New holding Company continued

The Group's consolidated financial statements are issued in the name of the legal parent Company, Hiscox Ltd. However, as a consequence of applying reverse acquisition accounting, the results for the year ended 31 December 2006 represent a continuation of the consolidated activities of Hiscox plc for the year ended 31 December 2006 plus those of Hiscox Ltd from 12 December 2006. The consolidated balance sheet at 31 December 2006 reflects the issued share capital and contributed surplus of Hiscox Ltd. The comparative figures are those of Hiscox plc, as originally reported for the year ended 31 December 2005. In accordance with Bermuda law the previously reported share premium, merger reserve and capital redemption reserve are presented as contributed surplus. The comparative earnings per share are not altered by the application guidance of IFRS 3.

2.4 Basis of consolidation

(a) Subsidiaries

Subsidiaries are those entities controlled by the Group. Control exists when the Group has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that are currently exercisable or convertible are taken into account. The consolidated financial statements include the assets, liabilities and results of the Group up to 31 December each year. The financial statements of subsidiaries are included in the consolidated financial statements only from the date that control commences until the date that control ceases.

Hiscox Dedicated Corporate Member Limited and the subsidiaries of Hiscox Select Holdings Limited underwrite as corporate members of Lloyd's on the syndicate managed by Hiscox Syndicates Limited (the 'managed syndicate'). In view of the several but not joint liability of underwriting members at Lloyd's for the transactions of syndicates in which they participate, the Group's attributable share of the transactions, assets and liabilities of the Syndicate has been included in the financial statements.

The Group uses the purchase method of accounting to account for the acquisition of subsidiaries. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the income statement.

(b) Associates

Associates are those entities in which the Group has significant influence but not control over the financial and operating policies. The consolidated financial statements include the Group's share of the total recognised gains and losses of associates on an equity accounted basis from the date that significant influence commences until the date that significant influence ceases. The Group's share of its associates' post-acquisition profits or losses after tax is recognised in the income statement each period, and its share of the movement in the associates' net assets is reflected in the investments' carrying values in the balance sheet. When the Group's share of losses equals or exceeds the carrying amount of the associate, the carrying amount is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred obligations in respect of the associate.

(c) Transactions eliminated on consolidation

Intragroup balances, transactions and any unrealised gains arising from intragroup transactions are eliminated in preparing the consolidated financial statements. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

Unrealised gains arising from transactions with associates are eliminated to the extent of the Group's interest in the entity. Unrealised gains arising from transactions in associates are eliminated against the investment in the associate.

2.5 Foreign currency translation

(a) Functional and presentational currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the 'functional currency'). The functional currency of all individual entities in the Group is deemed to be Sterling with the exception of the entities operating in France, Germany, the Netherlands and Belgium whose functional currency is Euros, those entities operating from the USA and Bermuda whose functional currency is US Dollars, and Hiscox Insurance Company (Guernsey) Limited whose functional currency is also US Dollars.

(b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the retranslation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement, except when deferred in equity as qualifying net investment hedges.

Non-monetary items carried at historical cost are translated in the balance sheet at the exchange rate prevailing on the original transaction date. Non-monetary items measured at fair value are translated using the exchange rate ruling when the fair value was determined.

(c) Group companies

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

(i) assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet

(ii) income and expenses for each income statement are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the date of the transactions)

(iii) all resulting exchange differences are recognised as a separate component of equity.

When a foreign operation is sold, such exchange differences are recognised in the income statement as part of the gain or loss on sale.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as the foreign entity's assets and liabilities and are translated at the closing rate.

2.6 Property, plant and equipment

Property, plant and equipment are stated at historical cost less depreciation and any impairment loss. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

2 Significant accounting policies continued
2.6 Property, plant and equipment continued
Land and Artwork assets are not depreciated as they are deemed to have indefinite useful economic lives. Depreciation on other assets is calculated using the straight-line method to allocate their cost or revalued amounts, less their residual values, over their estimated useful lives, as follows:

– Buildings	50 years
– Vehicles	3 years
– Short leasehold fixtures and fittings	10-15 years
– Furniture, fittings and equipment	3-15 years

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

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in the income statement.

2.7 Intangible assets
(a) Goodwill
Goodwill represents amounts arising on acquisition of subsidiaries and associates. In respect of acquisitions that have occurred since 1 January 2004, goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary or associate at the acquisition date.

In respect of acquisitions prior to this date, goodwill is included on the basis of its deemed cost, which represents the amount recorded under previous GAAP.

Goodwill on acquisition of subsidiaries is included in intangible assets. Goodwill on acquisition of associates is included in investments in associates. Goodwill is not amortised but is tested annually for impairment and carried at cost less accumulated impairment losses. The impairment review process examines whether or not the carrying value of the goodwill attributable to individual cash generating units exceeds its implied value. Any excess of goodwill over the implied value arising from the review process indicates impairment.

Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

(b) Syndicate capacity
The cost of purchasing the Group's participation in the Lloyd's insurance syndicates is not amortised but is tested annually for impairment and is carried at cost less accumulated impairment losses. Having considered the future prospects of the London insurance market, the Board believe that the Group's ownership of syndicate capacity will provide economic benefits over an indefinite number of future periods.

(c) Rights to customer contractual relationships
Costs directly attributable to securing the intangible rights to customer contract relationships are recognised as an intangible asset where they can be identified separately and measured reliably and it is probable that they will be recovered by directly related future profits. These costs are amortised on a straight-line basis over the useful economic life which is deemed to be 20 years and are carried at cost less accumulated amortisation and impairment losses.

(d) Computer software
Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring into use the specific software. These costs are amortised over the expected useful life of the software of three years on a straight-line basis.

Internally developed computer software is only capitalised where the cost can be measured reliably, the Group intends to and has adequate resources to complete development and where the computer software will yield future economic benefits in excess of the costs incurred.

2.8 Investments
The Group has classified financial investments as a) financial assets designated at fair value through profit or loss, and b) loans and receivables. Management determines the classification of its financial investments at initial recognition. The decision by the Group to designate all financial investments other than loans and receivables at fair value through profit or loss reflects the fact that the investment portfolios are managed, and their performance evaluated, on a fair value basis. Regular way purchases and sales of investments are accounted for at the date of trade.

Financial investments are de-recognised when the right to receive cash flows from them expires or where they have been transferred and the Group has also transferred substantially all risks and rewards of ownership.

Fair value for securities quoted in active markets is the bid price exclusive of transaction costs. For instruments where no active market exists, fair value is determined by referring to recent transactions and other valuation factors including the discounted value of expected future cash flows. Fair value changes are recognised immediately within the investment result line in the income statement.

(a) Financial assets at fair value through profit or loss
A financial asset is classified into this category at inception if it is managed and evaluated on a fair value basis in accordance with documented strategy, if acquired principally for the purpose of selling in the short-term, or if it forms part of a portfolio of financial assets in which there is evidence of short-term profit taking.

(b) Loans and receivables
Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted on an active market. Receivables arising from insurance contracts are also classified in this category and are reviewed for impairment as part of the impairment review of loans and receivables. Loans and receivables are carried at amortised cost less any provision for impairment in value.

2.9 Cash and cash equivalents
The Group has classified cash deposits and short-term highly liquid investments as cash and cash equivalents. These assets are readily convertible into known amounts of cash and are subject to inconsequential changes in value. Cash equivalents are financial investments with less than three months to maturity at the date of acquisition.

2.10 Impairment of assets
Assets that have an indefinite useful life are not subject to amortisation and are tested annually or whenever there is an indication of impairment. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

Objective factors that are considered when determining whether a non-monetary asset (such as an intangible asset or item of property, plant and equipment) or group of non-monetary assets may be impaired include, but are not limited to, the following:

- adverse economic, regulatory or environmental conditions that may restrict future cashflows and asset usage and/or recoverability;
- the likelihood of accelerated obsolescence arising from the development of new technologies and products;
- the disintergration of the active market(s) to which the asset is related.

Objective factors that are considered when determining whether a monetary asset or group of monetary assets may be impaired include, but are not limited to, the following:

- negative rating agency announcements in respect of investment issuers, reinsurers and debtors;
- significant reported financial difficulties of investment issuers, reinsurers and debtors;
- actual breaches of credit terms such as persistent late payments or actual default;

2 Significant accounting policies continued

2.10 Impairment of assets continued

– the disintegration of the active market(s) in which a particular asset is traded or deployed; and

– adverse economic or regulatory conditions that may restrict future cash flows and asset recoverability.

An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash generating units).

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior periods. A reversal of an impairment loss is recognised as income immediately unless the relevant asset was carried previously at a revalued amount and where the original revaluation had been recognised directly in equity.

2.11 Derivative financial instruments

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently valued at their fair value at each balance sheet date. Fair values are obtained from quoted market values, and if these are not available, valuation techniques including option pricing models as appropriate. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. For derivatives not formally designated as a hedging instrument, fair value changes are recognised immediately in the income statement.

Changes in the value of derivative and other financial instruments formally designated as hedges of net investments in foreign operations are recognised in the currency translation reserve to the extent they are effective; gains or losses relating to the ineffective portion of the hedging instruments are recognised immediately in the consolidated income statement.

The Group had no financial instruments designated for hedge accounting during the current and prior financial year.

2.12 Own shares

Where any Group company purchases the parent Company's equity share capital (own shares), the consideration paid, including any directly attributable incremental costs (net of income taxes), is deducted from equity attributable to the Company's equity holders. Where such shares are subsequently sold, reissued or otherwise disposed of, any consideration received is included in equity attributable to the Company's equity holders, net of any directly attributable incremental transaction costs and the related income tax effects.

2.13 Net revenue

Net revenue comprises insurance premiums earned, net of reinsurance, together with profit commission, investment returns, agency fees and other income inclusive of foreign exchange gains. The Group's share of the results of associates is reported separately. The accounting policies for insurance premiums are outlined below. Profit commission, investment income and other sources of income are recognised on an accruals basis net of any discounts and amounts such as sales based taxes collected on behalf of third parties.

2.14 Insurance contracts

(a) Classification

The Group issues short-term casualty and property insurance contracts that transfer significant insurance risk. Such contracts may also transfer a limited level of financial risk.

(b) Recognition and measurement

Gross premiums written comprise premiums on business incepting in the financial year together with adjustments to estimates of premiums written in prior accounting periods. Estimates are included for pipeline premiums and an allowance is also made for cancellations. Premiums are stated before the deduction of brokerage and commission but net of taxes and duties levied. Premiums are recognised as revenue (earned premiums) proportionally over the period of coverage. The portion of premium received on in-force contracts that relates to unexpired risks at the balance sheet date is reported as the unearned premium liability.

Claims and associated expenses are charged to profit or loss as incurred based on the estimated liability for compensation owed to contract holders or third parties damaged by the contract holders. They include direct and indirect claims settlement costs and arise from events that have occurred up to the balance sheet date even if they have not yet been reported to the Group. The Group does not discount its liabilities for unpaid claims. Liabilities for unpaid claims are estimated using the input of assessments for individual cases reported to the Group and statistical analysis for the claims incurred but not reported, and an estimate of the expected ultimate cost of more complex claims that may be affected by external factors e.g. court decisions.

(c) Deferred acquisition costs ('DAC')

Commissions and other direct and indirect costs that vary with and are related to securing new contracts and renewing existing contracts are capitalised as deferred acquisition costs. All other costs are recognised as expenses when incurred. The DAC is amortised over the terms of the policies as premium is earned.

(d) Liability adequacy test

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

Any DAC written-off as a result of this test cannot subsequently be reinstated.

(e) Outwards reinsurance contracts held

Contracts entered into by the Group, with reinsurers, under which the Group is compensated for losses on one or more insurance or reinsurance contracts and that meet the classification requirements for insurance contracts, are classified as insurance contracts held. Contracts that do not meet these classification requirements are classified as financial assets.

The benefits to which the Group is entitled under outwards reinsurance contracts are recognised as reinsurance assets. These assets consist of short-term balances due from reinsurers (classified within loans and receivables) as well as longer-term receivables (classified as reinsurance assets) that are dependent on the expected claims and benefits arising under the related reinsured insurance contracts. Reinsurance liabilities primarily comprise premiums payable for 'outwards' reinsurance contracts. These amounts are recognised in profit or loss proportionally over the period of the contract. Receivables and payables are recognised when due.

The Group assesses its reinsurance assets on a regular basis and if there is objective evidence, after initial recognition, of an impairment in value, the Group reduces the carrying amount of the reinsurance asset to its recoverable amount and recognises the impairment loss in the income statement.

(f) Receivables and payables related to insurance contracts

Receivables and payables are recognised when due. These include amounts due to and from agents, brokers and insurance contract holders.

If there is objective evidence that the insurance receivable is impaired, the Group reduces the carrying amount of the insurance receivable accordingly and recognises the impairment loss in profit or loss.

(g) Salvage and subrogation reimbursements

Some insurance contracts permit the Group to sell property acquired in settling a claim (i.e. salvage). The Group may also have the right to pursue third parties for payment of some or all costs (i.e. subrogation).

2 Significant accounting policies continued

2.14 Insurance contracts continued

Estimates of salvage recoveries are included as an allowance in the measurement of the insurance liability for claims and salvage property is recognised in other assets when the liability is settled. The allowance is the amount that can reasonably be recovered from the disposal of the property.

Subrogation reimbursements are also considered as an allowance in the measurement of the insurance liability for claims and are recognised in other assets when the liability is settled. The allowance is the assessment of the amount that can be recovered from the action against the liable third party.

2.15 Deferred tax

Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. However, if the deferred income tax arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss, it is not recognised. Deferred tax is determined using tax rates and laws that have been enacted or substantively enacted by the balance sheet date and are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled.

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

Deferred tax is provided on temporary differences arising on investments in subsidiaries and associates, except where the Group controls the timing of the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

2.16 Employee benefits

(a) Pension obligations

The Group operated both defined contribution and defined benefit pension schemes during the year under review.

The defined benefit scheme closed to future accrual with effect from 31 December 2006 and active members were offered membership of the defined contribution scheme from 1 January 2007.

A defined contribution plan is a pension plan under which the Group pays fixed contributions into a separate entity and has no further obligation beyond the agreed contribution rate. A defined benefit plan is a pension plan that defines an amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and compensation.

For defined contribution plans, the Group pays contributions to publicly or privately administered pension insurance plans on a contractual basis.

The contributions are recognised as an employee benefit expense when they are due. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in future payments is available.

The liability recognised in the balance sheet in respect of defined benefit pension plans is the present value of the defined benefit obligation at the balance sheet date less the fair value of plan assets, together with adjustments for unrecognised actuarial gains or losses and past service costs. Plan assets exclude any insurance contracts issued by the Group.

Until curtailment, actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to income over the employees' expected average remaining working lives. In addition, until curtailment actuarial gains and losses are only recognised when the net cumulative unrecognised actuarial gains and losses for each individual plan at the end of the previous accounting period exceeds 10 per cent of the higher of the defined benefit obligation and the fair value of the plan assets at that date. On curtailment, all unrecognised actuarial gains or losses are recognised in the income statement where relevant.

Past service costs are recognised immediately in income, unless the changes to the pension plan are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past service costs are amortised on a straight-line basis over the vesting period.

Rights to reimbursement from other parties participating in the Lloyd's Syndicate of some of the expenditure required to settle the defined benefit obligation are recognised as a component of the income statement charge or credit and within receivables on the balance sheet in accordance with the policies outlined at 2.8 (b) above.

(b) Other long-term employee benefits

The Group provides sabbatical leave to employees on completion of a minimum service period of ten years. The present value of the expected costs of these benefits is accrued over the period of employment.

(c) Share based compensation

The Group operates a number of equity settled share based employee compensation plans. These include both the approved and unapproved share option schemes outlined in the Directors' remuneration report together with the Group's save as you earn ('SAYE') schemes.

The fair value of the employee services received, measured at grant date, in exchange for the grant of the awards is recognised as an expense with the corresponding credit being recorded in retained earnings within equity. The total amount to be expensed over the vesting period is determined by reference to the fair value of the awards granted, excluding the impact of any non market vesting conditions (e.g. profitability or net asset growth targets). Non market vesting conditions are included in assumptions about the number of awards that are expected to become exercisable. At each balance sheet date, the Group revises its estimates of the number of awards that are expected to vest. It recognises the impact of the revision of original estimates, if any, in the income statement, and a corresponding adjustment to equity, over the remaining vesting period.

When the terms and conditions of an equity settled share based employee compensation plan are modified, and the expense to be recognised increases as a result of the modification, then the increase is recognised evenly over the remaining vesting period. When a modification reduces the expense to be recognised, there is no adjustment recognised and the pre-modification expense continues to be applied.

The proceeds received net of any directly attributable transaction costs are credited to share capital and share premium when the options are exercised.

In accordance with the transitional arrangements of IFRS 2, only share based awards granted or modified after 7 November 2002 but not yet vested at the date of adoption of IFRS, are included in the calculations.

(d) Termination benefits

Termination benefits are payable when employment is terminated before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Group recognises termination benefits when it is demonstrably committed to either: terminating the employment of current employees according to a detailed formal plan without possibility of withdrawal; or providing termination benefits as a result of an offer made to encourage voluntary redundancy.

(e) Profit sharing and bonus plans

The Group recognises a liability and an expense for bonuses and profit sharing, based on a formula that takes into consideration the profit attributable to the Company's shareholders after certain adjustments. The Group recognises a provision where contractually obliged or where there is a past practice that has created a constructive obligation.

(f) Accumulating compensation benefits

The Group recognises a liability and an expense for accumulating compensation benefits (e.g. holiday entitlement), based on the additional amount that the Group expects to pay as a result of the unused entitlement accumulated at the balance sheet date.

2.17 Borrowings

Borrowings are financial liabilities and are designated on inception as being held at fair value through profit or loss if they are managed and evaluated on a fair value basis in accordance with a documented strategy or if it eliminates or significantly reduces a measurement or recognition inconsistency. Financial liabilities are consequently measured at fair value at each balance sheet date thereafter, using observable market interest rate data for similar instruments, with

2.17 Borrowings continued
all changes in value from one accounting period to the next reflected in the income statement.

2.18 Finance costs
Finance costs consist of interest charges accruing on the Group's borrowings and bank overdrafts together with commission fees charged in respect of letters of credit. Arrangement fees in respect of financing arrangements are charged over the life of the related facilities.

2.19 Provisions
The Group is subject to various insurance related assessments and guarantee fund levies. Provisions are recognised where there is a present obligation (legal or constructive) as a result of a past event that can be measured reliably and it is probable that an outflow of economic benefits will be required to settle that obligation.

2.20 Leases
Leases in which significantly all of the risks and rewards of ownership are transferred to the Group are classified as finance leases. At the commencement of the lease term, finance leases are recognised as assets and liabilities at the lower of the fair value of the asset and the present value of the minimum lease payments. The minimum lease payments are apportioned between finance charges and repayments of the outstanding liability, finance charges being charged to each period of the lease term so as to produce a constant rate of interest on the outstanding balance of the liability.

All other leases are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease.

2.21 Dividend distribution
Dividend distribution to the Company's shareholders is recognised as a liability in the Group's financial statements in the period in which the dividends are approved.

2.22 Use of critical estimates and assumptions
The Directors consider the accounting policies for determining insurance liabilities, amounts denominated in foreign currencies, the valuation of investments, the recognition of premiums and the valuation of retirement benefit obligations as being most critical to an understanding of the Group's result and position.

The inherent uncertainty of insurance risk requires the Group to make estimates and assumptions that affect the reported amounts of assets and liabilities at the balance sheet date. The most significant area of uncertainty in the financial statements relates to the insurance claim liabilities of the Group and the related loss adjustment expenses. Estimates and judgements are continually evaluated based on historical experience and other factors, including expectations of future events that are believed to be reasonable in the circumstances.

There are several sources of uncertainty that need to be considered in the estimation of the liabilities that the Group will ultimately pay for valid claims. These include but are not restricted to: inflation; changes in legislation; changes in the Group's claims handling procedures; and discordant judicial opinions which extend the Group's coverage of risk beyond that envisaged at the time of original policy issuance. The Group seeks to gather corroborative evidence from all relevant sources before making judgements as to the eventual outcome of claims, particularly those under litigation, which have occurred and been notified to the Group but remain unsettled at the balance sheet date.

Note 24 to consolidated financial statements provides a greater analysis of the main methods used by the Group when formulating estimates of the insurance claims liabilities at each balance sheet date.

With regard to employee retirement benefit obligations, the assets, liabilities and changes disclosed in these consolidated financial statements are sensitive to assumptions regarding mortality, interest rates, inflation and investment returns.

3 Management of insurance and financial risk
The Group enters into contracts that directly accept and transfer insurance risk, which in turn creates exposures to financial and other classes of risk. Consequently, Hiscox is fundamentally concerned with the identification and management of all significant risks. The Board has set Group-wide risk management policies which cover specific areas such as risk tolerance boundaries and procedures for communicating risk matters in a timely manner to management.

The main sources of risk relevant to the financial statements are set out below together with an outline of the ways in which the Group manages them. Additional information is also provided in the Corporate Governance and Risk Management sections of this Report and Accounts.

3.1 Insurance risk and exposure controls
Insurance risk is transferred to the Group by contract holders through the underwriting process. The Group's exposure to insurance risk arises from the possibility that an insured event occurs, and a claim is subsequently submitted by the insured for payment.

The Group's overall appetite for accepting varying classes of insurance risk is set by the Group's Board. Management of insurance risk on a day-to-day basis is the responsibility of the Chief Underwriting Officer, who receives assistance from the management information and risk modelling departments.

The Group considers insurance risk at an individual contract level, and also from a portfolio perspective where the risks assumed in similar classes of policies are aggregated and the exposure evaluated in light of historical portfolio experience and prospective factors. To assist with the process of pricing and managing insurance risk the Group routinely performs a wide range of activities including the following:

- regularly updating the Group's risk models
- documenting, monitoring and reporting on the Group's strategy to manage risk
- developing systems that facilitate the identification of emerging issues promptly
- utilising sophisticated computer modelling tools to simulate catastrophes and measure the resultant potential losses before and after reinsurance
- monitoring legal developments and amending the wording of policies when necessary
- regularly aggregating risk exposures across individual underwriting portfolios and known accumulations of risk
- examining the aggregated exposures in advance of underwriting further large risks
- developing processes that continually factor market intelligence into the pricing process.

All underwriting staff and binding agencies are set strict parameters in relation to the levels and types of business they can underwrite, based on individual levels of experience and competence. The delegation of underwriting authority to specific individuals, both internally and externally, is subject to regular review.

Regular meetings are held between the leaders of individual underwriting teams and the Chief Underwriting Officer, the risk modelling department and the actuarial department in order to monitor claim development patterns and discuss individual issues as they arise.

One tool for managing insurance risk is reinsurance. Considerable reinsurance protection such as excess of loss cover is purchased at an entity level and is also considered at an overall Group level to mitigate the effect of catastrophes. The scope and type of reinsurance protection purchased may change depending on the competitiveness of cover available in the market. Very large or complex risks are often shared with a number of other insurers under co-insurance arrangements.

The Group's insurance contracts include provisions to contain losses such as the ability to impose deductibles and demand reinstatement premiums in certain cases. In addition, in order to manage the Group's exposure to repeated catastrophic events, relevant policies frequently contain payment limits to cap the maximum amount payable from these insured events over the contract period.

3 Management of insurance and financial risk continued

3.1 Insurance risk and exposure controls continued

The Group's internal audit function, which is wholly independent of the underwriting function, performs reviews throughout the Group to verify that underwriting teams are in compliance with the Board's policies and required procedures.

The Board requires all underwriters to operate within an overall Group appetite for individual events. This defines the maximum exposure that the Group is prepared to retain on its own account for any one potential catastrophe event or disaster. The Group's underwriting risk appetite is set such that it should not lose more than one year's profit plus 15 per cent of capital as a result of a 1 in 250 year event.

Realistic Disaster Scenarios are extreme, hypothetical events selected by Lloyds to represent major events occurring in areas with large insured values. They also reflect the areas that represent significant exposures for Hiscox. The Group compiles estimates of losses arising from realistic disaster events using statistical models alongside input from its underwriters. The events are extreme and as yet untested, and as such these estimates may prove inadequate resulting from incorrect assumptions, model deficiencies, or losses from unmodelled risks. Estimates of the Group maximum loss exposure to a selection of realistic disaster scenarios are shown below.

For a portfolio of insurance contracts where the theory of probability is applied to pricing and provisioning, the principal accounting risk that the Group faces is that the actual claim payments required exceed the projected amount of the insurance liabilities. This could occur because the frequency or severity of claims is greater than estimated. Insurance events are unpredictable in terms of occurrence, timing and magnitude. This means that the actual number and amount of claims will vary from the estimates established using statistical techniques. Other unpredictable factors that contribute towards the Group's insurance risk accounting exposure include the emergence of latent risks and legal developments such as broadening judicial interpretations of coverage and the measurement of damages, none of which can be quantified with any absolute certainty at the balance sheet date.

Historical experience suggests that the larger the portfolio of similar insurance contracts, the smaller the relative variability about the expected outcome will be. Factors that may increase insurance risk include lack of diversification in terms of type and amount of risk, geographical location and type of policyholder covered. Consequently, the Group seeks to diversify risk acceptances where possible. However, significant geographical concentrations of risk can exist within individual segments of the portfolio. The Group's reserves are calculated by an experienced in-house team of actuaries. The amounts reserved are subject to frequent peer reviews and, for the managed Syndicate, an annual actuarial audit is also performed by external actuaries.

The Group's concentration of insurance risk, determined in relation to the broad categories of insurance liabilities reserved on the balance sheet, is summarised in the bottom table below.

Realistic disaster scenario	Gross loss £m	Net loss £m	Gross loss as a % of GWP	Net loss as a % of NWP	Net loss as a % of insurance industry loss	Industry loss size £ billion	Return period years
Japan Earthquake	151	101	13	10	0.2	42	190
Gulf of Mexico Windstorm	376	139	33	14	0.2	64	100
Florida Windstorm	321	88	29	9	0.2	58	90
European Windstorm	341	147	30	15	0.9	17	80
San Francisco Earthquake	269	78	24	8	0.4	20	120

Concentration of gross and net insurance liabilities on balance sheet

31 December 2006		Type of insurance risk						
		Reinsurance inwards £000	**Property – Marine and major assets £000**	**Property – Other assets £000**	**Casualty – Professional indemnity £000**	**Casualty – Other risks £000**	**Other* £000**	**Total £000**
Territory of policyholder								
UK and Ireland	Gross	**75,059**	**15,885**	**92,929**	**237,914**	**17,452**	**50,372**	**489,611**
	Net	**50,264**	**13,448**	**85,779**	**188,166**	**16,927**	**29,496**	**384,080**
Europe	Gross	**32,941**	**22,068**	**47,172**	**40,539**	**2,275**	**22,130**	**167,125**
	Net	**27,494**	**18,903**	**39,297**	**32,995**	**1,822**	**16,927**	**137,438**
United States	Gross	**140,002**	**168,349**	**123,486**	**188,895**	**62,809**	**32,525**	**716,066**
	Net	**121,252**	**132,881**	**106,571**	**152,788**	**46,569**	**21,769**	**581,830**
Rest of World	Gross	**17,147**	**58,868**	**45,701**	**13,558**	**42,543**	**43,482**	**221,299**
	Net	**14,990**	**50,949**	**39,698**	**10,475**	**30,151**	**41,718**	**187,981**
Total	**Gross**	**265,149**	**265,170**	**309,288**	**480,906**	**125,079**	**148,509**	**1,594,101**
	Net	**214,000**	**216,181**	**271,345**	**384,424**	**95,469**	**109,910**	**1,291,329**

31 December 2005		Type of insurance risk						
		Reinsurance inwards £000	Property – Marine and major assets £000	Property – Other assets £000	Casualty – Professional indemnity £000	Casualty – Other risks £000	Other* £000	Total £000
Territory of policyholder								
UK and Ireland	Gross	61,792	33,921	96,063	227,692	45,959	54,357	519,784
	Net	33,432	22,375	87,538	185,025	30,947	30,938	390,255
Europe	Gross	33,467	20,078	59,242	36,644	6,378	14,351	170,160
	Net	17,036	12,608	52,322	29,865	4,885	9,802	126,518
United States	Gross	244,726	190,390	118,921	185,433	51,595	41,070	832,135
	Net	136,142	115,728	87,047	163,828	39,284	29,842	571,871
Rest of World	Gross	39,433	65,860	19,040	20,301	10,999	45,288	200,921
	Net	23,066	34,611	14,975	17,972	8,149	29,207	127,980
Total	Gross	379,418	310,249	293,266	470,070	114,931	155,066	1,723,000
	Net	209,676	185,322	241,882	396,690	83,265	99,789	1,216,624

*Includes a diverse mix of certain specialty lines such as kidnap and ransom, terrorism, bloodstock and other risks which contain a mix of property and casualty exposures.

3 Management of insurance and financial risk continued
3.1 Insurance risk and exposure controls continued
Frequency and severity of claims
The specific insurance risks accepted by the Group fall into four main categories: reinsurance inwards, marine and major property risks, other property risks and casualty insurance risks. A discussion of the frequency and severity of claims for each of those categories is given below. The Group has no significant exposure to asbestos risks or life and health insurance business.

Reinsurance inwards
The Group's reinsurance inwards acceptances are primarily focused on large commercial property, homeowner and marine exposures held by other insurance companies predominantly in North America and other developed economies. This business is characterised more by large claims arising from individual events or catastrophes than the high frequency, low severity attritional losses associated with certain other business written by the Group. Multiple insured losses can periodically arise out of a single natural or man-made occurrence.

The main circumstances that result in claims against the reinsurance inwards book are conventional catastrophes, such as earthquakes or storms, and other events including fires and explosions. The occurrence and impact of these events is very difficult to model over the short-term which complicates attempts to anticipate loss frequencies on an annual basis. In those years where there is a low incidence of severe catastrophes, loss frequencies on the reinsurance inwards book can be relatively low.

A significant proportion of the reinsurance inwards business provides cover on an excess of loss basis for individual events. The Group agrees to reimburse the cedant once their losses exceed a minimum level. Consequently the frequency and severity of reinsurance inwards' claims is related not only to the number of significant insured events that occur but also to their individual magnitude. If numerous catastrophes occurred in any one year but the cedant's individual loss on each was below the minimum stated, then the Group would have no liability under such contracts.

Maximum gross line sizes and aggregate exposures are set for each type of programme.

Property risks – Marine and major assets
The Group directly underwrites a diverse range of property risks. The risk profile of the property covered under marine and major asset policies is different to that typically contained in the other classes of property (such as private households and contents insurance) covered by the Group.

Typical property covered by marine and other major property contracts include fixed and moveable assets such as ships and other vessels, cargo in transit, energy platforms and installations, pipelines, other subsea assets, satellites, commercial buildings and industrial plants and machinery. These assets are typically exposed to a blend of catastrophic and other large loss events, and attritional claims arising from conventional hazards such as collision, flooding, fire and theft.

Climatic changes may give rise to more frequent and severe extreme weather events (for example earthquakes, windstorms and river flooding etc.) and it may be expected that their frequency will increase over time.

For this reason the Group accepts major property insurance risks for periods of mainly one year so that each contract can be re-priced on renewal to reflect the continually evolving risk profile. The most significant risks covered for periods exceeding one year are certain specialist lines such as marine and offshore construction projects which can typically have building and assembling periods of between three and four years. These form a small proportion of the Group's overall portfolio.

Marine and major property contracts are normally underwritten by reference to the commercial replacement value of the property covered. The cost of repairing or rebuilding assets, of replacement or indemnity for contents and time taken to restart or resume operations to original levels for business interruption losses are the key factors that influence the level of claims under these policies.

Other property risks
The Group provides home and contents insurance, together with cover for art work, antiques, classic cars, jewellery, collectables and other assets held by affluent individuals.

Events which can generate claims on these contracts include burglary, acts of vandalism, fires, flooding and storm damage. Losses can be predicted with a good degree of certainty as the locations of the assets covered, and the individual levels of security taken by owners, are relatively static from one year to the next. The losses associated with these contracts tend to be of a higher frequency and lower severity than the marine and other major property assets covered above.

The Group's home and contents insurance contracts are exposed to weather and climatic risks such as floods and windstorms and their consequences. As outlined earlier the frequency and severity of these losses do not lend themselves to accurate prediction over the short-term. Contract periods are therefore not normally more than one year at a time to enable risks to be regularly re-priced.

Contracts are underwritten by reference to the commercial replacement value of the properties and contents insured, and claims payment limits are always included to cap the amount payable on occurrence of the insured event.

Casualty insurance risks
The casualty underwriting strategy attempts to ensure that the underwritten risks are well diversified in terms of type and amount of potential hazard, industry and geography. However, the Group's exposure is more focused towards marine, professional and technological liability risks rather than human bodily injury risks, which are only accepted under limited circumstances. Claims typically arise from incidents such as errors and omissions attributed to the insured, professional negligence and specific losses suffered as a result of electronic or technological failure of software products and websites. The Group's casualty insurance contracts mainly experience low severity attritional losses.

The Group's pricing strategy for casualty insurance policies is typically based upon historical claims frequencies and average claim severities, adjusted for inflation and extrapolated forwards to incorporate projected changes in claims patterns. In determining the price of each policy an allowance is also made for acquisition and administration expenses, reinsurance costs, investment returns and the Group's cost of capital.

Sources of uncertainty in the estimation of future claim payments
The Group's procedures for estimating the outstanding costs of settling insured losses at the balance sheet date, including those not yet notified by, or apparent to, the insured, are detailed in note 24.

The majority of the Group's insurance risks are short tail and claims are normally notified and settled within 12 months of the insured event occurring. Those claims taking the longest time to develop and settle typically relate to casualty risks where legal complexities occasionally develop regarding the insured's alleged omissions or negligence. Certain marine and property insurance contracts such as those relating to subsea and other energy assets, and the related business interruption risks, can also take longer than normal to settle. This is because of the length of time required for detailed subsea surveys to be carried out and damage assessments agreed together with difficulties in predicting when the assets can be brought back into full production.

The majority of the Group's casualty exposures are on a claims made basis. However the final quantum of these claims may not be established for a number of years after the event. Consequently a significant proportion of the casualty insurance amounts reserved on the balance sheet may not be expected to settle within 12 months of the balance sheet date. A greater proportion of the casualty claims provision at the year end relates to IBNR losses than the provisions made for property and other categories of insurance risks.

Notes to the financial statements continued

3 Management of insurance and financial risk continued

3.2 Financial risk

The Group is exposed to financial risk through their ownership of financial assets, financial liabilities, reinsurance assets and insurance liabilities. In particular the key financial risk for the Group is that the proceeds from its financial assets are not sufficient to fund the obligations arising from its insurance contracts. The most important components of this financial risk are interest rate risk, credit risk, liquidity risk and currency risk. The Group's exposure to equity price risk is limited to a small proportion of the investment portfolio and is well diversified over a number of companies and industries. Furthermore the allocation of equity risk is not heavily confined to any one market index so as to reduce the Group's exposure to individual sensitivities. The carrying value of unquoted equity investments at 31 December 2006 was £976,000 (2005: £976,000).

An analysis of the Group's exposure to each significant component of financial risk is given in Sections 3.3 to 3.6 below.

3.3 Interest rate risk

Financial investments represent a significant proportion of the Group's assets and the Board continually monitors investment strategy to minimise the risk of a fall in the portfolio's market value which could affect the amount of business that the Group is able to underwrite or its ability to settle claims as they fall due. The vast majority of the Group's investments comprise debt and fixed income securities. The fair value of the Group's investment portfolio of debt and fixed income securities is inversely correlated to movements in market interest rates. If market interest rates fall, the fair value of the Group's debt and fixed income investments would tend to rise and vice versa.

Debt and fixed income assets are predominantly invested in high quality corporate, government and municipal bonds. The investments typically have relatively short durations and terms to maturity. The portfolio is managed to minimise the impact of interest rate risk on anticipated Group cash flows.

The fair value of debt and fixed income assets in the Group's balance sheet at 31 December 2006 was £1,044 million (2005: £1,029 million). Using a duration-convexation based sensitivity analysis, if market interest rates had risen by 100 basis points at the balance sheet date, the fair value might have been expected to decrease by £13 million (2005: decrease of £13 million).

Insurance contract liabilities are not directly sensitive to the level of market interest rates, as they are undiscounted and contractually non-interest-bearing.

The Group's major borrowing facility at 31 December 2006 totalled £92,852,000 (2005: £120,930,000). This interest rate is currently fixed at 6.67% until 31 May 2007. The Group has no other significant borrowings or other assets or liabilities carrying interest rate risk, other than the facilities and letters of credit outlined in note 31.

3.4 Credit risk

The Group has exposure to credit risk, which is the risk that a counterparty will suffer a deterioration in solvency or be unable to pay amounts in full when due.

Key areas of exposure to credit risk include:

- reinsurers' share of insurance liabilities;
- amounts due from reinsurers in respect of claims already paid;
- amounts due from insurance contract holders;
- amounts due from insurance intermediaries; and
- counterparty risk with respect to investments including deposits and derivative transactions.

The Group's maximum exposure to credit risk is represented by the carrying values of monetary assets and reinsurance assets included in the consolidated balance sheet.

The Group structures the levels of credit risk accepted by placing limits on their exposure to a single counterparty, or groups of counterparties, and to geographical and industry segments. Such risks are subject to an annual or more frequent review. There is no significant concentration of credit risk with respect to loans and receivables, as the Group has a large number of internationally dispersed debtors.

Reinsurance is used to contain insurance risk. This does not, however, discharge the Group's liability as primary insurer. If a reinsurer fails to pay a claim for any reason, the Group remains liable for the payment to the policyholder. The creditworthiness of reinsurers is continually reviewed throughout the year.

The Group Reinsurance Security Committee assesses the creditworthiness of all reinsurers by reviewing credit grades provided by rating agencies and other publicly available financial information detailing their financial strength and performance. The financial analysis of reinsurers produces an assessment categorised by Standard & Poor's (S&P) rating (or equivalent when not available from S&P). The Committee considers the reputation of its reinsurance partners and also receives details of recent payment history and the status of any ongoing negotiations between Group companies and these third parties. This information is used to update the reinsurance purchasing strategy.

Individual operating units maintain records of the payment history for significant brokers and contract holders with whom they conduct regular business. The exposure to individual counterparties is also managed by other mechanisms, such as the right of offset where counterparties are both debtors and creditors of the Group. Management information reported to the Group's Board includes details of provisions for impairment on loans and receivables and subsequent write-off. Exposures to individual intermediaries and groups of intermediaries are collected within the ongoing monitoring of the controls associated with regulatory solvency.

The Group also mitigates credit counterparty risk by concentrating debt and fixed income investments in high quality instruments, including a particular emphasis on government gilts and municipal agency instruments issued mainly by European Union and North American countries.

3 Management of insurance and financial risk continued

3.4 Credit risk continued

An analysis of the Group's major exposures to counterparty credit risk excluding loans and receivables, based on Standard & Poor's or equivalent rating, is presented below:

As at 31 December 2006	Notes	**AAA £000**	**AA £000**	**A £000**	**Other/ not rated £000**	**Total £000**
Debt and fixed income securities	18	**742,964**	**72,210**	**140,634**	**87,861**	**1,043,669**
Reinsurance assets	17	**20,892**	**130,155**	**121,261**	**30,464**	**302,772**
Cash and cash equivalents	21	**115,661**	**242,980**	**144,228**	**2**	**502,871**
Deposits with credit institutions	18	**–**	**–**	**54,715**	**–**	**54,715**
Derivative financial assets/(liabilities)	18, 20	**–**	**608**	**–**	**–**	**608**
Total		**879,517**	**445,953**	**460,838**	**118,327**	**1,904,635**

A significant proportion of 'other/not rated' reinsurance assets at 31 December 2006 are supported by letter of credit guarantees issued by financial institutions with Standard & Poor's or equivalent credit or financial strength ratings of A or better.

As at 31 December 2005	Notes	AAA £000	AA £000	A £000	Other/ not rated £000	Total £000
Debt and fixed income securities	18	733,809	57,648	128,326	109,012	1,028,795
Reinsurance assets	17	27,784	150,896	311,370	16,326	506,376
Cash and cash equivalents	21	291,548	112,039	10,169	3	413,759
Deposits with credit institutions	18	–	7,466	82,110	–	89,576
Derivative financial assets/(liabilities)	18, 20	–	(5,056)	–	–	(5,056)
Total		1,053,141	322,993	531,975	125,341	2,033,450

3.5 Liquidity risk

The Group is exposed to daily calls on its available cash resources mainly from claims arising from insurance contracts. Liquidity risk is the risk that cash may not be available to pay obligations when due at a reasonable cost. The Board sets limits on the minimum level of maturing funds available to meet such calls and on the minimum level of borrowing facilities that should be in place to cover maturities, claims and surrenders at unexpected levels of demand.

The vast majority of the Group's investments are in highly liquid assets which could be converted into cash in a prompt fashion and at minimal expense. The deposits with credit institutions largely comprise short dated certificates for which an active market exists and which the Group can easily access. The Group's exposure to equities is concentrated on shares and funds that are frequently traded on internationally recognised stock exchanges.

The main focus of the investment portfolio is on high quality and frequently traded short duration debt and fixed income securities. There is no significant repricing risk associated with these assets. Notwithstanding the regular interest receipts and also the Group's ability to liquidate these securities for cash in a prompt and reasonable manner, the contractual maturity profile of these securities at 31 December was as follows:

	2006 £000	2005 £000
Less than one year	**225,283**	167,175
Between one and two years	**257,883**	295,897
Between three and five years	**307,325**	327,522
Over five years	**192,890**	174,660
Sub-total	**983,381**	965,254
Perpetual notes and other non-dated instruments	**60,288**	63,541
Total debt and fixed income securities	**1,043,669**	1,028,795

Average contractual maturity analysed by denominational currency of investments

	2006 Years	2005 Years
Pound Sterling	**3.56**	5.65
US Dollar	**7.76**	6.01
Euro	**3.99**	3.83
Canadian Dollar	**1.47**	0.84

Notes to the financial statements continued

3 Management of insurance and financial risk continued

3.6 Currency risk

The Group operates internationally and its exposures to foreign exchange risk arise primarily with respect to the US Dollar and the Euro. The assets of the Group's Bermudian, US and European insurance businesses are generally invested in assets denominated in the same currencies as their insurance and investment liabilities.

The profile of the Group's assets and liabilities, categorised by currency at their translated carrying amount was as follows:

At 31 December 2006	Sterling £000	US Dollar £000	Euro £000	Other £000	Total £000
Intangible assets	33,212	–	–	–	33,212
Property, plant and equipment	12,222	1,088	511	–	13,821
Investments in associates	28	–	–	–	28
Deferred acquisition costs	53,503	52,463	10,276	873	117,115
Financial assets carried at fair value	478,159	580,028	147,386	36,337	1,241,910
Loans and receivables including insurance receivables	152,076	242,823	41,588	9,785	446,272
Reinsurance assets	83,325	192,657	20,758	6,032	302,772
Cash and cash equivalents	69,219	392,644	33,273	7,735	502,871
Total assets	881,744	1,461,703	253,792	60,762	2,658,001

	Sterling £000	US Dollar £000	Euro £000	Other £000	Total £000
Employee retirement benefit obligations	3,801	–	–	–	3,801
Deferred tax	8,467	–	–	–	8,467
Insurance liabilities	441,619	984,763	132,912	34,807	1,594,101
Financial liabilities carried at fair value	297	93,555	77	–	93,929
Current tax	20,793	–	–	–	20,793
Trade and other payables	114,428	99,382	35,432	5,583	254,825
Total liabilities	589,405	1,177,700	168,421	40,390	1,975,916

At 31 December 2005	Sterling £000	US Dollar £000	Euro £000	Other £000	Total £000
Intangible assets	33,099	–	–	–	33,099
Property, plant and equipment	11,311	388	429	–	12,128
Investments in associates	18	–	–	–	18
Deferred acquisition costs	29,071	54,226	19,632	3,818	106,747
Financial assets carried at fair value	450,142	623,824	136,220	27,592	1,237,778
Loans and receivables including insurance receivables	187,566	199,032	40,901	9,482	436,981
Reinsurance assets	67,762	415,793	18,104	4,717	506,376
Cash and cash equivalents	43,039	325,282	27,410	18,028	413,759
Total assets	822,008	1,618,545	242,696	63,637	2,746,886

	Sterling £000	US Dollar £000	Euro £000	Other £000	Total £000
Employee retirement benefit obligations	16,677	–	–	–	16,677
Deferred tax	15,193	–	–	–	15,193
Insurance liabilities	394,652	1,140,620	154,351	33,377	1,723,000
Financial liabilities carried at fair value	260	125,986	–	–	126,246
Current tax	16,581	–	–	–	16,581
Trade and other payables	141,090	79,226	38,070	12,790	271,176
Total liabilities	584,453	1,345,832	192,421	46,167	2,168,873

4 Segmental information

At 31 December 2006, the Group was managed on a worldwide basis in three primary business segments:

- **Global Markets and Corporate Centre** comprises the results of Syndicate 33, excluding Syndicate 33's specie, fine art, UK regional events coverage, non-US household business and the underwriting results of Hiscox Inc. It also includes the investment return and administrative costs associated with the Company and other Group management activities.
- **UK and Europe** comprises the results of Hiscox Insurance Company Limited, the results of Syndicate 33's specie, fine art, UK regional events coverage and non-US household business, together with income and expenses arising from the Group's retail agency activities in the UK and in continental Europe.
- **International** comprises the results of Hiscox Insurance Company (Guernsey) Limited, Hiscox Inc. and Hiscox Insurance Company (Bermuda) Limited.

This segmentation reflects the internal operational structure within the Group and how the business units' assets and operations are strategically managed to offer different products and services, with different risk profiles, to specific customer groups. All revenue sources are captured by one of the three business segments shown above.

The primary segment results for the year, presented in operational reporting format, are as follows:

(a) Profit before tax by segment

	Year to 31 December 2006				Year to 31 December 2005			
	Global Markets and Corporate Centre £000	UK and Europe £000	International £000	Total £000	Global Markets and Corporate Centre £000	UK and Europe £000	International £000	Total £000
Gross premiums written	689,912	284,946	151,306	1,126,164	555,183	262,271	43,720	861,174
Net premiums written	587,315	250,661	137,421	975,397	417,128	235,276	28,832	681,236
Net premiums earned	549,284	246,071	93,473	888,828	428,334	241,603	23,362	693,299
Investment result based on longer-term rates of return	38,786	18,169	13,109	70,064	36,181	14,300	1,632	52,113
Net claims incurred	(256,949)	(109,488)	(15,904)	(382,341)	(347,865)	(108,498)	(662)	(457,025)
Acquisition costs	(142,139)	(74,773)	(27,478)	(244,390)	(118,546)	(81,827)	(18,380)	(218,753)
Administration expenses	(35,149)	(33,212)	(8,172)	(76,533)	(14,342)	(24,571)	(2,284)	(41,197)
Foreign exchange gains/(losses)	(39,577)	(1,693)	2,916	(38,354)	55,060	2,362	(162)	57,260
Trading result	114,256	45,074	57,944	217,274	38,822	43,369	3,506	85,697
Agency and other income	5,007	23,639	421	29,067	8,376	22,640	2,469	33,485
Profit commission	5,332	–	–	5,332	7,357	–	–	7,357
Short-term investment return fluctuations	29,757	2,389	3,340	35,486	(15,252)	6,081	(70)	(9,241)
Other expenses	(28,448)	(38,461)	(9,794)	(76,703)	(15,253)	(28,740)	–	(43,993)
Operating result	125,904	32,641	51,911	210,456	24,050	43,350	5,905	73,305
Finance costs	(9,368)	–	(36)	(9,404)	(3,334)	–	–	(3,334)
Associates result	10	–	–	10	–	–	250	250
Profit before tax	116,546	32,641	51,875	201,062	20,716	43,350	6,155	70,221

The longer-term rates of return are calculated based on a 6 per cent return on equities and 4 per cent for all other investments including cash. These rates are applied to the average value of investments held in each class during the current and prior financial year.

The following charges are included within the consolidated income statement:

	Year to 31 December 2006				Year to 31 December 2005			
	Global Markets and Corporate Centre £000	UK and Europe* £000	International £000	Total £000	Global Markets and Corporate Centre £000	UK and Europe* £000	International £000	Total £000
Depreciation	1,452	2,276	170	3,898	1,318	1,963	–	3,281
Amortisation of intangible assets	52	135	–	187	47	120	–	167
Impairment loss on investment in associate	–	–	–	–	182	–	–	182

*The majority of all UK based tangible assets, and their related financing arrangements, have been accounted for and are held by entities in the Global Markets and Corporate Centre segment. The UK and Europe business benefits from certain operational facilities and other tangible assets shared with the Global Market and Corporate Centre segment. The depreciation cost reflected for the UK and Europe segment is that primarily recharged internally by the Global Markets and Corporate Centre segment.

The Group's wholly owned subsidiary, Hiscox Syndicates Limited, oversees the operation of Syndicate 33 at Lloyd's. The Group's percentage participation in Syndicate 33 can fluctuate from year to year and consequently, presentation of the results at the 100 per cent level removes any distortions arising therefrom.

	Year to 31 December 2006				Year to 31 December 2005			
100% Ratio analysis	Global Markets and Corporate Centre	UK and Europe	International	Total	Global Markets and Corporate Centre	UK and Europe	International	Total
Claims ratio (%)	54.6	45.5	17.5	49.3	70.8	45.1	2.8	61.8
Expense ratio (%)	34.4	50.2	44.7	39.0	29.1	41.8	88.5	34.2
Combined ratio (%)	89.0	95.7	62.2	88.3	99.9	86.9	91.3	96.0

In calculating the claims and expense ratios the Group has applied an estimated allocation of the foreign exchange gains and losses to each category.

4 Segmental information continued
The impact on profit before tax of a 1 per cent change in each component of the segmental combined ratios are:

	Year to 31 December 2006			Year to 31 December 2005		
	Global Markets and Corporate Centre £000	UK and Europe £000	International £000	Global Markets and Corporate Centre £000	UK and Europe £000	International £000
At 100% level (note 4c)						
1% change in claims or expense ratio	7,661	2,605	948	6,268	2,565	234
At Group level						
1% change in claims or expense ratio	5,493	2,461	935	4,289	2,416	234

(b) Reconciliation of 100% level to Group results

	2006 £000	2005 £000
Trading result based on longer-term rates of return at 100% level (note 4c)	239,345	102,381
Notional share attributable to Group at current level of capacity ownership	220,827	93,872
Adjustment to reflect different levels of capacity in prior years:		
2003 year of account	–	(2,505)
2004 year of account	(3,266)	(5,670)
2005 year of account	(287)	–
Trading result based on longer-term rates of return at Group level (note 4a)	217,274	85,697

For the 2006 year of account the Group owned 72.6 per cent (2005: 71.1 per cent) of the Syndicate.

(c) 100% level underwriting results by segment

	Year to 31 December 2006				Year to 31 December 2005			
	Global Markets and Corporate Centre £000	UK and Europe £000	International £000	Total £000	Global Markets and Corporate Centre £000	UK and Europe £000	International £000	Total £000
Gross premiums written	950,169	302,043	154,999	1,407,211	786,347	274,886	43,720	1,104,953
Net premiums written	809,973	265,342	141,114	1,216,429	584,132	245,823	28,832	858,787
Net premiums earned	766,053	260,457	94,794	1,121,304	626,784	256,472	23,362	906,618
Investment result based on longer-term rates of return	53,620	19,032	13,109	85,761	51,287	14,300	1,632	67,219
Net claims incurred	(357,632)	(118,421)	(16,597)	(492,650)	(504,042)	(115,659)	(662)	(620,363)
Acquisition costs	(201,056)	(79,376)	(27,763)	(308,195)	(174,189)	(87,501)	(18,380)	(280,070)
Administration expenses	(66,804)	(33,821)	(8,172)	(108,797)	(30,777)	(25,385)	(2,284)	(58,446)
Foreign exchange gains/(losses)	(58,664)	(2,330)	2,916	(58,078)	83,887	3,536	–	87,423
Trading result based on longer-term rates of return	135,517	45,541	58,287	239,345	52,950	45,763	3,668	102,381

(d) Segmental analysis of assets and liabilities
The segment assets and liabilities at 31 December and the capital expenditure for the year then ended are as follows:

	Year to 31 December 2006					Year to 31 December 2005				
	Global Markets and Corporate Centre £000	UK and Europe £000	International £000	Eliminations and unallocated items £000	Total £000	Global Markets and Corporate Centre £000	UK and Europe £000	International £000	Eliminations and unallocated items £000	Total £000
Intangible assets	30,092	3,120	–	–	33,212	30,144	2,955	–	–	33,099
Deferred acquisition costs	67,476	29,225	20,414	–	117,115	59,587	36,456	10,704	–	106,747
Financial assets	896,191	328,871	16,848	–	1,241,910	907,295	319,460	11,023	–	1,237,778
Reinsurance assets	227,655	70,438	4,679	–	302,772	426,718	67,177	12,481	–	506,376
Other assets	863,182	159,094	380,651	(439,935)	962,992	485,467	163,111	316,473	(102,165)	862,886
Total assets	2,084,596	590,748	422,592	(439,935)	2,658,001	1,909,211	589,159	350,681	(102,165)	2,746,886
Insurance liabilities	1,158,255	346,229	89,617	–	1,594,101	1,339,838	353,110	30,052	–	1,723,000
Other liabilities	323,689	155,606	16,154	(113,634)	381,815	369,415	134,218	12,631	(70,391)	445,873
Total liabilities	1,481,944	501,835	105,771	(113,634)	1,975,916	1,709,253	487,328	42,683	(70,391)	2,168,873
Capital expenditure	4,561	230	1,159	–	5,950	5,012	2,696	388	–	8,096

Segment assets and liabilities primarily consist of operating assets and liabilities, which represent the majority of the balance sheet. Inter-segmental assets and liabilities, together with taxation balances that are not allocated to specific segments, are presented under the separate category headed 'Eliminations and unallocated items'.

Capital expenditure comprises intangible assets other than goodwill (note 14) and additions to property, plant and equipment (note 15).

4 Segmental information continued

(e) Secondary reporting format – geographical segments

The Group's operational segments underwrite business from locations in the UK and Ireland, and also through its branch network in Guernsey, France, Germany, Belgium and the Netherlands. In addition, the Group commenced underwriting and agency operations in Bermuda and the USA in 2006.

The following table provides an analysis of the Group's gross premiums earned by geographical location of policyholders:

	Year to 31 December 2006				Year to 31 December 2005			
Gross premiums earned	Global Markets and Corporate Centre £000	UK and Europe £000	International £000	Total £000	Global Markets and Corporate Centre £000	UK and Europe £000	International £000	Total £000
UK and Ireland	83,415	199,425	5,361	288,201	99,916	207,338	2,449	309,703
Europe	80,713	65,875	11,518	158,106	51,504	55,616	8,841	115,961
United States	344,875	5,899	48,565	399,339	308,794	8,773	1,558	319,125
Rest of World	135,242	6,830	45,867	187,939	105,401	2,654	26,500	134,555
	644,245	278,029	111,311	1,033,585	565,615	274,381	39,348	879,344

The following tables provide an analysis of total segment assets at the end of the year, and capital expenditure incurred during the year, by geographical location. Capital expenditure relates to the acquisition of intangible assets and property, plant and equipment during the year. Amounts are stated before the elimination of inter-segmental assets and liabilities and also exclude taxation balances that are not allocated to specific segments (note 4(d)).

Amounts are allocated based on where the assets are located.

	At 31 December 2006				At 31 December 2005			
Total segment assets	Global Markets and Corporate Centre £000	UK and Europe £000	International £000	Total £000	Global Markets and Corporate Centre £000	UK and Europe £000	International £000	Total £000
UK and Europe	1,759,672	590,748	68,340	2,418,760	1,909,211	589,159	57,599	2,555,969
United States	267,200	–	9,523	276,723	–	–	508	508
Bermuda	–	–	344,729	344,729	–	–	292,574	292,574
Rest of World	57,724	–	–	57,724	–	–	–	–
	2,084,596	590,748	422,592	3,097,936	1,909,211	589,159	350,681	2,849,051

	At 31 December 2006				At 31 December 2005			
Capital expenditure	Global Markets and Corporate Centre £000	UK and Europe £000	International £000	Total £000	Global Markets and Corporate Centre £000	UK and Europe £000	International £000	Total £000
UK and Europe	4,561	230	–	4,791	5,012	2,696	–	7,708
United States	–	–	811	811	–	–	118	118
Bermuda	–	–	348	348	–	–	270	270
Rest of World	–	–	–	–	–	–	–	–
	4,561	230	1,159	5,950	5,012	2,696	388	8,096

5 Net asset value per share

	2006		2005	
	Net asset value £000	NAV per share pence	Net asset value £000	NAV per share pence
Net asset value	682,085	173.2	578,013	147.7
Net tangible asset value	648,873	164.8	544,914	139.3

The net asset value per share is based on 393,725,396 shares (2005: 391,216,294), being the adjusted number of shares in issue at 31 December.

There is no impact on the comparative amount for the application of reverse acquisition accounting (note 2.3).

Notes to the financial statements continued

6 Investment result

The total investment return for the Group before taxation comprises:

	2006 £000	2005 £000
Investment income including interest receivable	**75,526**	48,172
Net realised losses on investments at fair value through profit or loss	**(5,731)**	(8,040)
Net fair value gains on investments at fair value through profit or loss	**8,721**	10,155
Return on investments (note 7)	**78,516**	50,287
Fair value gains/(losses) on derivative instruments (note 20)	**27,034**	(6,404)
Total return on financial assets	**105,550**	43,883

Investment expenses are presented within other expenses (note 9).

7 Analysis of return on investments

The return on investments for the year by currency was:

	2006 %	2005 %
Sterling	**5.4**	6.1
US Dollar	**4.8**	2.5
Other	**2.2**	2.2

The return on investments by asset class for the year was:

	Global Markets and Corporate Centre £000	%	UK and Europe £000	%	International £000	%	2006 Total £000	%
Debt and fixed income securities at fair value through profit or loss	**33,263**	**4.1**	**8,509**	**3.6**	**323**	**2.6**	**42,095**	**4.0**
Equities and shares in unit trusts at fair value through profit or loss	**5,314**	**10.4**	**7,189**	**10.2**	**1,014**	**17.6**	**13,517**	**10.6**
Deposits with credit institutions/cash and cash equivalents	**2,932**	**3.7**	**4,860**	**4.3**	**15,112**	**4.9**	**22,904**	**4.6**
	41,509	**4.4**	**20,558**	**4.9**	**16,449**	**5.1**	**78,516**	**4.6**

	Global Markets and Corporate Centre £000	%	UK and Europe £000	%	International £000	%	2005 Total £000	%
Debt and fixed income securities at fair value through profit or loss	20,627	2.9	5,992	4.4	114	1.7	26,733	3.1
Equities and shares in unit trusts at fair value through profit or loss	4,294	10.8	7,524	15.2	460	10.8	12,278	13.1
Deposits with credit institutions/cash and cash equivalents	3,855	2.9	6,434	4.4	987	3.5	11,276	3.7
	28,776	3.2	19,950	6.0	1,561	4.0	50,287	4.0

8 Deferred acquisition costs

	2006 Gross £000	2006 Reinsurance £000	2006 Net £000	2005 Gross £000	2005 Reinsurance £000	2005 Net £000
Balance deferred at 1 January	**106,747**	**(2,496)**	**104,251**	109,970	(4,552)	105,418
Acquisition costs incurred in relation to insurance contracts written	**243,323**	**(11,139)**	**232,184**	203,289	(4,477)	198,812
Acquisition costs expensed to the income statement	**(232,955)**	**7,106**	**(225,849)**	(206,512)	6,533	(199,979)
Balance deferred at 31 December	**117,115**	**(6,529)**	**110,586**	106,747	(2,496)	104,251

The deferred amount of insurance contract acquisition costs attributable to reinsurers of £6,529,000 (2005: £2,496,000) is not eligible for offset against the gross balance sheet asset and is included separately within trade and other payables (note 25).

The amounts expected to be recovered before and after one year are estimated as follows:

	2006 £000	2005 £000
Within one year	**110,586**	104,251
After one year	**–**	–
	110,586	104,251

9 Other income and expenses

	2006 £000	2005 £000
Agency related income	**5,027**	3,044
Profit commission	**5,332**	9,807
Exchange gains (note 13)	**–**	57,420
Other income	**5,499**	11,026
Other income	**15,858**	81,297
Managing agency expenses	**17,258**	9,869
Overseas underwriting agency expenses	**32,147**	19,886
Connect agency expenses	**12,547**	6,135
Exchange losses (note 13)	**38,354**	–
Investment expenses	**1,306**	1,013
Other Group expenses including depreciation and amortisation (notes 14 and 15)	**13,445**	10,070
Other expenses	**115,057**	46,973

10 Employee benefit expense

The aggregate remuneration and associated costs were:

	2006 £000	2005 £000
Wages and salaries, including holiday pay and sabbatical leave charges	**58,568**	37,581
Social security costs	**7,512**	6,124
Share based payments cost of options granted to Directors and employees (note 22)	**5,238**	2,059
Pension costs – defined contribution	**1,689**	825
Pension costs – net expense arising on defined benefit plans (note 28)	**12,180**	4,047
	85,187	50,636

The average monthly number of staff employed by the Group was 637 (2005: 514) comprising 270 underwriting and 367 administrative staff (2005: 190 and 324 respectively). Of the total remuneration shown above, an amount of £20,780,000 (2005: £14,433,000) was recharged to the syndicate managed by Hiscox Syndicates Limited.

11 Finance costs

	2006 £000	2005 £000
Interest and expenses associated with bank borrowings and letters of credit (note 31)	**9,363**	3,302
Interest charges arising on finance leases	**41**	32
	9,404	3,334

12 Auditors' remuneration

Fees payable to the auditors and its associates (exclusive of VAT) include the following amounts recorded in the consolidated income statement:

Group	2006 £000	2005 £000
Fees payable to the Company's auditor for the audit of the Group's consolidated financial statements	**110**	115
Fees payable to the Company's auditor and its associates for other services:		
The audit of the Company's subsidiaries pursuant to legislation	**321**	190
Other services pursuant to legislation	**30**	25
All other services*	**307**	255
	768	585
Fees in respect of the defined benefit pension scheme:		
Audit	**9**	9
Total auditors' remuneration expense	**777**	594

*Other fees include work performed in relation to the Group's Scheme of Arrangement and the listing of Hiscox Ltd on the London Stock Exchange. Non-audit services with fees greater than £50,000 must be pre-approved by the Audit Committee which is composed solely of independent Non Executive Directors.

KPMG Audit Plc acted as auditors to the Group during the previous financial year and continue to audit a number of the Group's subsidiaries during 2006. KPMG are the auditors of the new holding company, Hiscox Ltd. The full fee payable for the Syndicate audit has been included above, although an element of this is borne by the third party participants in the Syndicate.

In addition to the above expenses, the auditors also earned fees of £nil (2005: £245,000 exclusive of VAT) in relation to the issuance of share capital (2005: Rights Issue) which have been deducted from the share premium reserve (note 22).

13 Net foreign exchange gains/(losses)

The net foreign exchange gains/(losses) for the year include the following amounts:

	2006 £000	2005 £000
Exchange gains/(losses) recognised in the consolidated income statement	**(38,354)**	57,420
Exchange gains/(losses) classified as a separate component of equity	**(41,218)**	1,290

This excludes profits or losses on foreign exchange derivative contracts which are included within the investment result and are outlined in note 20.

Overall impact of foreign exchange related items	2006 £000	2005 £000
Consolidated income statement		
Derivative gains/(losses) on foreign exchange contracts included within investment return (notes 6 and 20)	**27,034**	(6,404)
Unearned premiums and deferred acquisition costs adjustment	**(25,511)**	22,401
Foreign exchange gains/(losses) on borrowings for economic hedging of Hiscox Insurance Company (Bermuda) Limited	**14,121**	(120)
Other foreign exchange gains/(losses)	**(26,964)**	35,139
	(38,354)	57,420
Impact of foreign exchange related items on consolidated income statement	**(11,320)**	51,016
Balance sheet		
Foreign exchange differences recognised directly in equity	**(41,218)**	1,290
Overall impact of foreign exchange related items on net assets	**(52,538)**	52,306
Profit before tax		
Profit before tax	**201,062**	70,221
Unearned premiums and deferred acquisition costs retranslation adjustment	**25,511**	(22,401)
Adjusted profit before tax	**226,573**	47,820

14 Intangible assets

	Goodwill £000	Syndicate capacity £000	Other £000	Total £000
At 1 January 2005				
Cost	8,547	23,629	269	32,445
Accumulated amortisation and impairment	(2,442)	–	(14)	(2,456)
Net book amount	6,105	23,629	255	29,989
Year ended 31 December 2005				
Opening net book amount	6,105	23,629	255	29,989
Additions in year	–	876	2,401	3,277
Amortisation	–	–	(167)	(167)
Closing net book amount	6,105	24,505	2,489	33,099
At 31 December 2005				
Cost	8,547	24,505	2,670	35,722
Accumulated amortisation and impairment	(2,442)	–	(181)	(2,623)
Net book amount	6,105	24,505	2,489	33,099
Year ended 31 December 2006				
Opening net book amount	**6,105**	**24,505**	**2,489**	**33,099**
Additions in year	**–**	**–**	**300**	**300**
Amortisation and impairment charge	**–**	**–**	**(187)**	**(187)**
Closing net book amount	**6,105**	**24,505**	**2,602**	**33,212**
At 31 December 2006				
Cost	**8,547**	**24,505**	**2,970**	**36,022**
Accumulated amortisation and impairment	**(2,442)**	**–**	**(368)**	**(2,810)**
Net book amount	**6,105**	**24,505**	**2,602**	**33,212**

The additions to syndicate capacity during 2005 represent the amounts paid, inclusive of transaction costs, by the Group in acquiring an additional 1% of capacity of Syndicate 33 in open market auctions. The Group's intangible asset relating to syndicate capacity has been allocated, for impairment testing purposes, to one individual cash generating unit being the Lloyd's corporate member entities. The Group has considered the recoverable amount from the Lloyd's corporate member entities on a value in use basis. This calculation uses cash flow projections based on financial forecasts approved by management covering a five year period. Cash flows beyond the five year period are extrapolated based on an average level of return and annual growth. The results of this exercise indicate that the recoverable amount exceeds the intangible's carrying value.

Other intangibles primarily relate to the costs of acquiring rights to customer contractual relationships and also include a limited level of capitalised software costs. The additions during 2006 primarily comprise the Group's acquisition of the customer relationships of Global Flying Insurance Services (2005: Insurex Expo-Sure).

The amortisation charge for the year includes £40,000 (2005: £40,000) relating to capitalised software costs. The net book value of capitalised software costs at 31 December 2006 was £40,000 (2005: £80,000). There are no charges for impairment during the current or prior financial year.

The Group had no internally generated intangible assets at 31 December 2006 (2005: £nil).

Goodwill is allocated to the Group's cash generating units ('CGUs') identified according to country of operation and business segment.

At 31 December 2006 and 2005 the Group's goodwill net book amount is all attributable to UK based operations.

Notes to the financial statements continued

15 Property, plant and equipment

	Land and buildings £000	Leasehold improvements £000	Vehicles £000	Furniture, fittings and equipment and art £000	Total £000
At 1 January 2005					
Cost	2,985	–	508	20,430	23,923
Accumulated depreciation	(40)	–	(113)	(13,079)	(13,232)
Net book amount	2,945	–	395	7,351	10,691
Year ended 31 December 2005					
Opening net book amount	2,945	–	395	7,351	10,691
Additions	–	6	217	4,596	4,819
Disposals	–	–	(36)	(65)	(101)
Depreciation charge	(40)	–	(100)	(3,141)	(3,281)
Closing net book amount	2,905	6	476	8,741	12,128
At 31 December 2005					
Cost	2,985	6	647	24,925	28,563
Accumulated depreciation	(80)	–	(171)	(16,184)	(16,435)
Net book amount	2,905	6	476	8,741	12,128
Year ended 31 December 2006					
Opening net book amount	**2,905**	**6**	**476**	**8,741**	**12,128**
Additions	**–**	**508**	**169**	**4,973**	**5,650**
Disposals	**–**	**–**	**(55)**	**(4)**	**(59)**
Depreciation charge	**(40)**	**(78)**	**(125)**	**(3,655)**	**(3,898)**
Closing net book amount	**2,865**	**436**	**465**	**10,055**	**13,821**
At 31 December 2006					
Cost	**2,985**	**514**	**679**	**29,894**	**34,072**
Accumulated depreciation	**(120)**	**(78)**	**(214)**	**(19,839)**	**(20,251)**
Net book amount	**2,865**	**436**	**465**	**10,055**	**13,821**

The Group's land and buildings assets relate to freehold property in the United Kingdom. At 31 December 2006 and 2005 part of the buildings were occupied by third parties under separate operating lease arrangements (note 32).

Assets with a net book value of £465,000 were held under finance leases (2005: £476,000). The total depreciation charge for the year in respect of assets held under finance leases was £125,000 (2005: £100,000).

16 Investments in associates

	2006 £000	2005 £000
Year ended 31 December		
At beginning of year	**18**	1,109
Investments disposed of during year	**–**	(1,159)
Share of post-tax profit for the period	**10**	250
Provision for impairment	**–**	(182)
At end of year	**28**	18

The Group's interests in its principal associates, all of which are unlisted, were as follows:

Name	% interest held at 31 December	Country of incorporation	Assets £000	Liabilities £000	Revenues £000	Profit/ (loss) £000
Heritage Group Ltd	–	Guernsey	–	–	–	–
Blyth Valley Ltd	25.2	UK	160	87	512	(11)
Total at the end of 2005			160	87	512	(11)
Blyth Valley Ltd	**25.2**	**UK**	**192**	**83**	**784**	**40**
Total at the end of 2006			**192**	**83**	**784**	**40**

The equity interest held by the Group in respect of the associate does not have a quoted market price and is not traded in any active market. An impairment charge of £nil (2005: £182,000) was recognised in profit or loss during the year.

The Group sold its investment in Heritage Group Limited on 11 July 2005 for a net consideration of £3,750,000. The gain arising on disposal of £2,591,000 was included within other income in the prior year (note 9).

17 Reinsurance assets

	2006 £000	2005 £000
Reinsurers' share of insurance liabilities	**306,550**	514,248
Provision for non recovery and impairment	**(3,778)**	(7,872)
Reinsurance assets (note 24)	**302,772**	506,376

The amounts expected to be recovered before and after one year, based on historical experience, are estimated as follows:		
Within one year	**136,790**	189,258
After one year	**165,982**	317,118
	302,772	506,376

Amounts due from reinsurers in respect of outstanding premiums and claims already paid by the Group are included in loans and receivables (note 19). The Group recognised a gain during the year of £4,094,000 (2005: £1,811,000) in respect of the recovery and reversal of previously impaired amounts.

Notes to the financial statements continued

18 Financial assets and liabilities carried at fair value

Financial assets and liabilities are measured at their bid price fair values and ask price fair values respectively, with all changes from one accounting period to the next being recorded through the income statement as provided for by IAS 39.

	2006 Cost £000	2006 Fair value £000	2005 Cost £000	2005 Fair value £000
Debt and fixed income securities	**1,046,009**	**1,043,669**	1,036,335	1,028,795
Equities and shares in unit trusts	**117,457**	**141,841**	101,895	119,407
Deposits with credit institutions	**54,800**	**54,715**	89,532	89,576
Total investments	**1,218,266**	**1,240,225**	1,227,762	1,237,778
Derivative instrument assets (note 20)	**–**	**1,685**	–	–
Total financial assets at fair value through profit or loss	**1,218,266**	**1,241,910**	1,227,762	1,237,778

	2006 Cost £000	2006 Fair value £000	2005 Cost £000	2005 Fair value £000
Borrowings from credit institutions	**92,857**	**92,852**	121,070	121,190
Derivative instrument liabilities (note 20)	**–**	**1,077**	–	5,056
Total financial liabilities at fair value through profit or loss	**92,857**	**93,929**	121,070	126,246

An analysis of the credit risk and contractual maturity profiles of the Group's debt and fixed income securities is given in notes 3.4 and 3.5. The Group has no material exposure to financial assets not actively traded on recognised markets. The Group's borrowings from credit institutions at 31 December 2006 are denominated in US Dollars, half fall due for repayment in 2008 and half fall due for repayment in 2009. The movement in fair value of financial liabilities during 2006 includes £14,212,000 of net principal repayments, £14,121,000 of foreign exchange gains (note 13) and £5,000 of fair value gains. The amounts recognised as fair value gains are all attributable to changes in the comparable benchmark interest rate.

The amount of financial liabilities payable on maturity is not materially different to the cost disclosed above.

Investments at 31 December are denominated in the following currencies at their fair value:

	2006 £000	2005 £000
Debt and fixed income securities		
Sterling	**308,914**	266,771
US Dollars	**552,015**	598,834
Euro and other currencies	**182,740**	163,190
	1,043,669	1,028,795
Equities and shares in unit trusts		
Sterling	**114,530**	93,916
US Dollars	**26,328**	24,990
Euro and other currencies	**983**	501
	141,841	119,407
Deposits with credit institutions		
Sterling	**54,715**	89,455
US Dollars	**–**	–
Euro and other currencies	**–**	121
	54,715	89,576
Total investments	**1,240,225**	1,237,778

The table below illustrates the movements in financial assets during the year:

	2006 £000	2005 £000
At 1 January	**1,237,778**	980,731
Net additions/(disposals) into investment portfolio	**(6,274)**	246,892
Net fair value gains	**8,721**	10,155
At 31 December	**1,240,225**	1,237,778

19 Loans and receivables including insurance receivables

	2006 £000	2005 £000
Gross receivables arising from insurance and reinsurance contracts	**356,354**	351,051
Less provision for impairment	**(875)**	(1,018)
Net receivables arising from insurance and reinsurance contracts	**355,479**	350,033
Due from contract holders, brokers, agents and intermediaries	**280,694**	302,571
Due from reinsurance operations	**74,785**	47,462
	355,479	350,033
Other loans and receivables:		
Prepayments and accrued income	**6,746**	8,632
Net profit commission receivable	**14,443**	17,410
Accrued interest	**6,065**	6,943
Right to reimbursement of defined benefit obligation (note 28)	**1,163**	5,462
Share of syndicate's other debtors balances	**44,316**	40,579
Other debtors including related party amounts (note 34)	**18,060**	7,922
Total loans and receivables including insurance receivables	**446,272**	436,981
The amounts expected to be recovered before and after one year are estimated as follows:		
Within one year	**446,272**	436,818
After one year	**–**	163
	446,272	436,981

There is no significant concentration of credit risk with respect to loans and receivables, as the Group has a large number of internationally dispersed debtors. The Group has recognised a gain of £143,000 (2005: loss of £449,000) for the impairment (and subsequent recovery) of receivables during the year ended 31 December 2006.

20 Derivative financial instruments

The Group's derivative financial instruments are used to hedge several economic relationships including the foreign exchange volatility arising from translating the net investments in, and results of, subsidiary companies with different functional currencies, and the foreign exchange impact of insurance business dominated in foreign currencies. During the current and prior financial year, the Group has not elected to denominate any derivative contracts as formal hedging instruments and, as a consequence, has not applied the hedge accounting provisions of IAS 39.

At 31 December 2006 the net fair value position of the Group's derivative exposure on foreign exchange cylinder option contracts was a financial asset of £1,685,000 (2005: liability of £4,892,000 included within financial liabilities). The Group recognised gains totalling £6,577,000 in respect of these contracts in the current year (2005: loss of £6,240,000). No expenses or charges were incurred in the acquisition of the derivative contracts (2005: £nil).

	2006			2005		
	Contract notional amounts $000	Fair value of assets £000	Fair value of liabilities £000	Contract notional amounts $000	Fair value of assets £000	Fair value of liabilities £000
Foreign exchange cylinder option contracts expiring:						
Within one year	**50,000**	**1,700**	**15**	160,000	297	4,010
Between one and five years	**–**	**–**	**–**	50,000	472	1,651
Total at 31 December	**50,000**	**1,700**	**15**	210,000	769	5,661
Foreign exchange forward contract expiring:						
Within one year	**293,000**	**–**	**1,077**	292,689	–	164
Total at 31 December	**293,000**	**–**	**1,077**	292,689	–	164

The Group had the right and intention to settle each of the above contracts on a net basis at 31 December 2005. Consequently, only the net liability was recognised in the 2005 balance sheet as detailed in note 18.

The Group also entered into foreign exchange forward contracts during the current and prior year primarily in order to manage the net investment in the Bermudian operation and currency exposures related to the proceeds raised from the Rights Issue. The contract outstanding at the balance sheet date requires the Group to sell $293,000,000 (2005: $292,689,000) at an agreed future rate to Pound Sterling at a fixed date within one year of the balance sheet date. At 31 December 2006, the fair value position of the contract outstanding to the Group was a liability of £1,077,000 (2005: £164,000). The Group recognised gains totalling £20,457,000 in respect of these contracts in the current year (2005: loss of £164,000).

21 Cash and cash equivalents

	2006 £000	2005 £000
Cash at bank and in hand	**142,200**	370,165
Short-term bank deposits	**360,671**	43,594
	502,871	413,759

22 Share capital

Group	31 December 2006 Number of shares	Share capital £000	31 December 2005 Number of shares on incorporation*	Share capital £000
Issued share capital	**393,915,738**	**19,694**	140,000	19,570

The number of shares presented in the equity structure of the Group above relates to Hiscox Ltd, the legal parent Company.

In accordance with the reverse acquisition provisions of IFRS 3 *Business Combinations,* the amount of issued share capital included in the consolidated balance sheet at 31 December 2005 reflects that of Hiscox plc, the legal subsidiary.

*Hiscox Ltd was incorporated on 6 September 2006.

Changes in Group share capital	Ordinary share capital £000	Share premium £000	Contributed surplus £000
At 1 January 2005	14,685	234,267	–
Employee share option scheme – proceeds from shares issued	67	1,522	–
Rights Issue of ordinary shares	4,818	171,550	–
Expenses related to Rights Issue	–	(5,974)	–
At 31 December 2005	19,570	401,365	–
Employee share option scheme – proceeds from shares issued	124	2,829	264
Transfers on reverse acquisition (note 2.3)	–	(404,194)	442,161
At 31 December 2006	**19,694**	**–**	**442,425**

In accordance with Bermuda law, an amount of £442,161,000 was reclassified as contributed surplus on completion of the reverse acquisition of Hiscox Ltd. Included in this amount are balances of £4,723,000 and £33,244,000 relating to the previously reported merger reserve and capital redemption reserve respectively (note 23).

Equity structure of Hiscox Ltd	Number of 5p ordinary shares in issue (thousands)
At 1 January 2005 and 31 December 2005	–
Issue of ordinary shares to original subscriber at par value on incorporation	140
Issue of ordinary shares on scheme of arrangement	393,707
Employee share option scheme – ordinary shares issued	209
Redemption of subscriber's shares	(140)
At 31 December 2006	**393,916**

At the date of incorporation of the Company the authorised share capital of £7,000 comprised 140,000 ordinary shares of 5p each. On 21 September 2006 the authorised share capital was increased to £30,000,000 comprising 600,000,000 ordinary shares of 5p each.

The redemption of the original subscriber's shares was at par value.

393,707,089 shares were issued at fair value to the members of Hiscox plc on 12 December 2006 in consideration for the cancellation of their shareholdings in that company.

All issued shares are fully paid.

22 Share capital continued

Share options

Share options are granted to Directors and to senior employees. The exercise price of the granted options is equal to the closing mid-market price of the shares on the day before the date of the grant. Options are conditional on the employee completing three years' service (the vesting period). The options are exercisable starting three years from the grant date only if the Group achieves its targets of profitability; the options have a contractual option term of ten years. The Group has no legal or constructive obligation to re-purchase or settle the options in cash.

In accordance with IFRS 2 the Group recognises an expense for the fair value of share option instruments issued to employees, over their vesting period through the income statement. The expense recognised in the Consolidated Income Statement during the year was £5,238,000 (2005: £2,059,000). The amount expensed in the current year has been adjusted for a modification arising in January 2006, pursuant to the Group's Rights Issue in November 2005. Details of the modification are shown in the Directors' remuneration report to these consolidated financial statements. The Group has applied the principles outlined in the Black-Scholes option pricing model when determining the fair value of each share option instrument.

The range of principal Group assumptions applied in determining the fair value of options that have not yet fully vested at 31 December are:

Assumptions affecting inputs to options pricing model	**2006**	2005
Annual risk free rates of return (%)	**3.5-5.0**	3.5-5.0
Long-term dividend yield and growth (%)	**2.0-4.0**	2.0
Expected life of options (years)	**3.25-7.5**	3.25-7.5
Implied volatility of share price over a ten year period (%)	**32-49**	32-49
Weighted average share price (pence)	**149.5**	149.5

Movements in the number of share options during the year and details of the balances outstanding at 31 December 2006 are shown in the Directors' remuneration report.

The implied volatility assumption is based on historical data.

For options issued after 1 January 2006 the assumptions regarding long-term dividend yield have been aligned to the progressive dividend policy announced during the 2005 Rights Issue.

Additional details on the Group's share option schemes are shown in the Directors' remuneration report accompanying these financial statements.

23 Retained earnings and other reserves

	Group 2006 £000	Group 2005 £000
Merger reserve	**–**	4,723
Capital redemption reserve	**–**	33,244
Currency translation reserve	**(40,396)**	822
Total other reserves at 31 December	**(40,396)**	38,789
Retained earnings at 31 December	**260,362**	118,289

The merger reserve reflected the net premium on shares issued as part of several business combinations which occurred in 1996 and 1998.

The capital redemption reserve arose from the redemption of some of Hiscox plc's issued share capital. These redemptions occurred in prior financial years. The purpose of establishing the capital redemption reserve was to maintain the level of equity represented by contributed capital.

In accordance with Bermuda law, the merger reserve and the capital redemption reserve are presented as contributed surplus at 31 December 2006.

The currency translation reserve comprises foreign exchange differences arising from the translation of the financial statements of, and investments in, foreign operations.

Included within Group retained earnings is an amount of £20,578,000 (2005: £17,941,000), which is not distributable and is held to meet solvency capital requirements to maintain an equalisation provision. The amounts in the equalisation provision are realised when particular entities in the Group have suffered insurance losses in excess of levels set out in the relevant solvency capital regulations.

24 Insurance liabilities and reinsurance assets

	2006 £000	2005 £000
Gross		
Claims reported and loss adjustment expenses	**703,159**	815,307
Claims incurred but not reported	**425,170**	507,186
Unearned premiums	**465,772**	400,507
Total insurance liabilities, gross	**1,594,101**	1,723,000
Recoverable from reinsurers		
Claims reported and loss adjustment expenses	**214,148**	281,746
Claims incurred but not reported	**50,925**	186,054
Unearned premiums	**37,699**	38,576
Total reinsurers' share of insurance liabilities (note 17)	**302,772**	506,376
Net		
Claims reported and loss adjustment expenses	**489,011**	533,561
Claims incurred but not reported	**374,245**	321,132
Unearned premiums	**428,073**	361,931
Total insurance liabilities, net	**1,291,329**	1,216,624
The amounts expected to be recovered and settled before and after one year, based on historical experience, are estimated as follows:		
Within one year	**685,409**	628,383
After one year	**605,920**	588,241
	1,291,329	1,216,624

The gross claims reported, the loss adjustment expenses liabilities and the liability for claims incurred but not reported are net of expected recoveries from salvage and subrogation. The amounts for salvage and subrogation at the end of 2006 and 2005 are not material.

24.1 Insurance contracts assumptions

(a) Process used to decide on assumptions

The risks associated with insurance contracts and in particular with casualty insurance contracts are complex and subject to a number of variables that complicate quantitative sensitivity analysis.

For all risks, the Group uses several statistical methods to incorporate the various assumptions made in order to estimate the ultimate cost of claims. The reserves for outstanding claims are actuarially estimated primarily by using both the Chain Ladder and Bornhuetter-Ferguson methods. There is close communication between the actuaries involved in the estimation process and the Group's underwriters to ensure that, when applying both estimation techniques, both parties are cognisant of all material factors relating to outstanding claims, and allowance is also made for the rating environment.

The Chain Ladder method is adopted for mature classes of business where sufficient claims development data is available in order to produce estimates of the ultimate claims and premiums by actuarial reserving Group and underwriting year or year of account for the managed syndicate. This methodology produces optimal estimates when a large claims development history is available and the claims development patterns throughout the earliest years are stable.

Where losses in the earliest underwriting years or years of account have yet to fully develop, a 'tail' arises on the reserving data, i.e. a gap between the current stage of development and the fully developed amount. The Chain Ladder methodology is used to calculate average development factors which, by fitting these development factors to a curve, allows an estimate to be made of the potential claims development expected between the current and the fully developed amount, known as a 'tail reserve'. This tail reserve is added to the current reserve position to calculate the total reserve required.

Chain Ladder methods may be applied to premiums, paid claims or incurred claims (i.e. paid claims plus case estimates). The basic technique involves the analysis of historical claims development factors and the selection of estimated development factors based on this historical pattern. The selected development factors are then applied to cumulative claims data for each accident year that is not yet fully developed to produce an estimated ultimate claims cost for each accident year.

Chain Ladder techniques are less suitable in cases in which the insurer does not have developed claims history data for a particular class of business (e.g. in relation to more recent underwriting years or years of account). In these instances the Group's actuaries make reference to the Bornhuetter-Ferguson method.

The Bornhuetter-Ferguson method is based on the Chain Ladder approach but utilises estimated ultimate loss ratios. This method uses a combination of a benchmark or market-based estimate and an estimate based on claims experience. The former is based on a measure of exposure such as premiums; the latter is based on the paid or incurred claims to date. The two estimates are combined using a formula that gives more weight to the experience-based estimate as time passes. This technique has been used in situations in which developed claims experience was not available for the projection (recent accident years or new classes of business).

24 Insurance liabilities and reinsurance assets continued
24.1 Insurance contracts assumptions continued
(a) Process used to decide on assumptions continued
In exceptional cases the required provision is calculated with reference to the actual exposures on individual policies.

Adjustments are made within the claims reserving methodologies to remove distortions in the historical claims development patterns from large or isolated claims not expected to reoccur in the future. In addition, the reserves determined for the managed syndicate are converted to annually accounted figures using earnings patterns that are consistent with those for the underlying syndicate business.

The choice of selected results for each accident year of each class of business depends on an assessment of the technique that has been most appropriate to observed historical developments. In certain instances, this has meant that different techniques or combination of techniques have been selected for individual accident years or groups of accident years within the same class of business.

(b) Claims development tables
The development of insurance liabilities provides a measure of the Group's ability to estimate the ultimate value of claims. The Group analyses actual claims development compared with previous estimates on an accident year basis. This exercise is performed to include the liabilities of Syndicate 33 at the 100 per cent level regardless of the Group's actual level of ownership, which has increased significantly over the last six years. Analysis at the 100 per cent level is required in order to avoid distortions arising from reinsurance to close arrangements which subsequently increase the Group's share of ultimate claims for each accident year three years after the end of that accident year.

The top half of each table illustrates how estimates of ultimate claim costs for each accident year have changed at successive year-ends. The bottom half reconciles cumulative claim costs to the amounts still recognised as liabilities. A reconciliation of the liability at the 100 per cent level to the Group's share, as included in the Group balance sheet, is also shown.

Insurance claims and claims expenses reserves – gross at 100%

Accident year	2001 £000	2002 £000	2003 £000	2004 £000	2005 £000	2006 £000	**Total £000**
Estimate of ultimate claims costs as adjusted for foreign exchange*							
at end of accident year	584,594	354,025	393,710	588,360	957,095	505,542	**3,383,326**
one year later	570,042	375,217	401,846	649,915	1,056,674	–	**3,053,694**
two years later	629,080	381,274	377,883	614,305	–	–	**2,002,542**
three years later	648,468	367,076	388,264	–	–	–	**1,403,808**
four years later	683,400	363,443	–	–	–	–	**1,046,843**
five years later	680,365	–	–	–	–	–	**680,365**
Current estimate of cumulative claims	680,365	363,443	388,264	614,305	1,056,674	505,542	**3,608,593**
Cumulative payments to date	(530,063)	(266,737)	(264,799)	(393,401)	(526,250)	(116,794)	**(2,098,044)**
Liability at 100% level	150,302	96,706	123,465	220,904	530,424	388,748	**1,510,549**
Liability in respect of prior accident years at 100% level							**28,689**
Total gross liability at 100% level							**1,539,238**

*The foreign exchange adjustment arises from the retranslation of the estimates at each date using the exchange rate ruling at 31 December 2006.

Reconciliation of 100% disclosures above to Group's share – gross

Accident year	2001 £000	2002 £000	2003 £000	2004 £000	2005 £000	2006 £000	**Total £000**
Current estimate of cumulative claims	680,365	363,443	388,264	614,305	1,056,674	505,542	**3,608,593**
Less: Attributable to external names	(211,422)	(93,162)	(107,196)	(177,085)	(285,104)	(103,814)	**(977,783)**
Group share of current ultimate claims estimate	468,943	270,281	281,068	437,220	771,570	401,728	**2,630,810**
Cumulative payments to date	(530,063)	(266,737)	(264,799)	(393,401)	(526,250)	(116,794)	**(2,098,044)**
Less: Attributable to external names	159,859	63,138	69,510	115,202	141,797	20,347	**569,853**
Group's share of cumulative payments	(370,204)	(203,599)	(195,289)	(278,199)	(384,453)	(96,447)	**(1,528,191)**
Liability recognised in the balance sheet for 2001 to 2006 accident years	98,739	66,682	85,779	159,021	387,117	305,281	**1,102,619**
Liability recognised in the balance sheet in respect of prior accident years							**25,710**
Total Group liability included in the balance sheet**							**1,128,329**

**This represents the claims element of the Group's insurance liabilities.

24 Insurance liabilities and reinsurance assets continued
24.1 Insurance contracts assumptions continued
(b) Claims development tables continued
Insurance claims and claims expenses reserves – net at 100%

Accident year	2001 £000	2002 £000	2003 £000	2004 £000	2005 £000	2006 £000	Total £000
Estimate of ultimate claims costs as adjusted for foreign exchange*							
at end of accident year	287,548	236,498	306,099	491,109	571,081	450,286	**2,342,621**
one year later	323,118	257,998	321,054	534,718	653,143	–	**2,090,031**
two years later	381,780	264,783	296,203	514,606	–	–	**1,457,372**
three years later	413,712	250,729	306,634	–	–	–	**971,075**
four years later	403,887	245,056	–	–	–	–	**648,943**
five years later	391,767	–	–	–	–	–	**391,767**
Current estimate of cumulative claims	391,767	245,056	306,634	514,606	653,143	450,286	**2,561,492**
Cumulative payments to date	(329,036)	(175,157)	(211,058)	(318,682)	(291,425)	(105,412)	**(1,430,770)**
Liability at 100% level	62,731	69,899	95,576	195,924	361,718	344,874	**1,130,722**
Liability in respect of prior accident years at 100% level							**44,684**
Total net liability at 100% level							**1,175,406**

Reconciliation of 100% disclosures above to Group's share – net

Accident year	2001 £000	2002 £000	2003 £000	2004 £000	2005 £000	2006 £000	Total £000
Current estimate of cumulative claims	391,767	245,056	306,634	514,606	653,143	450,286	**2,561,492**
Less: Attributable to external names	(114,746)	(60,478)	(83,802)	(148,811)	(168,326)	(92,735)	**(668,898)**
Group's share of current ultimate claims estimate	277,021	184,578	222,832	365,795	484,817	357,551	**1,892,594**
Cumulative payments to date	(329,036)	(175,157)	(211,058)	(318,682)	(291,425)	(105,412)	**(1,430,770)**
Less: Attributable to external names	93,414	38,284	53,905	93,099	72,324	18,729	**369,755**
Group's share of cumulative payments	(235,622)	(136,873)	(157,153)	(225,583)	(219,101)	(86,683)	**(1,061,015)**
Liability recognised in the balance sheet for 2001 to 2006 accident years	41,399	47,705	65,679	140,212	265,716	270,868	**831,579**
Liability recognised in the balance sheet in respect of prior accident years							**31,677**
Total net liability included in the balance sheet†							**863,256**

*The foreign exchange adjustment arises from the retranslation of the estimates at each date using the exchange rate ruling at 31 December 2006.

†This represents the claims element of the Group's insurance liabilities and reinsurance assets.

24.2 Movements in insurance claims liabilities and reinsurance claims assets

Year ended 31 December	2006 Gross £000	2006 Reinsurance £000	2006 Net £000	2005 Gross £000	2005 Reinsurance £000	2005 Net £000
Total at beginning of year	**(1,322,493)**	**467,800**	**(854,693)**	(830,681)	195,730	(634,951)
Claims and claims handling expense for year	**(395,497)**	**13,156**	**(382,341)**	(810,678)	353,653	(457,025)
Cash paid for claims settled in the year	**504,656**	**(193,527)**	**311,129**	391,710	(109,904)	281,806
Exchange differences and other movements	**85,005**	**(22,356)**	**62,649**	(72,844)	28,321	(44,523)
Total at end of year	**(1,128,329)**	**265,073**	**(863,256)**	(1,322,493)	467,800	(854,693)
Notified claims	**(703,159)**	**214,148**	**(489,011)**	(815,307)	281,746	(533,561)
Incurred but not reported	**(425,170)**	**50,925**	**(374,245)**	(507,186)	186,054	(321,132)
Total at end of year	**(1,128,329)**	**265,073**	**(863,256)**	(1,322,493)	467,800	(854,693)

The insurance claims expense reported in the consolidated income statement is comprised as follows:

	2006 Gross £000	2006 Reinsurance £000	2006 Net £000	2005 Gross £000	2005 Reinsurance £000	2005 Net £000
Current year claims and loss adjustment expenses	**(353,895)**	**3,275**	**(350,620)**	(785,128)	322,278	(462,850)
(Under)/over provision in respect of prior year claims and loss adjustment expenses	**(41,602)**	**9,881**	**(31,721)**	(25,550)	31,375	5,825
Total claims and claims handling expense	**(395,497)**	**13,156**	**(382,341)**	(810,678)	353,653	(457,025)

25 Trade and other payables

	2006 £000	2005 £000
Creditors arising out of direct insurance operations	**33,473**	30,945
Creditors arising out of reinsurance operations	**126,319**	150,947
	159,792	181,892
Obligations under finance leases (note 32)	**442**	449
Share of syndicate's other creditors balances	**15,481**	34,331
Reinsurers' share of deferred acquisition costs (note 8)	**6,529**	2,496
Social security and other taxes payable	**5,846**	6,191
Other creditors	**8,049**	12,255
	36,347	55,722
Accruals and deferred income	**58,686**	33,562
Total	**254,825**	271,176

The amounts expected to be settled before and after one year are estimated as follows:		
Within one year	**252,298**	269,246
After one year	**2,527**	1,930
	254,825	271,176

The amounts expected to be settled after one year of the balance sheet date primarily relate to finance leases and the Group's provision of sabbatical leave employee benefits.

26 Tax expense

The amounts charged in the consolidated income statement comprise the following:

	2006 £000	2005 £000
Current tax expense	**8,770**	22,564
Deferred tax expense/(credit) (note 27)	**28,446**	(973)
	37,216	21,591

The tax expense on the Group's profit before tax differs from the theoretical amount that would arise using the weighted average tax rate applicable to profits of the consolidated companies as follows:

	2006 £000	2005 £000
Profit before tax	**201,062**	70,221
Tax calculated at the standard corporation tax rate applicable in the UK* of 30% (2005: 30%)	**60,319**	21,067
Effects of:		
Expenses not deductible for tax purposes	**652**	687
Income not subject to tax	**(10,264)**	(113)
Group entities subject to overseas tax at lower rates	**(18,121)**	(2,535)
Tax losses for which no deferred tax asset is recognised	**4,351**	1,011
Other items	**(75)**	(347)
Prior year tax adjustments	**354**	1,821
Tax charge for the period	**37,216**	21,591

*The principal charge to current tax arises in respect of the Group's UK subsidiaries.

27 Deferred tax

	2006 £000	2005 £000
Deferred tax assets	**24,945**	16,366
Deferred tax liabilities	**(33,412)**	(31,559)
Total net deferred tax liability	**(8,467)**	(15,193)

All material tax assets and liabilities relate to the same tax authority.

The movement on the total net deferred tax liability is as follows:

	2006 £000	2005 £000
At 1 January	**(15,193)**	(14,517)
Income statement (charge)/credit:	**(28,446)**	973
Transfer from deferred tax to current tax	**31,805**	(3,599)
Released from equity	**3,367**	1,950
At 31 December	**(8,467)**	(15,193)

(a) Group deferred tax assets analysed by balance sheet headings

At 31 December	2005 £000	Income statement (charge)/credit £000	Transfer to current tax £000	Transfer from equity £000	2006 £000
Tangible assets	879	465	–	–	**1,344**
Financial assets	3,967	(3,967)	–	–	**–**
Trade and other payables	3,192	5,799	–	–	**8,991**
Retirement benefit obligations	5,004	1,872	–	–	**6,876**
Other items	3,324	1,043	–	3,367	**7,734**
Total deferred tax assets	16,366	5,212	–	3,367	**24,945**

(b) Group deferred tax liabilities analysed by balance sheet headings and syndicate participation

At 31 December	2005 £000	Income statement (charge)/credit £000	Transfer to current tax £000	Transfer from equity £000	2006 £000
Intangible assets	(377)	–	–	–	**(377)**
Investment in associated enterprises	(191)	–	–	–	**(191)**
Financial assets	–	(3,785)	–	–	**(3,785)**
Insurance contracts – equalisation provision*	(5,637)	(427)	–	–	**(6,064)**
Other items	(1,826)	(1,828)	–	–	**(3,654)**
	(8,031)	(6,040)	–	–	**(14,071)**
Open years of account and Section 107 disclaimers	(23,528)	(27,618)	31,805	–	**(19,341)**
Total deferred tax liabilities	(31,559)	(33,658)	31,805	–	**(33,412)**

*The solvency regulations in the UK require certain entities within the Group to establish an equalisation provision, to be utilised against abnormal levels of future losses in certain lines of business. The regulations prescribe that the provision is increased every year by an amount that is calculated as a percentage of net premiums written for those lines of business during the financial year subject to a maximum percentage. The amount of each annual increase is a deductible expense for tax purposes, and the equalisation provision is taxed when released. The entities within the Group that are affected by this requirement continue to prepare their individual financial statements, for statutory filing and tax purposes, in accordance with UK GAAP which permits the recognition of equalisation provisions on the balance sheet. Equalisation provisions are not permitted under IFRS which therefore results in the temporary difference for tax purposes.

Deferred income tax assets are recognised for tax losses carried forward to the extent that the realisation of the related tax benefit through the future taxable profits is probable. The Group has not provided for deferred tax assets totalling £7,023,000 in relation to losses of overseas companies (2005: £2,671,000). The aggregate amount of temporary differences associated with investments in subsidiaries and associates for which no deferred tax liability has been recognised is £73,855,000 (2005: £16,892,000). These temporary differences are unlikely to reverse in the foreseeable future. In accordance with IAS 12, all deferred tax assets and liabilities are classified as non current.

28 Employee retirement benefit obligations

The Company's legal subsidiary, Hiscox plc, operates a defined benefit pension scheme based on final pensionable salary. The funds of the scheme are controlled by the trustee, administered by Mercer Human Resource Consulting Limited, and are held separately from those of the Group.

The gross amount recognised in the Group balance sheet is determined as follows:

	2006 £000	2005 £000
Present value of funded obligations	**137,461**	137,533
Fair value of plan assets	**(133,660)**	(101,409)
Present value of unfunded obligations	**3,801**	36,124
Unrecognised actuarial losses	**–**	(19,447)
Unrecognised past service cost	**–**	–
Gross liability in the balance sheet	**3,801**	16,677

Included within loans and receivables for the Group (note 19) is a right to reimbursement of £1,163,000 (2005: £5,462,000) recoverable from third party names in Syndicate 33 representing their contribution to funding the defined benefit scheme obligation.

The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. A full actuarial valuation is performed on a triennial basis and updated at each intervening balance sheet date by the actuaries. The last full actuarial valuation was performed at 31 December 2006. The present value of the defined benefit obligation is determined by discounting the estimated future cash flows using interest rates of AA rated corporate bonds that have terms to maturity that approximate to the terms of the related pension liability.

The plan assets are invested as follows:

At 31 December	2006 £000	2005 £000
Equities	**98,738**	81,577
Debt and fixed income securities	**10,098**	4,993
Cash	**24,824**	14,839
	133,660	101,409

The amounts recognised in the Group's income statement are as follows:

	2006 £000	2005 £000
Current service cost	**4,191**	2,916
Interest cost	**6,397**	5,228
Expected return on plan assets	**(6,431)**	(4,767)
Net actuarial losses including curtailment charges recognised during the year	**7,355**	–
Past service cost	**668**	670
Total included in staff costs (note 10)	**12,180**	4,047

The actual return on plan assets was £12,911,000 (2005: £15,531,000).

The movement in liability recognised in the Group's balance sheet is as follows:

	2006 £000	2005 £000
At beginning of year	**16,677**	34,718
Total expense charged in the income statement of the Group (note 10)	**12,180**	4,047
Contributions paid	**(25,056)**	(22,088)
At end of year	**3,801**	16,677

A reconciliation of the fair value of the scheme assets is as follows:

	2006 £000	2005 £000
Opening fair value of scheme assets	**101,409**	65,020
Expected return on scheme assets	**6,431**	4,767
Difference between expected and actual return on scheme assets	**6,480**	10,764
Contributions by the employer	**25,056**	22,088
Benefits paid	**(5,716)**	(1,230)
Closing fair value of scheme assets	**133,660**	101,409

28 Employee retirement benefit obligations continued

A reconciliation of the present value of funded obligations of the scheme is as follows:

	2006 £000	2005 £000
Benefit obligation at beginning of year	**137,533**	99,229
Current service cost	**4,191**	2,916
Interest cost	**6,397**	5,228
Actuarial (gains)/losses	**(5,917)**	30,680
Benefits paid from plan	**(5,716)**	(1,230)
Curtailments and amendments	**973**	710
Closing present value of funded obligations	**137,461**	137,533

A summary of the scheme's recent experience is shown below:

	2006 £000	2005 £000	2004 £000
Experience (losses)/gains on plan liabilities	**(3,310)**	(1,223)	992
Experience gains on plan assets	**6,480**	10,764	1,316

The Group's actuaries have based their assessment on the most recent mortality data available which suggests that the average pensionable period in which benefits will be paid to members is 26 years (2005: 26 years). The other principal actuarial assumptions used in determining the defined benefit scheme's obligation were as follows:

	2006 %	2005 %
Discount rate	**5.10**	4.75
Expected return on plan assets	**6.09**	5.79
Future salary increases	**4.30**	4.00
Inflation assumption	**3.30**	3.00
Pension increases	**3.30**	3.00

During the year the Group contributed to the defined benefit scheme at the rate of 33.3 per cent (2005: 22.6 per cent) of pensionable salaries. Additional contributions totalling £20,570,000 were paid during 2006 (2005: £19,400,000) to reduce the deficit. The Group has agreed that further additional contributions will be made. 61 per cent of the deficit calculated is recharged to Syndicate 33.

The expected return on plan assets is based on historical data and management's expectations of long-term future returns.

29 Earnings per share

Basic earnings per share is calculated by dividing the profit attributable to equity holders of the Company by the weighted average number of shares in issue during the year, excluding ordinary shares purchased by the Group and held as own shares.

The earnings per share amounts are not altered by applying the application guidance of IFRS 3 in relation to the reverse acquisition of Hiscox Ltd.

Basic

	2006	2005
Profit attributable to the Company's equity holders (£000)	**163,846**	48,630
Weighted average number of ordinary shares (thousands)	**392,558**	310,797
Basic earnings per share (pence per share)	**41.7p**	15.6p

Diluted

Diluted earnings per share is calculated adjusting for the assumed conversion of all dilutive potential ordinary shares. The Company has one category of dilutive potential ordinary shares, share options. For the share options, a calculation is made to determine the number of shares that could have been acquired at fair value (determined as the average annual market share price of the Company's shares) based on the monetary value of the subscription rights attached to outstanding share options. The number of shares calculated as above is compared with the number of shares that would have been issued assuming the exercise of the share options.

	2006	2005
Profit attributable to the Company's equity holders (£000)	**163,846**	48,630
Weighted average number of ordinary shares in issue (thousands)	**392,558**	310,797
Adjustments for share options (thousands)	**12,449**	12,283
Weighted average number of ordinary shares for diluted earnings per share (thousands)	**405,007**	323,080
Diluted earnings per share (pence per share)	**40.5p**	15.1p

Diluted earnings per share has been calculated after taking account of 11,806,000 (2005: 11,829,000) options under employee share schemes and 643,000 (2005: 454,000) options under SAYE schemes.

30 Dividends

	2006 £000	2005 £000
Interim dividend for the year ended:		
31 December 2005 of 2.25p (net) per share	–	6,631
31 December 2006 of 3.0p (net) per share	**11,790**	–
Final dividend for the year ended:		
31 December 2004 of 3.5p (net) per share	–	10,286
31 December 2005 of 4.75p (net) per share	**18,638**	–
	30,428	16,917

A final dividend in respect of 2006 of 7p per share, amounting to a total dividend of 10p for the year, is to be proposed at the Annual General Meeting on 23 May 2007. These financial statements do not reflect this final dividend as a distribution or liability in accordance with IAS 10 *Events after the Balance Sheet Date*.

31 Contingencies and guarantees

The Group's subsidiaries are like most other insurers, continuously involved in legal proceedings, claims and litigation in the normal course of business. The Group does not believe that such actions will have a material effect on its profit or loss and financial condition.

The Group is subject to insurance solvency regulations in all the territories in which it issues insurance contracts, and it has complied with all the local solvency regulations. There are no contingencies associated with the Group's compliance or lack of compliance with these regulations.

The following guarantees have also been issued:

(a) Hiscox plc has entered into a deed of covenant in respect of its corporate member subsidiaries, Hiscox Dedicated Corporate Member Limited, Hiscox Select A to J Limited, to meet the subsidiaries' obligations to Lloyd's. The total guarantee given by the Company under this deed of covenant (subject to limited exceptions) amounts to £118,831,798 (2005: £118,831,798). The obligations in respect of this deed of covenant are secured by a fixed and floating charge over certain of the investments and other assets of the Company in favour of Lloyd's. Lloyd's has a right to retain the income on the charged investments in circumstances where it considers there to be a risk that the covenant might need to be called and may be met in full.

(b) Hiscox plc has an agreement with Lloyds TSB Bank, an agent for a syndicate of banks, for a £137,500,000 irrevocable standby Letter of Credit Facility and a US $225,000,000 Term and Revolving Credit Facility. Commencing 7 November 2005 £137,500,000 was drawn down on the Letter of Credit Facility to support part of the Group's underwriting activities. The Group has given a fixed and floating charge over certain assets as a guarantee to the group of banks led by Lloyds TSB Bank in connection with their Letter of Credit. At 31 December 2006, $182,000,000 of the term and revolving credit facility was available and fully drawn.

(c) Hiscox Insurance Company Limited has arranged a Letter of Credit of £325,000 with Natwest Bank plc to support its consortium activities with Lloyd's.

(d) The managed syndicate is subject to the New Central Fund annual contribution, which is an annual fee calculated on capacity. This fee was 1.0 per cent for 2006, and is 1.0 per cent for 2007 with a further 0.75 per cent being loaned to the New Central Fund for both years. In addition to this fee, the Council of Lloyd's has the discretion to call a further contribution of up to 3 per cent of capacity if required.

(e) As Hiscox Bermuda is not an admitted insurer or reinsurer in the US, the terms of certain US insurance and reinsurance contracts require Hiscox to provide letters of credit or other terms of collateral to clients.

On 1 December 2006, Hiscox entered into a Letter of Credit Reimbursement and Pledge Agreement with Citibank for the provision of a letter of credit facility in favour of US ceding companies. The agreement was a three year secured facility that allowed Hiscox to request the issuance of up to $300 million in letters of credit. Letters of credit issued under these facilities are collateralised by pledged cash and cash equivalents of Hiscox Bermuda. Letters of credit under this facility totalling approximately $12 million were issued with an effective date of 31 December 2006.

32 Capital and lease commitments

Capital commitments

The Group's capital expenditure contracted for at the balance sheet date but not yet incurred for property, plant and equipment was £161,000 (2005: £1,150,000)

Operating lease commitments

The Group acts as both lessee and lessor in relation to various offices in the UK and overseas which are held under non-cancellable operating lease agreements. The leases have varying terms, escalation clauses and renewal rights. The Group also has payment obligations in respect of operating leases for certain items of office equipment. Operating lease rental expenses for the year totalled £4,859,000 (2005: £1,936,000). Operating lease rental income for the year totalled £675,000 (2005: £586,000).

The aggregate minimum lease payments required by the Group under non-cancellable operating leases, over the expected lease terms, are as follows:

	2006 £000	2005 £000
No later than one year		
Land and buildings	**4,553**	4,326
Office equipment	**129**	57
Later than one year and no later than five years		
Land and buildings	**14,687**	14,679
Office equipment	**246**	31
Later than five years		
Land and buildings	**22,917**	26,126
	42,532	45,219

32 Capital and lease commitments continued

Operating lease commitments continued

The total future aggregate minimum lease rentals receivable by the Group as lessor under non-cancellable operating property leases are as follows:

	2006 £000	2005 £000
No later than one year	**513**	586
Later than one year and no later than five years	**1,974**	2,205
Later than five years	**1,027**	1,027
	3,514	3,818

Obligations under finance leases

It is the Group's policy to lease certain of its motor vehicles under finance lease arrangements. The leases have a typical term of three years and are on a fixed repayment basis with a final lump sum component at the end of each agreement should the Group decide to acquire ownership of the vehicle. Interest rates are fixed at the contract commencement date. The Group's obligations under leases are secured by the lessors' charges over the leased assets.

Finance lease interest expenses for the year totalled £41,000 (2005: £32,000).

The finance lease obligations to which the Group are committed include the following minimum lease payments:

	2006 £000	2005 £000
Current liabilities due for settlement within one year	**233**	222
Non-current liabilities due for settlement after one year and no later than five years	**273**	293
	506	515
Less: future finance lease interest charges	**(64)**	(66)
	442	449

The present value of the minimum lease payments is not materially different to the currently disclosed obligation.

33 Principal subsidiary companies of Hiscox Ltd at 31 December 2006

Company	Nature of business	Country
Hiscox plc*	Holding company	Great Britain
Hiscox Insurance Company Limited	General insurance	Great Britain
Hiscox Insurance Company (Guernsey) Limited	General insurance	Guernsey
Hiscox Inc.	Underwriting agent	USA (Delaware)
Hiscox Holdings Inc.	Insurance holding company	USA (Delaware)
Hiscox Insurance Company (Bermuda) Limited	General insurance and reinsurance	Bermuda
Hiscox Dedicated Corporate Member Limited	Lloyd's corporate name	Great Britain
Hiscox Select Insurance Fund PLC	Insurance holding company	Great Britain
Hiscox Select Holdings Limited	Insurance holding company	Great Britain
Hiscox Select A to J Limited	Lloyd's corporate names	Great Britain
Hiscox Holdings Limited**	Insurance holding company	Great Britain
Hiscox Insurance Holdings Limited	Insurance holding company	Great Britain
Hiscox Assurances Services SARL	Underwriting agent	France
Hiscox International Holdings B.V.	Insurance holding company	Netherlands
Hiscox Syndicates Limited	Lloyd's managing agent	Great Britain
Hiscox Underwriting Ltd	Lloyd's managing agent	Great Britain
Hiscox AG	Underwriting agent	Germany
Hiscox bv	Underwriting agent	Netherlands
Hiscox Investment Management Limited	Investment management	Great Britain
Hiscox Connect Limited	Online intermediary	Great Britain
Hiscox Underwriting Group Services Limited	Service company	Great Britain
Hiscox NV	Underwriting agent	Belgium
Hiscox Trustees Limited†	Corporate trustee	Great Britain
Hiscox Pension Trustees Limited	Pension trustee	Great Britain
Hiscox Qualifying Employees Share Ownership Trustees Limited	Share scheme trustee	Great Britain

All companies are wholly owned. The proportion of voting rights of subsidiaries held is the same as the proportion of equity shares held.

*Held directly.

**Hiscox Holdings Limited held 54,560 shares in Hiscox Ltd (2005: 54,560 shares in Hiscox plc) at 31 December 2006.

†Hiscox Trustees Limited is the trustee of the Hiscox Employee Share Ownership Plan (ESOP). The ESOP owned 135,782 shares in Hiscox Ltd (2005: 135,782 shares in Hiscox plc) at 31 December 2006. The shares have been purchased by the ESOP for future use in employee share option schemes and are held as own shares. None of these shares are currently under option to employees, nor have any been conditionally gifted to them.

34 Related-party transactions

Details of the remuneration of the Group's key personnel are shown in the Directors' remuneration report on pages 42 to 47. A number of the Group's key personnel hold insurance contracts and investment management agreements with the Group, all of which are on normal commercial terms.

The following transactions were conducted with related parties during the year.

(a) Syndicate 33 at Lloyd's

Hiscox Syndicates Limited, a wholly owned subsidiary of the Company, received management fees and profit commissions for providing a range of management services to Syndicate 33 in which Hiscox Dedicated Corporate Member Limited and the corporate member subsidiaries of Hiscox Select Insurance Fund PLC participated.

	2006 £000	2005 £000
Value of services provided by Hiscox Syndicates Limited to Syndicate 33	**19,877**	25,918
Amounts receivable from Syndicate 33 at 31 December excluding profit commission	**1,695**	3,157

(b) Associates

Certain companies within the Group received management and other commercial services from a number of wholly owned subsidiaries of Heritage Group Limited, which was an associate of the Group and a related party until 11 July 2005. These transactions arose in the normal course of business and are based on arms length arrangements. One Director of Heritage Group Limited was also a Director of Hiscox Insurance Company (Guernsey) Limited during the period when it was an associate of the Group. The ultimate parent Company of Hiscox Insurance Company (Guernsey) Limited is Hiscox Ltd.

	2005 $000
Value of management services provided during the year by the consolidated operations of the Heritage Group Limited	855
Amounts payable/(receivable) at 31 December	–

Certain companies within the Group conduct insurance and other business with Blyth Valley Limited, an associate. These transactions arise in the normal course of obtaining insurance business through brokerages, and are based on arms length arrangements. One Director of Blyth Valley Limited also served as a Director of Hiscox Insurance Company Limited. The ultimate parent Company of Hiscox Insurance Company Limited is Hiscox Ltd.

	2006 £000	2005 £000
Gross premium income achieved through Blyth Valley Limited during year	**2,325**	1,808
Commission expense for year charged by Blyth Valley Limited	**503**	368
Amounts payable to Blyth Valley Limited at 31 December in respect of commissions	**48**	40
Amounts receivable from Blyth Valley Limited at 31 December in respect of insurance premiums	**16**	1

(c) Other

BE Masojada was a non-executive Director of Ins-sure Holdings Limited and its subsidiaries throughout the year until resignation on 31 December 2006. These companies operate in a joint venture between Lloyd's, the International Underwriting Association (IUA) and Xchanging. These companies provide policy issuance, premium collection, claims settlement and clearing services to Lloyd's and the London insurance company markets. Hiscox Underwriting Group Services Limited receives the annual fee of £20,000 (2005: £20,000) in relation to this directorship. The balance due at 31 December 2006 was £20,000 (2005: £10,000).

BE Masojada was also Deputy Chairman of Lloyd's. Hiscox Underwriting Group Services Limited received the annual fee of £46,250 (2005: £41,250) in relation to his services. There were no amounts outstanding at 31 December 2006 (2005: £nil).

Five year summary

	2006 £000	2005 £000	2004 £000	2003 £000	2002 £000
Results					
Gross premium written	**1,126,164**	861,174	816,609	797,380	676,705
Net premium written	**975,397**	681,236	704,085	660,966	416,144
Net premium earned	**888,828**	693,299	714,852	547,451	385,129
Results of operating activities	**201,062**	70,221	89,522	83,408	20,739
Profit for the year	**163,846**	48,630	63,948	60,491	14,399
Assets employed					
Intangible assets	**33,212**	33,099	29,989	21,753	23,086
Financial assets carried at fair value	**1,241,910**	1,237,778	980,731	773,289	501,774
Cash and cash equivalents	**502,871**	413,759	119,563	52,945	121,196
Insurance liabilities and reinsurance assets	**(1,291,329)**	(1,216,624)	(1,008,032)	(845,450)	(613,108)
Other net assets	**195,421**	110,001	246,575	327,300	246,184
Net assets	**682,085**	578,013	368,826	329,837	279,132
Net asset value per share	**173.2p**	147.7p	125.7p	113.5p	97.0p
Key statistics					
Basic earnings per share	**41.7p**	15.6p	21.3p	20.9p	6.9p
Diluted earnings per share	**40.5p**	15.1p	21.0p	20.6p	6.7p
Combined ratio	**88.3%**	96.0%	92.6%	87.2%	94.8%
Return on equity	**28.9%**	12.8%	20.6%	21.7%	8.7%
Dividends per share	**10.00p**	7.00p	5.00p	4.20p	3.54p
Share price – high*	**280.25p**	234.5p	180.5p	170.5p	164.5p
Share price – low*	**193.75p**	152.25p	143.5p	137.0p	120.5p

*Closing mid market prices.

The amounts and ratios for 2002 and 2003 are those previously published on a UK GAAP basis, the Group's primary reporting framework at that time. The figures reported for 2004 to 2006 are prepared in accordance with IFRS.

Glossary

Binder (or binding authority)
An authority granted by an underwriter to an agent (known as a coverholder) whereby that agent is entitled to accept, within certain limits, insurance business on behalf of the underwriter.

Cedant
An insurer that transfers insurance risk to another insurer under a reinsurance contract.

Claims ratio
Net claims incurred, including IBNR, as a percentage of net earned premiums.

Combined ratio
The total of the claims and expenses ratios.

Expense ratio
Net operating expenses as a percentage of net earned premiums.

Gross written premium
Premiums contracted for before any deductions.

Incurred loss ratio
Paid and outstanding losses as a percentage of premiums. Gross incurred loss ratio is before deducting any reinsurance; the net loss ratio is after deducting reinsurance.

Individual capital assessments
Risk-based calculations of the capital required by each FSA-authorised insurance entity in accordance with FSA regulations.

Long-tail
A term used to describe an insurance risk that has the potential for claims development or new claims to be reported a number of years after expiry of the term of the policy.

Member or Lloyd's Member
An underwriting member of Lloyd's. Members collectively accept insurance risks through a Lloyd's syndicate. Members are required to meet certain Lloyd's solvency requirements and are responsible for their share of any losses made by the syndicates on which they participate, and are entitled to an equivalent share of any profits.

Names
Individual Members of Lloyd's.

Net earned premium
Premiums received after the cost of reinsurance and adjustment for unearned premium. Unearned premium covers the future period of risk of an insurance policy.

Net written premium
Premiums received after the cost of reinsurance.

Open year
A year of account of a syndicate which has not been closed by reinsurance to close ('RITC'). RITC usually occurs at the end of the third year. A year of account can be left open beyond the third year if the extent of the future liability cannot be accurately quantified.

PSC
Professions and Speciality Commercial division (commercial lines).

Qualifying quota share reinsurance
These are quota share reinsurance policies, which Lloyd's allow in certain circumstances, that enable a syndicate to write gross premium in excess of its authorised stamp capacity.

Quota shares
Where insurance risks are re-insured on a proportional basis, premiums and claims are divided in the same proportions between the insurer and re-insurer.

Re-domicile
The establishment of a new parent company for the Hiscox Group, based in Bermuda.

Return on Equity (ROE)
Net profit after tax expressed as a percentage of adjusted opening equity. This percentage measures profitability by expressing the efficiency of the Group's utilisation of shareholders' funds.

Reinsurance to Close (RITC)
The reinsurance to close of a syndicate comprises a premium payable by the closing year to the members on the next open year of account and a contract which transfers the liability for all claims in respect of the closing year to the next open year.

Short-tail
A term used to describe an insurance risk where claims are expected to arise near to the dates on which a policy was current.

Sidecar
A limited lifespan insurance company formed to give its investors access to the insurance market, and its cedants access to capital.

Specie
The line of business that covers cash and valuables in vaults, premises or transit.

Stamp capacity or syndicate capacity
The maximum amount of business that a syndicate in Lloyd's can write per year, aggregated from all its members.

Syndicate
A grouping of Lloyd's underwriters. Each syndicate has an active underwriter who is authorised to accept business on behalf of each underwriting member participating therein. A member of a syndicate is still a principal in his own right and is personally liable for his agreed share of each risk that is accepted by the syndicate. He is not liable for the debts of other syndicate members and thus the liability is several but not joint.

TMT
Technology, Media and Telecommunications classes of business.

Year of account
The year to which risk is allocated and to which all premiums and claims in respect of that risk are attributed. The year of account of a risk is determined by the calendar year in which it incepts. A syndicate year of account is normally closed by reinsurance at the end of 36 months.

Hiscox Ltd
4th Floor
Wessex House
45 Reid Street
Hamilton HM 12
Bermuda

T +1 441 278 8300
F +1 441 278 8301
E enquiries@hiscox.bm
www.hiscox.com