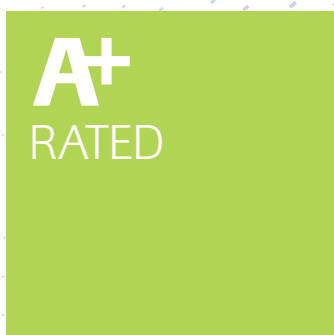


Forward thinking

Brit Insurance Holdings PLC // Annual Report 2005

DIVIDEND
6p



// Leading the way

2001

First UK non-life insurer to raise new capital following 11 September industry losses.

Resolves not to write finite business or to enter volume-related broker commission arrangements, well ahead of Spitzer review.

1999

Acquires both Lloyd's and non-Lloyd's platforms.

2000

Founds RISK to offer an industry-wide contract certainty platform, well in advance of the current regulatory imperative for contract certainty.



2002

Embarks on policy of active diversification of underwriting, including building substantial UK SME business, three years ahead of widespread catastrophe-driven losses and ratings agency downgrades for "monoline" reinsurers.

2003

Switches its asset management mandates to "total return" basis and sees excellent investment performance in 2004-5.

Public commitment to radical market process reform with specific focus on contract certainty, some 18 months ahead of FSA announcement of contract certainty initiative.

2004

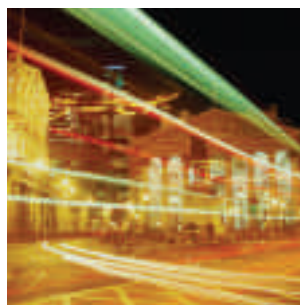
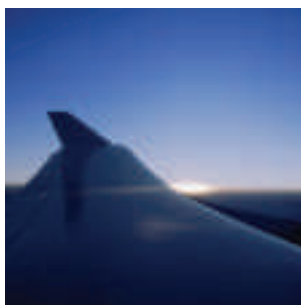
First UK non-life insurer to announce agreement of ICA from FSA.

First UK non-life insurer to raise lower tier two subordinated debt via private placement.

As part of its claims management initiative, one of the first UK insurers to accredit US loss adjusters, TPAs and lawyers.

2005

First UK insurer (life or non-life) to raise subordinated debt post Hurricane Katrina.



Contents

Group Overview	2
Chairman's Statement	4
Financial Highlights	6
Operating & Financial Review	8
Board of Directors	37
Corporate Governance	41
Report of the Directors	42
Directors' Remuneration Report	45
Corporate Governance Report	54
Report of the Audit Committee	59
Report of the Nomination Committee	61
Financial Statements	63
Consolidated Income Statement	64
Consolidated Statement of Recognised Income & Expense	64
Consolidated Balance Sheet	65
Consolidated Cash Flow Statement	66
Notes to the Financial Statements	67
Independent Auditor's Report	121
Statement of Directors' Responsibilities in Respect of the Company	122
Balance Sheet of the Company	123
Notes and Financial Statements of the Company	124
Independent Auditor's Report in Respect of the Company	134
Company Information	135



Dane Douetil
Chief Executive Officer

Brit Insurance Holdings PLC (“Brit” or the “Group”) is a major UK-based general insurance and reinsurance group writing both UK and international business.

Brit’s ordinary shares are listed on the London Stock Exchange; it is a constituent of the **FTSE 250 Index**.

As at 1 March 2006, Brit’s equity market capitalisation was **£1,057.8m**, ranking Brit the 193rd largest company on the London stock market and the fourth largest UK-headquartered non-life insurer by market capitalisation. In addition, the market value of Brit’s listed subordinated loan stock was **£175.3m**, giving a total capitalisation in excess of **£1.2bn**.

Brit operates via a single underwriting platform spanning both Lloyd’s and non-Lloyd’s distribution and regulation. Its principal subsidiary Brit Insurance Limited (“BIL”) is rated **A+ (Strong)** by Fitch Ratings and **A (Excellent)** by AM Best. Both ratings were reaffirmed with stable outlook during 2005. Its Lloyd’s business, Syndicate 2987, is the ninth largest Lloyd’s syndicate with **£500m** capacity for 2005 and 2006. Brit owns 100% of BIL and all the capacity on its active underwriting syndicate.

Total capitalisation in excess of £1.2bn.

The Group's strategic goal is to continue to deliver shareholder value by achieving long-term growth in profits and a share price which reflects market confidence. In pursuing this strategy, we will aim to:

Maintain excellent standards of underwriting

Produce less volatile results over time

Continue to provide the highest standards of customer security and service

Strengthen our position as one of the leading UK-based general insurers

Maintain a broad spread of business to maximise opportunity and reduce undue concentration of risk in any given area

Grow our UK and London Market Underwriting Centres

Build the business on firm foundations in underwriting, finance and operations



Clive Coates
Chairman

Overview

Two years ago I set two specific goals for the Company:

- ▲ To return to the dividend list
- ▲ To grow the market capitalisation of the Company to £1bn without a new equity issue.

I am delighted to reflect that these objectives have now been achieved, in May 2004 and February 2006 respectively. I will be setting further demanding targets for management.

Market Conditions in 2005

2005 will go down in history as a year of natural catastrophes of unprecedented frequency and severity. Before making any comment on their effect on Brit's financial statements, prospects and strategy, I consider it appropriate to reflect on the human costs of these events. I regard the Group's Tsunami-related charitable donations as an appropriate response.

Only time will tell whether the current significant increase in world-wide natural catastrophes is seen to abate again towards historic normalised levels or to escalate yet further, fuelled by global warming and increasing economic development in risk-exposed zones.

Results

We are delighted to have reported a pre-tax profit for the year of £62.4m and a full year dividend of six pence per share, in what was by a considerable margin the worst ever year for global catastrophe claims. This level of profit shows the strength, diversity, depth and quality of the Group's business. We continued to grow top line premium significantly but selectively and profitably, despite an insurance cycle which was, for the greater part of the year before the US hurricanes, softening. Our broad spread of business and the quality of our underwriting have served us very well. Non-catastrophe lines of business have performed extremely well, especially the liability classes which have benefited from back year releases from reserves and increased investment income from assets held to match longer tail business.

Strategy and Risk Appetite

We have built Brit significantly over recent years on a sound, prudent underwriting, financial and operational model. We aim to deliver superior shareholder value based on growing profits and reducing volatility.

We have re-examined our risk models and reduced our risk appetites in peak zones, recognising that this will result in writing less premium in certain classes of business and forgoing short-term pricing opportunities in highly catastrophe-exposed areas.

We aim to deliver superior shareholder value based on growing profits and reducing volatility.

The downward pressure on pricing in mid 2005 has been reversed in some classes and arrested in others.

Capital Structure and Dividend Policy Review

As indicated at the half year, we have conducted a thorough review of the Group's capital structure and were delighted by the market's response to our £150m subordinated bond issue in December. The issue was more than two-and-a-half times subscribed and has provided the Group with new long-term capital qualifying as lower tier two for regulatory purposes. This has opened a new source of quality long-term finance for the Group which is cheaper than equity capital and has re-balanced our gearing ratio to a more appropriate level of approximately 23% debt to net tangible assets on a proforma basis. We expect the improved capital mix to deliver a higher return on equity over the long-term and therefore to be value-enhancing to shareholders. The new debt, being subordinated, also adds further security to our customer proposition and allows us to continue our measured growth strategy without impairing our financial strength ratings and without recourse to the equity markets.

As previously indicated, Brit has also reviewed its dividend policy and is pleased to announce that for the foreseeable future (by which Brit means a minimum of the next three years) the intention of the Board is to pay up to 50% of earnings over the period subject to a minimum of 5p per 25p ordinary share per annum. However, in the event that market conditions do not permit Brit to utilise fully its capital then it would be the Board's intention to seek to return such excess capital to shareholders in the most appropriate and efficient manner.

As set out in more detail in the Notice of Annual General Meeting, we are also proposing a share consolidation on the basis of one new share for three existing shares, which we believe will make our shares more attractive to investors.

Board, Advisers and Senior Management

The year saw a number of significant changes. Ernst & Young succeeded Mazars as the Group's auditor. Mazars' input over many years was invaluable and we have retained them as tax advisers. We have appointed Citigroup as joint adviser and corporate broker alongside Numis. Neil Eckert stepped down from the post of CEO and is now a Non-Executive Director. Glyn MacAulay, another of the founding directors from 1995, retired from the Board. In last year's report I paid tribute to their enormous contributions over the years. Don McCrickard has announced his intention to stand down from the Board at the end of 2006. Dane Douetil was promoted to CEO; Cees Schrauwers and Joe MacHale joined as Non-Executive Directors, and Peter Hazell became Chairman of the Audit Committee. Within the Group's senior executive management, Mike Sibthorpe was promoted to the Executive Management Committee and Kathy Lisson joined from Barclays as Group COO and member of the Executive Management Committee.

Staff and Culture

I am very proud of the strong culture of teamwork and excellence we have built at Brit and of the quality and unstinting determination of staff at all levels in the organisation, for which I thank all concerned. It also fills me with huge confidence.

Outlook

Extraordinary events affect the ordinary cycle of supply, demand and pricing in the insurance industry. The downward pressure on pricing in mid 2005 has been reversed in some classes and arrested in others. We expect this pattern to continue in 2006 and Brit is well positioned to take full advantage of this favourable environment.

Clive Coates

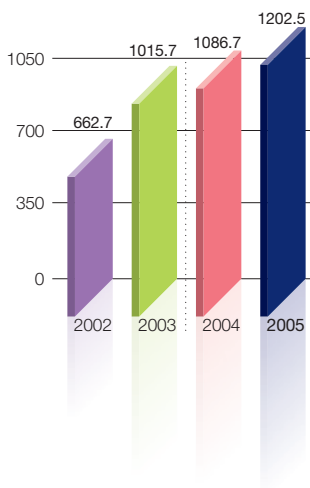
Chairman

14 March 2006

// Financial Highlights

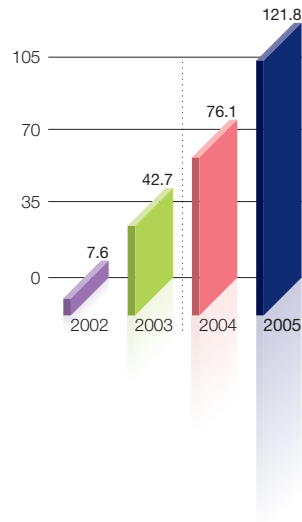
▲
10.7%

Gross Written Premium £m

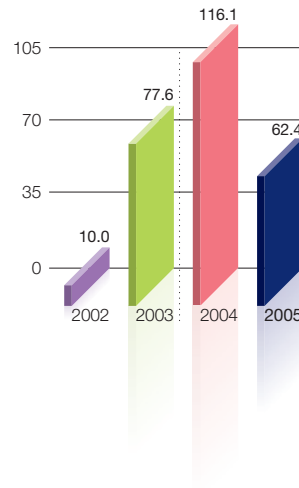


▲
60.2%

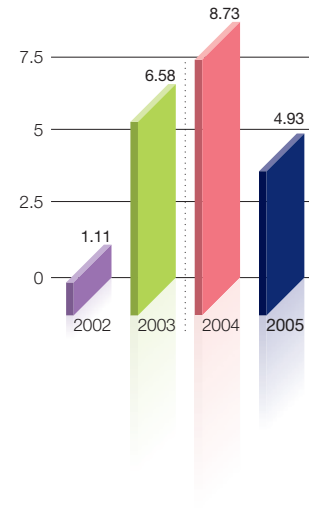
Investment Return £m



Pre-tax Profit £m



Earnings Per Share pence



Figures for 2002 and 2003 are stated in accordance with UK GAAP; figures for 2004 and 2005 are stated in accordance with IFRS.

Continued high quality underwriting performance.

Full year dividend of **6p** per share.

Continued premium growth – gross written premium
£1,202.5m, up 10.7%

Despite an unprecedented level of catastrophe claims, profit
before tax of **£62.4m** and earnings per share of **4.93p**

Excellent investment performance £121.8m, **up 60.2%**

Robust claims reserves – **£110.8m** prior year releases
(2004: £47.7m)

Final dividend of **3p per share** and full year dividend of
6p per share underpinned by strong fundamentals

Net tangible assets **£638.4m**, or 65.1p per share (2004: 66.1p)

Combined ratio 105.2% (2004: 92.9%), materially affected by
catastrophe claims

Completion of strategic review of Group capital structure and
gearing, culminating in **successful £150m** lower tier two
subordinated bond issue

Dividend policy revised – from 2006 for the foreseeable future
(not less than three years), the Board will distribute up to 50%
of earnings over the period subject to a minimum distribution
of **5p per 25p ordinary share** per year, absent unforeseen
circumstances

Proposed share consolidation on the basis of one new share
for three existing shares

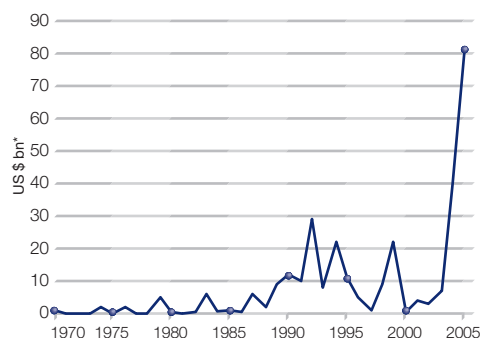
PRE-TAX
PROFIT
£62.4
MILLION

The first half of 2005 saw a relatively benign claims environment with a gently softening insurance cycle. This situation changed fundamentally towards the end of the year and into 2006:

Catastrophe Activity

- ▲ The chart to the right shows that the level of natural catastrophe claims for 2005 was over twice that of 2004 – which itself, was over 35% higher than any previous recorded year.
- ▲ The following table shows that nine of the 20 largest insured events in history have occurred in the last two years (shown in red), causing insurers and reinsurers to review not only 2005 experience but also to consider whether the combination of frequency and severity in both 2004 and 2005 signals some kind of change in the long-term trend of natural catastrophes, or just a short-term fluctuation.

Great Natural Disasters – Insured Losses



Source: Munich Re
* Costs rebased to 2005 US dollars.

Most Expensive Insured Losses

Rank	Year	Event	Region	Insured Cost (\$bn) [†]
1	2005	Hurricane Katrina	US	50.0
2	1992	Hurricane Andrew	US	21.5
3	2001	WTC	US	20.0
4	1994	Northridge Earthquake	US	17.8
5	2004	Hurricane Ivan	US, Caribbean	11.0
6	2005	Hurricane Wilma	US, Mexico	10.0
7	2005	Hurricane Rita	US	8.0
8	2004	Hurricane Charley	US	8.0
9	1991	Typhoon Mireille	Japan	7.8
10	1990	Winterstorm Daria	France, UK et al	6.6
11	1999	Winterstorm Lothar	Western Europe	6.6
12	1989	Hurricane Hugo	US, Puerto Rico	6.4
13	2004	Hurricane Frances	US	5.0
14	2004	Tsunami	Indian Ocean	5.0
15	1987	European Storms	Europe	5.0
16	1990	Winterstorm Vivian	Europe	4.6
17	1999	Typhoon Bart	Japan	4.6
18	1998	Hurricane Georges	US, Caribbean	4.1
19	2004	Hurricane Jeanne	US, Dom Rep	4.0
20	2004	Typhoon Songda	Japan	3.6
21	2001	Tropical Storm Allison	US	3.4
22	2003	Thunderstorms, Tornadoes	US	3.3
23	1988	Piper Alpha Explosion	UK	3.2
24	1995	Kobe Earthquake	Japan	3.1
25	1999	Winterstorm Martin	Spain, France, CH	2.7

Source: Swiss Re, RMS
[†] Costs rebased to 2004 US Dollars.

Non-Catastrophe Classes

The performance of these classes in 2005 was in marked contrast to the catastrophe classes. There was a notable absence of major new claims in the big-ticket liability classes (such as US professional indemnity) and a number of outstanding prior year cases were wholly or partially resolved at a discount to the reserves which we had already established. UK division claims experience in all key areas (motor, liability and property) was also benign for both current and prior years.

Industry Pricing for 2005 and Outlook

- ▲ The premium rating index charts for our three underwriting centres on pages 13 to 15 show the effect on pricing of last year's catastrophes. As yet, and as we would expect, this effect is largely limited to the higher-risk, higher-reward classes of business, particularly catastrophe retrocessional, US property reinsurance and primary business including energy and property in directly wind-exposed areas of the USA. Based on both economic fundamentals and experience, we expect the firming of rates, albeit less marked, to ripple into other reinsurance classes and then into primary business classes as the price-rises and annual renewals cycle work their way through the system.
- ▲ In our least catastrophe-exposed underwriting centre, the UK division, rates continued to fall throughout 2005. This is likely to be the last of our underwriting centres to be affected by any general improvement in market pricing, and the effects are unlikely to have worked through before late 2006.

The level of natural catastrophe claims for 2005 was over 60% higher than 2004.

// Brit's Position in the Market

Brit's Competitive Position and Peer Group

While there are a number of examples in the insurance industry of growth or profitability, a continued combination of both is much rarer and is a measure of the high quality of our entire underwriting team and approach.

Our overall result for the year shows the strength of our diversified business model, such that favourable experience in one area was able to counterbalance adverse volatility in another.

Brit operates through its three distinct customer-facing underwriting centres, as follows:

UK – Brit estimates the UK commercial lines market to be approximately £20bn. It is a concentrated market with the top seven groups having an estimated share of in excess of 50%. Brit's share of this market is approximately 2%, already a top ten market participant, and is targeting growth in this area over the medium term. Growth has not been pursued during the soft market conditions of 2005 and early 2006 because it would have meant reducing pricing excessively. It is a feature of UK commercial insurance that during softer points in the pricing cycle, more business is done in the regions and less in London. We anticipated this and established our network of regional offices in time to take a share of this business as it migrated away from London.

London Market – Brit competes with the major Lloyd's syndicates and London Market insurers for global business distributed into London by broking firms. Lloyd's has 62 syndicates of which Brit owns and manages the ninth largest Lloyd's syndicate, with a Lloyd's market share of approximately 3.4%. Brit is targeting growth in the non-aggregating areas within its London Market business.

Reinsurance – Brit competes globally with other major reinsurers, especially those based in Continental Europe, Bermuda and at Lloyd's. Brit's global market share is less than 1%. Global reinsurance market conditions are currently undergoing significant change in the light of the 2004 and 2005 catastrophes, new capital and revisions to risk estimates of buyers and catastrophe modelling agencies. This represents significant challenge and opportunity.



We established our network of regional offices.

Dane Douetil has been elected by his peers in 2006 to the leading post as Chair of the Market Reform Group.

Key Business Relationships

Brit actively monitors its financial and operational exposures to counterparties.

All of Brit's business comes via intermediaries. As such, Brit is exposed to the insurance broking industry. This is a highly concentrated industry, especially among the "Big Three" – Marsh, Aon and Willis. Brit believes it is less reliant on these three counterparties than most insurers.

Brit's reinsurance purchasing exposes it to the global reinsurance industry. This industry is experiencing both increasing consolidation and credit rating downgrades for many participants. Such trends serve to reduce the number of potential providers of acceptable security for Brit. However, as the Group grows and further diversifies, Brit's need to purchase reinsurance is reducing.

New Regulations and Other Key Process Changes

2005 also saw progress on a series of regulatory initiatives which we believe will have a profound effect on the insurance marketplace and potential benefit to the Group in terms of its competitive market position:

- ▲ The likely shift in a number of administrative functions from brokers to insurers
- ▲ FSA contract certainty requirements, which are being enforced incrementally through 2006
- ▲ Increased capital requirements driven by the FSA, Lloyd's, EU regulation and global rating agency criteria.

Brit has been at the forefront of each of these areas and is confident of realising benefit from its proactivity. For example:

- ▲ Having previously held a number of significant industry positions, Dane Douetil has been elected by his peers in 2006 to the leading post as Chair of the Market Reform Group, a reflection of Brit's commitment to leading the modernisation of the industry.
- ▲ Brit's contract certainty platform, RI3K, enabled the achievement for its own 1 January 2006 reinsurance purchases of full contract certainty at inception of 75% of the programme and 100% certainty by 12 January 2006. This was a significant achievement as it involved more than 15 brokers and 50 carriers globally, and would have been impossible without the technology.

Full contract certainty at inception of 75% of the programme.



Roger Field
Underwriting Director

The Group's underwriting core policies and values are as follows:

- ▲ Quality of underwriting is the number one criterion at all times
- ▲ Broadly spread underwriting portfolio encompassing more than 80 sub-classes of business to maximise opportunity and reduce concentration on any single risk, class or individual
- ▲ Constant monitoring of exposure limits
- ▲ Strong collegiate team ethic and culture, including collective incentivisation of underwriting and other staff within a single Group bonus pool based on Group profitability. This bonus structure helps maximise alignment of interests of staff with each other and with shareholders; strong peer review process among underwriters; internal capital market for continual capital re-assignment, which resulted in 94 internal trades in respect of £144.1m of underwriting capital in 2005
- ▲ Maintenance of high A insurer financial strength rating from our chosen ratings agency partners so as to attract and retain the right quality of new business from brokers and clients
- ▲ Commitment to empowerment of underwriters within the control framework to allow prompt decisive customer-facing decisions to be made; we employ 128 lead underwriters and 254 underwriting staff
- ▲ Strong reserving process and track record
- ▲ Commitment to highest standards of customer security and service, including integrity of process and technology.

We continue to deliver on this strategy on all fronts. For any insurance group however, the quality of the underwriting is absolutely paramount. In this context, it is particularly pleasing to note, for example, that our active Lloyd's Syndicate 2987 has closed its 2003 year of account with a return on capacity of 25.6%, which we believe will be in the upper quartile of market results; and our UK Underwriting Centre has produced a record of growth and combined ratio that compares favourably with its peers in that market.

If 2005 had been a "normal" catastrophe year, we would have expected a Group claims ratio not greater than 60.9%, which would have represented net catastrophe claims of £117.3m. In fact it totalled 74.4%, giving a difference from our assumed long term result of £127.0m. This has materially affected the results for 2005.

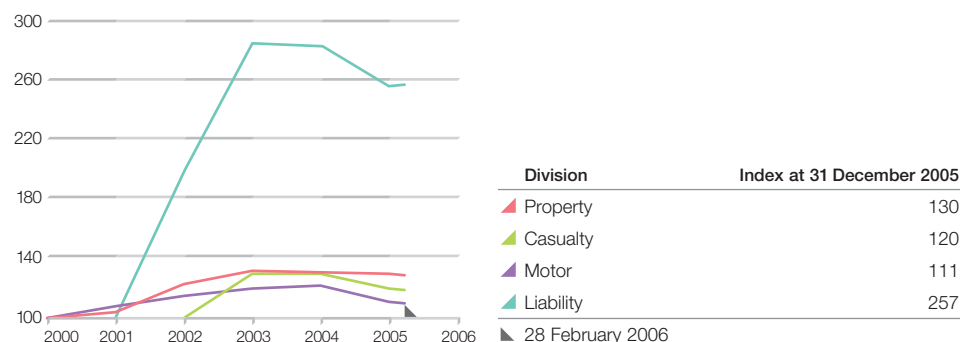
Premium Index

Brit's Premium Index uses 2000 as its base year and reflects the broad trend for each underwriting centre in respect of rates, terms and conditions. The analysis is based on a set coding structure with the data being input by Brit's underwriters. It is compulsory for all open market business to be included and the data is independently audited by the compliance team on a regular basis. The index mainly tracks renewal business as it is often hard to judge differences in rates for new business. Some caution needs to be exercised when using this table as the varying levels of claims inflation in different classes require different rating increases simply to retain the status quo. Inevitably there is also an element of subjectivity in respect of any assessment of the impact of changes in terms and conditions.

The indices are based on the underwriters' estimates of the rate movements experienced by their business. They are subjective as they are calculated using judgement to estimate the effect of changes in terms and conditions as well as changes in premium.

Underwriting Results

UK Underwriting Centre



	31 December 2005	31 December 2004
Gross written premiums £'000	317,862	345,401
Earned premiums, net of reinsurance £'000	302,595	300,948
Underwriting result before investment return £'000	65,653	24,484
Total result £'000	112,304	54,333
Claims ratio %	55.8	68.1
Expense ratio %	22.6	23.9
Combined ratio %	78.4	92.0

Given its position at a relatively soft point in its separate underwriting cycle, 2005 was a year of protecting the bottom line even if that meant modest top-line reduction. Gross premiums written were down 8.0%. We successfully renewed most of our existing book of business without aggressively chasing new business market share at the expense of underwriting discipline or profitability.

We continued to establish our regional presence during the year, replacing temporary accommodation with permanent offices in Leeds and Manchester. Our final regional office (Reading) has been opened in 2006. Non-London premiums increased by 7.3% in the year. It is the normal pattern in a softening market for certain premiums to migrate from London to regional markets and we positioned ourselves well for this development.

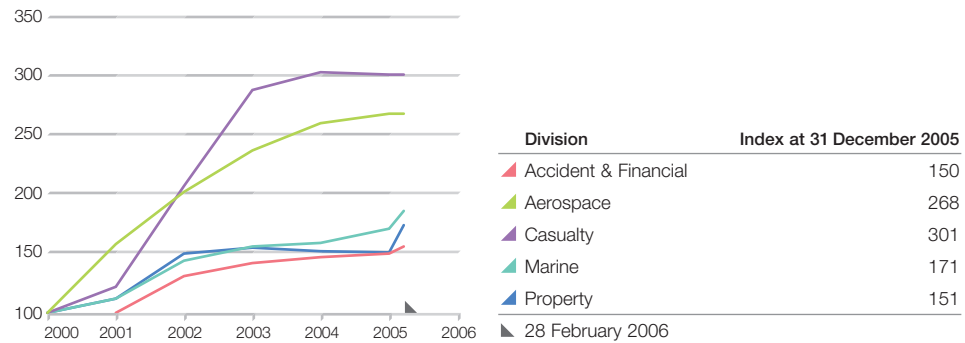
The combined ratio for this division was an excellent 78.4% (2004: 92.0%). In addition to quality underwriting in a competitive market, the division benefited from favourable reserve development for prior years. It is the Group's overall policy to take a cautious stance on projected ultimate claims ratios for new classes of business until a proven track record and development pattern is established. A favourable pattern of claims experience is now beginning to emerge as prior years mature, following the formation of this division in 2002. Any combined ratio below 95% is an excellent achievement in terms of competitive position and return on capital, given the lower risk nature of this business.



Brent Escott
Managing Director UK Division

COMBINED
RATIO
78.4%

London Market Underwriting Centre



	31 December 2005	31 December 2004
Gross written premiums £'000	558,568	431,613
Earned premiums, net of reinsurance £'000	412,136	367,410
Underwriting result before investment return £'000	(768)	28,151
Total result £'000	44,181	57,386
Claims ratio %	63.8	58.0
Expense ratio %	38.2	34.5
Combined ratio %	102.0	92.5



Mike Sibthorpe
London Market Underwriting Director

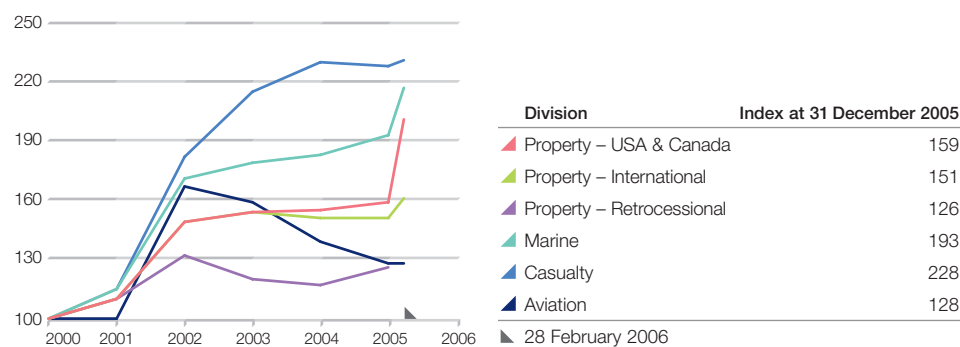
The impressive growth of our London Market Underwriting Centre continued in 2005 and gross written premium income grew ahead of expectations from £431.6m to £558.6m. Much of this growth was achieved by building on the new classes of underwriting introduced over the past few years. Brit has been successful in attracting quality underwriting teams bringing potential new business with them. With pro-active management and first class infrastructure support we have been able significantly to advance our business proposition.

In addition to new classes of business, disciplined underwriting throughout the London Market team has been instrumental in developing a diversified risk portfolio. This diversification has been critical in 2005 – catastrophe losses incurred on the North American Property book and the Marine (Off-Shore Energy) account have been more than offset by excellent results from the Casualty, Accident & Financial and Aerospace classes. These are long-term, sustainable business sectors where Brit has an excellent market position.

Market conditions in the loss affected classes are very much improved but we are looking at aggregated exposures on a group basis. Elsewhere in the London Market environment, terms and conditions remain broadly favourable. The division is well placed to take advantage of these market conditions and to make a good contribution to the Group's results in 2006.

Diversification has been critical in 2005.

Reinsurance Underwriting Centre



Jonathan Turner
Reinsurance Underwriting Director

	31 December 2005	31 December 2004
Gross written premiums £'000	328,807	279,994
Earned premiums, net of reinsurance £'000	224,199	179,878
Underwriting result before investment return £'000	(103,494)	8,967
Total result £'000	(81,120)	23,204
Claims ratio %	119.8	68.5
Expense ratio %	28.5	26.6
Combined ratio %	148.3	95.1

The Reinsurance Underwriting Centre enjoyed strong premium growth during 2005 writing £328.8m of premiums (2004: £280.0m). While an element of the reported premium increases represented reinstatement premiums arising from the year's major catastrophes, the underlying growth in premiums was also ahead of expectations.

The division posted a loss after allocated investment return for the year of £81.1m compared with a profit of £23.2m in 2004. This deterioration is more than fully accounted for by an increase in catastrophe claims, and the trends of both premium income and underlying profitability are both encouraging.

The impact of the catastrophes in 2005 has generated a positive pricing environment for the loss impacted classes and at the same time has helped to stabilise the pricing environment in other non-affected lines of business. This bodes well for the performance of the account in 2006.

We have adopted a more conservative aggregate management policy using new industry models and risk accumulation tools so as to help the Group reduce the account's overall volatility. This will result in a notable reduction of our peak zone catastrophe aggregates.

This has meant, for example, that we have not participated in the 1 January 2006 renewals round for "catastrophe retrocessional" business, even though it is priced more attractively than it was in 2005 and prior. We have not permanently withdrawn from this line of business, but we are allowing time to manage down existing exposures, review the market and consider our strategy for this kind of potentially very profitable but high volatility business. Future strategy in this area may include the possible use of a so-called "side-car" structure utilising third party underwriting capital.



Matthew Scales
Finance Director

Balance Sheet

The balance sheet remains strong despite the most challenging catastrophe environment in history. BIL's credit ratings were unchanged throughout the year with both the relevant ratings agencies. Significantly at no stage was either rating placed on creditwatch.

Following a strategic review of the Group's capital structure, the Group balance sheet was further strengthened by the successful lower tier two subordinated bond issue in December 2005 so that we finished the year both with increased capital resources compared with 2004 and with a more efficient mix of equity and debt, which has lowered our overall weighted average cost of capital going forward.

Capital Resources

We set out below a summary of our capital resources, which we define as net tangible assets plus subordinated borrowings which have at least five years remaining to maturity or call and are of the types which qualify as regulatory capital.

Capital Resources

	31 December 2005 £m	31 December 2004 £m
Net tangible assets	638.4	643.5
Long-term subordinated debt	147.1	-
Total capital resources	785.5	643.5

As described more fully in Note 26 to the financial statements, the new bond issue represents unsecured subordinated debt with 25-year maturity and a 15-year call option exercisable by Brit. The interest rate is fixed at 6.71% for the first 15 years, after which (if not called) it is re-set to a level equal to 3.4 percentage points above the relevant gilt for the remaining ten years of its life. The loan instrument contains no financial covenants. There are provisions which would permit Brit to defer interest payments in certain defined circumstances, for instance in the event that such payment would cause or increase a shortfall in regulatory capital in the Company or in BIL.

This represents high quality subordinated debt capital, given the long maturity, the wide-ranging interest deferral features and the absence of material financial covenants. Brit was the first UK insurer (life or non-life) to access the public debt markets following Hurricane Katrina; the issue was also the first public insurance-related subordinated Eurobond to be successfully issued with an indicative rating from Fitch Ratings only and the first public bond issue by an insurance group with a material proportion of its business at Lloyd's.

The issue was priced at the bottom of its indicative pricing spread above gilts (i.e. favourable to Brit), and generated total demand of £390m for a £150m issue from 35 institutional investors, many of whom were not existing holders of Brit securities and thus represented a new source of capital to the Group. We estimate that this new source of approximately 20% of our overall enlarged capital base has lowered our overall weighted average cost of capital by approximately one percentage point.

Our intended uses of the funds are as follows:

Use of Funds

	£m
Business growth	80+
Refinancing of short term loan stock, early or on maturity	44
Elimination of pension fund deficit, in part or whole	Up to 23
Total net proceeds	147

Brit was the first UK insurer (life or non-life) to access the public debt markets following Hurricane Katrina.

We have continued to be proactive in our balance sheet management into 2006. We issued a tender offer for our £40m nominal of loan stock due 2008 (which approximately 49% by value accepted and we have subsequently purchased a further 3%). With only three years to maturity, the 2008 loan stock was not providing us with suitable long-term capital.

We also held an Extraordinary General Meeting on 3 March 2006 at which shareholders approved a further share premium reduction of £180m to create more distributable reserves subject to High Court approval later this month. The creation of more distributable reserves provides maximum flexibility for capital management for the Group in a number of ways:

- ▲ Bridging the three year gap which can otherwise exist between Lloyd's reported profits and cash distribution
- ▲ Facilitating regular dividends at parent company level without reducing capital strength in key operating subsidiaries
- ▲ Allowing a full and prompt return of cash to shareholders by way of share buy-back or special dividend should excess capital build up at any time in the light of prevailing market conditions.

Our gearing ratio at 31 December 2005 was approximately 30.4%. Following post year end activity the tender offer for our 2008 loan stock and the setting aside of funds in connection with the share premium account reduction, the pro-forma gearing ratio has reduced to around 23%.

High A Rating Maintained

The Group is pleased that BIL maintained its ratings of A+ (Strong) with Fitch Ratings and A (Excellent) with AM Best throughout the year, especially given:

- ▲ An industry-wide trend of downgrades for insurance groups as a whole since 2001
- ▲ Widespread downgrades and/or announcements of credit-watch with negative outlook throughout the industry when the large claims estimates and subsequent revisions were announced in September to December 2005. As part of our own processes, we monitor rating agency actions not only for Brit but for a peer-group of 31 other major international reinsurers as rated by one or more of Standard & Poor's, AM Best and Fitch. Apart from BIL, only five of this peer-group were neither downgraded nor placed on negative outlook between 1 September and 31 December 2005.

We regard BIL's financial strength rating and its stability as important in building the Group's non-Lloyd's business with appropriate quality brokers and clients.

The £150m new bond issue was assigned debt ratings of BBB by Fitch Ratings and BBB- by AM Best, in each case representing four notches below the financial strength rating of BIL, taking into account the subordination features and the fact that the bonds were issued by the holding Company rather than the rated operating subsidiary and without an upstream guarantee. Such a four-notch differential is common in such structures.

BIL maintained its ratings of A+ (Strong) with Fitch Ratings and A (Excellent) with AM Best.

Regulatory Capital

The FSA is introducing new capital regulations for Lloyd's business on a similar basis to company regulation. In June 2005 the Group submitted calculations for its Individual Capital Assessment ("ICA") for its Lloyd's Syndicate 2987 and provided updated calculations in December 2005. In December 2005 the Group received a routine "ARROW" visit from its monitoring team at the FSA. In January 2006 the Group submitted updated calculations for its Enhanced Capital Requirements ("ECR") and ICA for BIL, this following initial agreement in 2004.

Reinsurance Security

The table on the right sets out the ratings of our reinsurance recoverables on paid, outstanding and IBNR claims at 31 December 2005. Reinsurance recoverables have risen during the year because of the high incidence of catastrophe events, both in terms of frequency and severity, which the reinsurance outwards program is principally designed to cover. We have kept the level of security high albeit that the number of highly rated reinsurers continues to reduce by virtue of industry consolidation and more demanding scrutiny by ratings agencies.

Rating of Reinsurance Recoverables

	31 December 2005 %	31 December 2004 %
AAA	0.4	1.2
AA	29.7	21.3
A	62.6	69.1
BBB and below	2.1	0.4
Not rated	5.2	8.0
Total	100.0	100.0

Pension Fund Liability

With the adoption of International Financial Reporting Standards ("IFRS"), our pension fund deficit is now included as a net liability on the Group balance sheet. During the year it grew from £18.5m to £22.8m (before deferred tax) on the basis of IAS 19, despite a strong investment performance, principally because the relevant calculation is more sensitive to changes in liability-based assumptions concerning long-term interest rates, salary inflation and mortality than to asset growth in a single period. As a percentage of the Group's market capitalisation and liquid resources, the deficit is small compared with many in the FTSE 350. Nevertheless, the Group will make extra contributions of £2m in 2006 and £5m per annum from 2007 to reduce the current stated deficit. The scheme has been closed to new members since October 2001.

Reinsurance recoverables have risen during the year because of the high incidence of catastrophe events.

Our overall current and deferred tax rate for the year was 23.7%.

Expense Management

Overheads grew by 7.2% compared with 2004 in line with business growth. The pure expense ratio (excluding commission costs) was 8.8% of net earned premium (2004: 8.6%). Total headcount rose from 530 to 601.

	Year ended 31 December 2005 £'000	Year ended 31 December 2004 £'000
Staff costs	45,110	41,672
Other staff related costs	4,423	3,775
Accommodation costs	5,741	4,073
Legal and professional charges	6,218	3,050
IT costs	4,727	4,084
Marketing and communications	3,261	2,613
VAT irrecoverable	1,691	2,299
Depreciation of property, plant and equipment	1,648	1,757
Amortisation of intangible assets	3,202	3,087
Printing, stationery, postage and telephone	1,056	1,148
Travel and entertaining	2,557	2,174
Insurance	1,419	1,413
Regulatory levies and charges	14,777	14,096
Other	2,907	1,679
Movement on related non-commission acquisition cost deferral	(1,031)	4,223
Total overheads	97,706	91,143
Investment management expenses	3,066	2,744
Total expenses	100,772	93,887
Commission acquisition costs	219,570	188,889
Movement on related commission acquisition cost deferral	(12,133)	(12,347)
Total commission costs	207,437	176,542
Acquisition costs and other operating expenses	308,209	270,429

Taxation

During the year we became a net payer of UK corporation tax for the first time since 2000. Lloyd's profits are historically taxed only on a distribution basis, three years after the accounting profit is reported. We are therefore beginning to pay tax on the strong Lloyd's profits of the 2002-4 underwriting years, which had previously been recognised in our deferred tax calculations. Our overall current and deferred tax rate for the year was 23.7%, reflecting a number of "once only" reliefs, principally the utilisation of capital allowances and capital losses not previously recognised.

Our effective rate is expected to track the UK rate of 30% fairly closely in the medium term. Overseas taxation is expected to be lower for the Group in future years than in past years due to a lower basis of US taxation of Lloyd's syndicate profits from 2005.

Total invested assets grew from £1.9bn to £2.4bn



Nigel Bennett
Treasurer

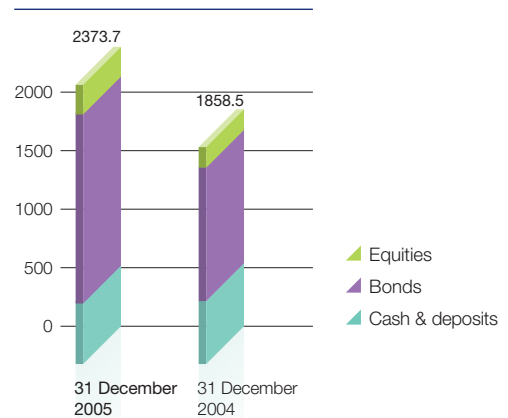
The Group's investment return was ahead of expectations for 2005. Total invested assets grew from £1.9bn to £2.4bn, principally based on strong cash flows from continued growth of premium income and the planned increase in assets held to match claims reserves, especially on the medium and longer tail classes of business. Funds were also increased by the new bond issue.

The average return on invested assets was 5.4% (2004: 4.6%) based on a consistent approach to asset allocation (over 90% cash and fixed income, very high credit quality, short bond duration) and a strong relationship with our investment managers, especially our affiliate, Equity Investment Partners Limited ("EIP") and its subsidiaries, which manage 84.6% of our total invested assets. Our policy of setting total return mandates for our investment managers has been successful. The sterling bond portfolio has performed particularly well, as the managers have judged market movements well and have been successful in switching duration within the guidelines of 0-3 years to maximise value from interest rate fluctuations. The Group's equity investments have again outperformed the relevant indices.

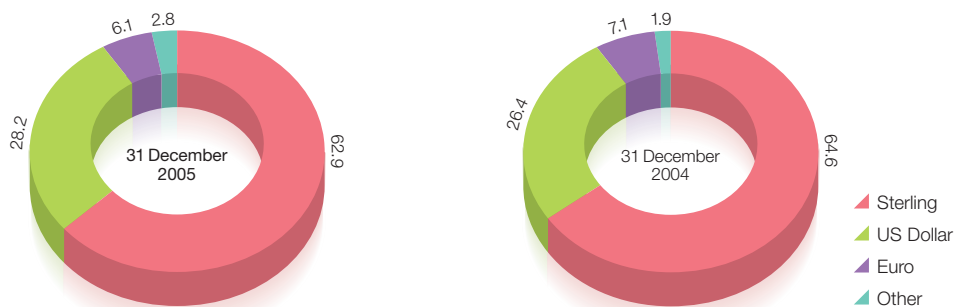
We have this year continued our trend of realising assets which are unlisted or relatively illiquid given the size of our holding compared with market volumes regularly traded. A number of these assets represented residual holdings from 1999 and before, when Brit was an investment trust taking material stakes in insurers and insurance-related businesses, compared with our current core strategy of underwriting for our own account. In 2005 we disposed of our remaining shares in Chaucer Holdings PLC.

We also decided during 2005 that it is not in shareholders' interests that the Group remains a long-term shareholder of EIP, despite its very good investment performance track record. Accepted best practice has become for insurers, especially non-life, to dispose of their in-house asset managers and to contract for these services from third parties, while retaining in-house capability in asset allocation and supervision of outsourcing. The Board believes Brit is likely to receive more value from a sale of our stake in EIP than either its book value or the implicit value which is currently ascribed to the stake in the Group's share price and accordingly has appointed financial advisers with a view to seeking a buyer at a suitable price. Under the new IFRS rules and in the light of the process which is now underway, EIP is now held in the balance sheet at its book value of £1.4m as an asset held for sale rather than as an associate. EIP's results have ceased to be equity-accounted from 15 November 2005. The process is currently at an early stage; a number of parties have expressed interest.

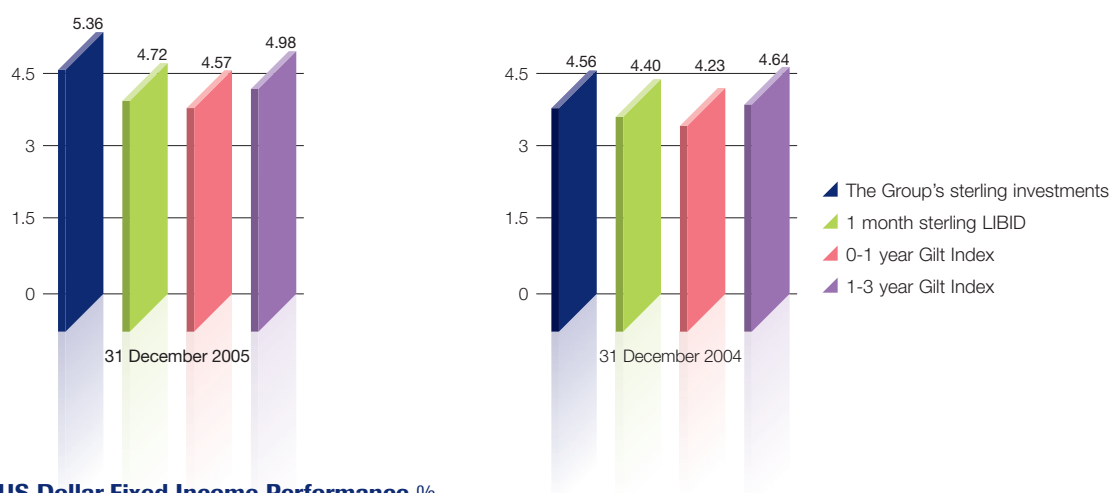
Asset Allocation £m



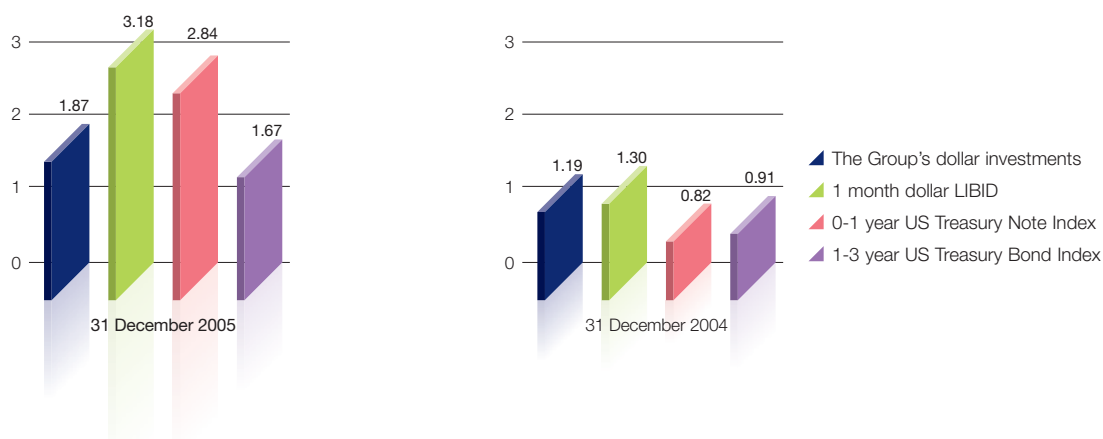
Bonds, Cash & Deposits Currency Mix %



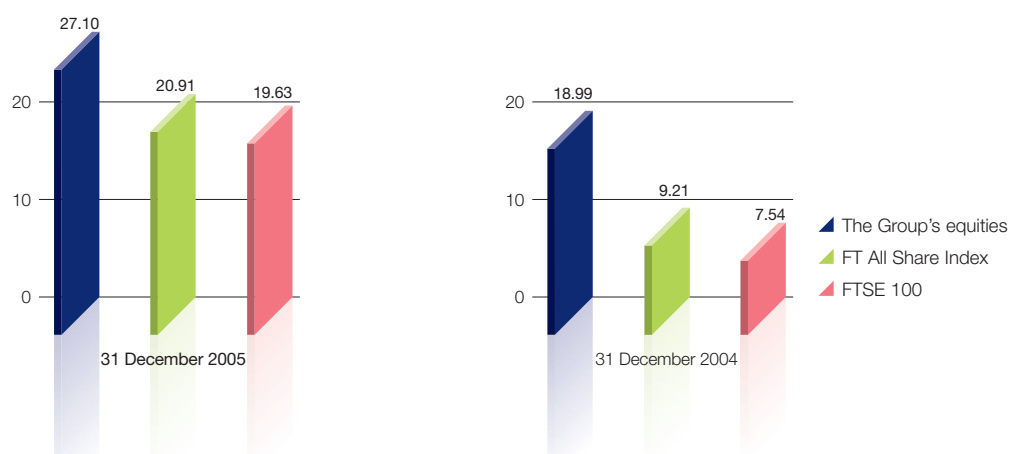
Sterling Fixed Income Performance %



US Dollar Fixed Income Performance %



Equity Returns %



Bond Portfolio Duration

	31 December 2005	31 December 2004
Sterling	1.57	0.94
US dollar	1.40	1.51
Euro	1.40	0.20
Canadian dollar	1.48	1.47

Bond Portfolio Credit Ratings

	31 December 2005	31 December 2004
Government	49	50
AAA	14	22
AA	26	20
A	11	8
Total	100	100



Peter Goddard
Company Secretary and
Chairman of Risk Management Group

The Group proactively manages risk under five main headings consistent with the FSA's categorisation; at its most recent FSA "ARROW" visit in December 2005, all main areas of risk were discussed with the FSA, including areas which the Group targets for further improvement in 2006.

Insurance Risk

The Group's underwriting philosophy is set out on page 12. The Group aspires to the highest standards in both underwriting and reserving.

By its nature, insurance business always requires a level of estimation of future claims payments, and the reported result for any single accounting period is sensitive to the accuracy of these estimates. This year, for the first time, we are pleased to disclose claims development by accident year to show how our ultimate claims estimates have stood the test of time:

Ultimate Gross Claims

Accident year:	2001 and prior years £'000	2002 £'000	2003 £'000	2004 £'000	2005 £'000	Total £'000
At end of accident year	1,961,803	262,425	452,600	739,801	1,220,765	
1 year later	2,001,444	269,548	417,555	678,017	–	
2 years later	2,016,191	261,137	385,977	–	–	
3 years later	2,019,350	265,041	–	–	–	
4 years later	2,017,412	–	–	–	–	
Estimate of cumulative claims	2,017,412	265,041	385,977	678,017	1,220,765	4,576,212
Cumulative claims paid						(2,583,014)
Less third party participations on syndicates						(533)
Gross liability as per the balance sheet (Note 21(i))						1,992,665

Ultimate Net Claims

Accident year:	2001 and prior years £'000	2002 £'000	2003 £'000	2004 £'000	2005 £'000	Total £'000
At end of accident year	1,339,697	204,454	399,452	608,644	839,212	
1 year later	1,379,766	207,041	367,146	538,788	–	
2 years later	1,387,924	194,827	328,155	–	–	
3 years later	1,384,722	191,138	–	–	–	
4 years later	1,386,445	–	–	–	–	
Estimate of cumulative claims	1,386,445	191,138	328,155	538,788	839,212	3,283,738
Cumulative claims paid						(1,883,521)
Less third party participations on syndicates						(533)
Net liability as per the balance sheet (Note 21(i))						1,400,684

The tables above show the development of claims over a period of time on a gross and net of reinsurance basis. The tables show the cumulative incurred claims, including both notified and IBNR claims, for each successive accident year at each balance sheet date since 2001. The claims have been adjusted to make them comparable on a year by year basis. They have been grossed up to include 100% of the managed syndicate claims rather than the claims that reflects the Brit percentage ownership of each syndicate's capacity during the respective accident years. In addition, claims in currencies other than sterling have been retranslated at 31 December 2005 exchange rates.

We are pleased to disclose claims development by accident year to show how our ultimate claims estimates have stood the test of time.

In 2005, the total claims estimates from prior years were reduced by £110.8m (2004: £47.7m). It is part of the Group's reserving philosophy that the most recent years, with the greatest uncertainty of result, be prudently reserved leaving a potential for subsequent release.

Many different classes of business experienced releases in 2005. In global long tail classes, claims experience was benign for recent years and a number of long-standing issues were settled or progressed favourably. In the UK division, reserve development also reflects the release of conservative actuarial reserves pertaining to early years of new classes of business which were set up before a proven underwriting track record had been established.

Catastrophe Claims

The table below shows the financial effect on the Group of large and small catastrophes, net of reinsurance recoveries and inwards and outwards reinstatements, in 2005 and 2004. The large catastrophes are Hurricanes Katrina, Rita and Wilma (2005) and Charley, Frances, Ivan and the South East Asia Tsunami (2004). Other catastrophes include Hurricanes Jeanne and Dennis, Typhoon Songda, Windstorm Erwin and the Mumbai Floods.

When major events occur, Brit's response is to assemble a team from all key areas of the business to conduct a complete contract review, in addition to immediate site visits where practicable and reviewing any industry estimates for the total insured exposure.

Catastrophe Claims

Year ended	London Market	London Market	Reinsurance	Reinsurance	Total	Total
	US\$'000 31.12.05	US\$'000 31.12.04	US\$'000 31.12.05	US\$'000 31.12.04	US\$'000 31.12.05	US\$'000 31.12.04
Large catastrophes	175,690	57,844	212,282	89,568	387,972	147,413
Other catastrophes	(12,459)	6,372	44,745	17,962	32,286	24,333
Total	163,231	64,216	257,027	107,530	420,258	171,746
GBP equivalent (£'000)*	94,902	33,446	149,434	56,005	244,336	89,451

* Converted at year end rates.



Baldeep Johal
Actuary

Aggregate Management, PMLs and RDSs

The Group manages its overall gross and net aggregate sums insured at risk by type and location; it has been reducing aggregates by a combination of non-renewal of certain risks, smaller lines and reduced limits for catastrophe risk. The reduction in aggregate sums insured can be seen in the table below:

Class of Business	Contribution to 2005 gross hurricane claims %	Reduction in exposure 1 January 2006 %	Target reduction in exposure 1 July 2006 %
Catastrophe Retrocession	23	42	96
Property Reinsurance	32	26	33
US Property Direct	21	–	30
Energy Offshore	17	–	40
Other	7	–	–

What will always remain judgemental for Brit and others in the industry is the size of a probable maximum loss (“PML”) – i.e. how much of this gross aggregate can be assumed to be impacted by an event or series of events based on certain probabilities and severities. Brit has re-evaluated its PML estimates for given loss scenarios, taking into account available evidence and modelling input. We have anticipated a significant uplift (15% to 35%) that is likely to be revealed when the main modelling agencies deliver their next version of catastrophe models. This has already been built into our models.



Kathy Lisson
Chief Operating Officer

Investment Risk

Our investment portfolios and performance are analysed in detail on pages 20 and 21. The Group has achieved good investment performance without relaxing its internal risk parameters:

- ▲ Equities not to exceed 30% of NTA other than through outperformance. During 2005 this control was re-based from an earlier limit of equities as 10% of total invested assets. We consider a guideline based on net tangible assets as a more appropriate and prudent control for the longer term as the total portfolio grows relative to NTA.
- ▲ Fixed income kept to high quality (100% A or better, 89% AA or better at year end) and fixed income duration kept low (1.5 years at year end, well below the duration of our insurance liabilities).
- ▲ As set out more fully on page 20, we have taken a number of steps in recent years to reduce those investment holdings which are relatively illiquid, either because the investee company is unlisted, or because our stake is high compared with normal market volumes in the stock.

Liquidity Risk

The Group’s high cash component, low bond duration, high bond quality and reducing levels of illiquid equities all contribute to this risk being minimised. The Group also has facilities for overdrafts and collateralised letters of credit should these be required to cover short term cash flow requirements, for example claims reserve collateralisation, as currently required by US regulations for non-US insurance groups in respect of US insureds. At 31 December 2005, it had £112.2m of facilities of which only £10.7m was drawn.

The Group manages its liabilities carefully against early crystallisation. An example of this is in our use of lower tier two long-term subordinated debt rather than bank debt, whether term or overdraft or “capital substitute” letters of credit. Lower tier two debt has a number of ‘shock absorption’ characteristics which can help a borrower withstand an unexpected event – for example, it has no financial covenants which could, if breached, trigger early repayment and exacerbate the original problem. Furthermore it has certain interest deferral provisions. Bank debt, on the other hand, can become repayable at the time when a borrower can least afford to do so and we do not rely on it for long-term use.

Brit's claims team was the first to represent London Market Insurers on the ground in the Southern US States following Hurricane Katrina.

Counterparty/Credit Risk

The Group's principal exposures to reinsurers are analysed by rating on page 18. The Group also runs, at any time, shorter term credit exposures in respect of premium income due from clients and/or brokers. The Group believes it has a good track record of avoiding credit losses, due in part to its highly experienced underwriting and finance professionals and in part to its investment, several years ago, in hiring a senior specialist in-house credit analyst team with experience gained at leading ratings agencies. In the course of 2005, the Group conducted a further review of its processes for managing credit risk and collecting receivables which has led to its strengthening certain functions and agreeing a further set of procedural improvements which are to be implemented in 2006.

Operational Risk

We were pleased to win the Technology prize for the Brit Real-Time Interactive Trucking broker portal in the 2005 Insurance Day Awards. This is a clear example of success from an earlier investment of time and resource to provide cutting-edge service. This year we also implemented BUKS, the UK Underwriting Centre's new system to service our brokers and clients more effectively and support the growth of this business.

There is still more to deliver in many areas. The Group continues to invest in people and systems to keep itself at the forefront of modern process and technology. The insurance industry is undergoing a level of fundamental operational change and the Group took the conscious decision to recruit from outside of the traditional UK insurance industry. We are delighted that Kathy Lisson, formerly director of operational transformation at Barclays, agreed to join us as COO to drive through further improvements. The banking industry experienced its own "big bang" 20 years ago and now is the turn of insurance. Following a wide ranging review, Kathy and her team have embarked on a broad program of enhancements for 2006.

Claims Management

The Group continues to place prompt service and settlement of valid claims at the centre of its customer proposition and brand – it is what the client really buys. When a client has experienced a significant insured event this is often a time of the utmost urgency and tension in terms of swift financial recompense to minimise personal and commercial disruption.

Having won an award for Claims Team of the Year in 2004, Brit's team has remained top-quartile rated on claims performance.*

In the subscription market, where risks are syndicated between a number of insurers, Brit has not only gained an enviable claims reputation where it acts as leader but also taken a more active role in certain cases where it is a following insurer and has needed to protect its interests.

Brit's claims team was the first to represent London Market Insurers on the ground in the Southern US states following Hurricane Katrina.

* Source: Gracechurch Consulting Claims Survey 2005.



Bob Foster
Claims Director

Brit's team has remained top-quartile rated on claims performance.

// Our Brand & People



Brand

The first phase of our strategy has been to raise the Group's name and brand awareness. This has been done by delivering our key brand building objectives. We have employed an integrated approach including;

- ▲ Building our corporate identity through sports sponsorships and other brand identity building activities
- ▲ Advertising to reach the correct brokers through careful selection of publications and features
- ▲ Press information (editorial, by-lines and advertorial)
- ▲ More extensively integrated internal communications
- ▲ Improved product and technical information including meeting the new regulatory demands
- ▲ Representation and speaking at industry forums.

Sponsorship of sporting or entertainment events has been linked with corporate hospitality in building a higher profile. We were delighted with our success as lead sponsor of Surrey County Cricket Club and The Brit Insurance Oval ground. In this, the second year of a three year contract with an optional two year extension, we surpassed all our original expectations. In September, The Brit Insurance Oval was the venue for the decisive Ashes Test Match against Australia, which is believed to have been the highest profile UK sporting event in terms of broad public interest since 1966. The result remained uncertain until the final afternoon of the final day of the series, culminating in the first England Ashes series victory on home soil for 20 years.

The size of the national television audience peaked at over 10m, twice the norm. The global television audience also grew, with around 250 million people following the game. The number of hours of coverage (including reviews, repeats and highlights packages) exceeded all expectations and helped accelerate our overall name awareness campaign. Allied to our other sports sponsorships (squash, table tennis and horse racing), our total television exposure is estimated to have been 400 hours rather than an expectation of 300. "Total media value" is a technical media industry measure of advertising and sponsorship effectiveness, taking into account all relevant factors, such as the duration, size and prominence of the display, the time of day, the size and nature of the audience, etc. The estimated total media value of all our televised sponsorships exceeded our direct spend by a ratio of more than 5:1. Above and beyond the hard facts, the cricket sponsorship campaign had the vital added ingredient of being associated with a national success.

the **Brit Oval**
Insurance



Where the Ashes were won.



The cricket sponsorship campaign had the vital added ingredient of being associated with a national success.

People

Insurance is ultimately a people business. Brit aims to secure and develop a leading position in the insurance market by recruiting, training and retaining quality staff. The environment is demanding and rewarding and Brit strives to retain the fun element that makes it a great place to work. Brit's environment and approach encourages dedicated individuals to flourish and excel.

Headcount

During 2005, the total headcount of the Group has increased by 13.4% (13.9% excluding RI3K), with growth both in London and the regions.



Employees by Division

Division	31 December 2005		31 December 2004	
	Number	%	Number	%
Underwriting – London Market	80	13.3	71	13.4
Underwriting – Reinsurance	28	4.7	22	4.1
Underwriting – UK	143	23.8	140	26.4
Underwriting – Other	3	0.5	3	0.6
Underwriting – Total	254	42.3	236	44.5
Advisory	18	3.0	20	3.8
Claims	105	17.4	89	16.8
Corporate Development	21	3.4	14	2.6
Finance	49	8.2	44	8.3
Group Services	10	1.7	10	1.9
Operations, IT and Actuarial	84	14.0	66	12.5
Other	25	4.2	18	3.4
	566	94.2	497	93.8
RI3K	35	5.8	33	6.2
Totals	601	100.0	530	100.0

Employees by Location

Location	31 December 2005		31 December 2004	
	Number	%	Number	%
Birmingham	11	1.8	7	1.3
Bristol	7	1.2	9	1.7
Darlington	28	4.7	30	5.7
Glasgow	9	1.5	7	1.3
Ilford	119	19.8	120	22.7
Leeds	11	1.8	7	1.3
London	371	61.7	315	59.4
Manchester	10	1.7	2	0.4
	566	94.2	497	93.8
RI3K	35	5.8	33	6.2
Total	601	100.0	530	100.0



Leo Barran, from our London office, put his Get a Life money towards achieving his life long ambition of climbing The Matterhorn in Switzerland.

Recruitment and Retention

Brit has a staff turnover of 7.5% (excluding retirements and redundancies) of the current workforce, compared to the UK labour turnover rate reported for 2004 of 15.7%. Across the Group 28.4% of employees have at least five years' service, and 11.0% have at least ten years' service.

All new recruits attend a basic one day induction programme at our London Office which provides them with information about the Company, their benefits, compliance and regulatory requirements as well as a further insight into the culture and practices of Brit.

During initial employment, staff are performance managed by their line manager to the level required for the roles and teams. This framework of performance management ensures that both new employees and their managers are supported during an intense integration period.

The Group operates an innovative "Get a Life" scheme which provides up to £500 per employee as a contribution towards a constructive experience to be spent in the employee's own time and on a different project each year.

Training and Development

The Brit Development Programme provides all employees with the opportunity to increase their technical, personal and management skills, in line with their personal aspirations, the development of business objectives, regulatory compliance and best practice. During 2005, 2,092 employee training days were completed (2004 1,943 days).

Professional Qualifications

Professional qualifications are actively encouraged by the Company and are considered a compulsory element of development for those employees who work in underwriting roles. Of those employees in underwriting roles, 57 have a Chartered Insurance Institute qualification and a further 64 are studying with the full support of the Company.

Other professional bodies represented among Brit employees include the Institute of Chartered Accountants in England and Wales, the Institute of Actuaries, the Law Society, the Chartered Institute of Bankers, the Chartered Institute of Personnel Development and the Institute of Directors.

Graduate Programme

Brit offers a 12 week internship programme for undergraduates. This may lead to the participants securing a placement on our two year graduate programme. During 2005 we welcomed a further four graduates onto the programme.

This method aligns all staff, including our class underwriters, to the shareholders of the Group.

Remuneration and Benefits

The organisation has a remuneration strategy that aims to attract and retain quality staff and to provide reward for performance and achievement. The continual review of the benefits package includes a benchmarking element whereby Brit is able to compare against its competitors and take advice from organisations which collect specific data across industry and regional sectors.

The team spirit around the organisation is underpinned by a number of participative schemes. These include the bonus scheme and the Employee Share Ownership Plan ("ESOP").

The Group's bonus scheme rules allow for up to 7% of Group's pre-tax profit (before calculation of the bonus pool) to be allocated to the bonus pool. The Remuneration Committee has absolute discretion to determine the final quantum of this percentage. It also determines the extent to which the pool, once created, will be distributed.

Of the bonus pool created from 2005 profit, 50% is allocated to staff on a formulaic basis, linked to a number of salary bands. The remaining 50% is available to be awarded across the Group on a discretionary basis. Both proportions will be paid to staff in the April 2006 salaries to staff in employ on 31 December 2005.

This method aligns all staff, including our class underwriters, to the shareholders of the Group. It also allows for staff who have made an outstanding contribution or displayed exceptional performance to be specifically rewarded. It discourages individualistic behaviour and aligns all Group employees to achieve the objective of maximising shareholder return.

The ESOP is open to all employees who have been with the Group for at least 12 months. It encourages employee interest in the Company's share price, and allows an increase in share ownership by them. Shares can be obtained through the scheme on a free, partnership and matching share basis.

▲ **Free Shares:** From time to time the Company may choose to make a grant of Free Shares to eligible employees. They are held in an independent Trust and may be withdrawn after five years free of income tax and national insurance

▲ **Partnership Shares:** Eligible employees can choose to buy shares by making monthly contributions up to a maximum of £125. These shares can be withdrawn from Trust at any time on payment of income tax and NIC. However, after five years they can be withdrawn free from income tax and national insurance

▲ **Matching Shares:** If an employee chooses to buy Partnership Shares, they are matched by the Company, one Matching Share for every two Partnership Shares. Matching Shares must be held in Trust for a minimum of five years, after which they may be withdrawn free of income tax and national insurance.

Family policies in place meet the statutory requirements dictated by employment law, and are further enhanced on completion of a specified period of service. The Company recognises the importance of family life and will continue to review such benefits into the future.

Pension legislation is experiencing significant changes as a result of the pension simplification rules and the Finance Act 2004. As a result the schemes provided to Brit employees are under constant review. It is always the aim to keep individuals informed of issues relating to pensions and a series of presentations at all offices as part of the communication process have recently been undertaken.

Succession Planning

The needs of the business are strengthened by the succession planning process that is in place. The continual development, assessment and support of human resources with the appropriate talent, skills and training allows us to ensure that in situations where key individuals leave the Company the organisation can continue to be supported through structured change. With this plan in place, stakeholders will be reassured that the organisation has assessed and catered for the risk of a key individual's departure. The succession plan also plays an important role in business continuity planning.

Employee Survey

This year, Brit published the results of its first employee survey, covering areas such as corporate direction, character and structure, the external perception, working practices, personal development, the executive team and internal communication. The response rate was over 50%.

The survey asked staff to express agreement or disagreement with a number of statements. Some of the key responses are summarised below.

As a result of the survey, we have taken steps in certain areas to make Brit employees more aware of our group strategy, structure and products to ensure our employees are equipped with the information they need to carry out their role.

“Brit demonstrates a **commitment to making profitable returns**” **97%**

“I am **proud to tell others I work for Brit**” **96%**

“People at Brit are willing to go the **extra mile to get things done**” **90%**

“Employees are provided with **opportunities for growth and personal development**” **85%**

“Employees are given the opportunity to **explore and develop new ideas**” **81%**

% Respondents partially or completely agreeing.





Industry Leadership

Brit Directors and employees sit on various insurance market committees. Brit is represented on 12 ABI committees and interest groups and on over 30 Lloyd's / Lloyd's Market Association ("LMA") committees and groups. This enables Brit to be at the forefront of key market issues and discussions. Such representation includes:

Brit representative	Body
Dane Douetil	Lloyd's Market Reform Group (Chairman) LMA (Board Member and Past Chairman)
Anthony Townsend	Council of Lloyd's
Matthew Scales	LMA Finance Committee
Peter Goddard	LMA Risk Management Committee
Michael Jackson	LMA Regulatory Committee (Chairman)
Hugh Maltby	LMA Market Process Committee
Terry Sams	Thatcham – The Motor Insurance Repair Research Centre (Board member) LMA Joint Motor Underwriting Committee
Jonathan Nunes-Cavalho	LMA Delegated Underwriting Committee
James Day	LMA International Reinsurance Group
Matthew Williams	ABI Legal Expenses Insurance Committee (Chairman)
Bob Foster	LMA Claims Focus Group LMA Non-Marine Claims Committee



Employees

As set out more fully on pages 27 to 30, the Group places the highest priority on employee health and safety, welfare, prosperity and the overall 'work-life' balance.

Clients, Suppliers and Intermediaries

The Group is committed to the highest standards of ethical behaviour, fairness and prompt payment of valid invoices and claims.

Regulation and Crime

The Group has a well established compliance function consistent with its position as one of the leading members of a highly regulated industry. There are established procedures for all key detection, control and reporting functions on many matters including financial crime, money laundering, whistle-blowing and disaster recovery.

The Environment

The Group does not have a major direct environmental impact as it is essentially office-based and non-manufacturing. However, the Group is very aware of its environmental responsibilities.

Brit has made a three year commitment to report, reduce and offset the carbon dioxide emissions due to the energy use in its buildings and business travel. ECX Associate Membership Ltd is working with Brit to calculate its emissions. Once the calculations have been independently audited, ECX Associate Membership will arrange for carbon credits equivalent to our annual emissions to be bought and donated to its designated charity "Pure: the Clean Planet Trust". This reduces global carbon emissions by funding projects to reduce emissions, such as clean energy for developing countries, and by reducing the total supply of carbon credits in the global carbon markets. Brit emissions data, when finalised and audited, will be published on its website.

For 2006 the focus of our programme is three-fold:

- ▲ to improve data collection processes
- ▲ to calculate emissions from business travel; and
- ▲ to set an appropriate target to reduce Brit's carbon emissions.

Other key initiatives include:

- ▲ the Group maintains video conferencing facilities at its main locations
- ▲ the Group has invested substantial sums in a paperless document filing, retrieval and viewing system to reduce environmental waste
- ▲ the Group provides recycling facilities for office waste including bottles, cans, paper and printing cartridges; in addition, redundant computer hardware and mobile phones are donated to charity for refurbishment and further use
- ▲ the Group has made a number of investments in seed capital for specific ecology-related start-up companies, notably those involved in carbon emissions reduction and management. These are the Climate Exchange plc and Trading Emissions plc.

Brit was delighted to receive the Charity Initiative of the Year Award from its peers.

Brit in the Community

Brit is cognisant of its implicit obligations in the context of the many communities in which it is involved:

The global community of insurance and insurance-related events

Brit was a leader in funding and organising significant relief to the often uninsured victims of global catastrophes:

- ▲ Early in 2005, the Sri Lanka cricket tour of New Zealand was cancelled in the wake of the Tsunami of December 2004 which had devastated large areas of Sri Lanka and other countries. Brit swiftly assisted and funded the Federation of International Cricketers' Associations to assemble an elite international XI to play a series of one-day matches against New Zealand, which raised NZ\$1.1m (£0.5m) in aid of Tsunami relief
- ▲ Later in 2005, Brit sponsored a 20/20 cricket match at the Brit Insurance Oval between Asia and the Rest of the World. Brit donated £500,000 which more than underwrote the costs of staging the match and enabled it to go ahead. The ultimate sum raised by the event was £1.1m, thus leveraging our donation for the benefit of the charity
- ▲ Brit's own staff raised in excess of £6,500 via a series of their own initiatives for the Tsunami Relief Fund. Brit matched this with an equal donation
- ▲ Brit has joined with Surrey County Cricket Club in co-founding the Oval Cricket Relief Trust, of which Peter Hazell, Neil Eckert and Michael Smith are trustees, to assist the relief of poverty and financial hardship among communities in cricketing nations affected by natural disasters. Immediate projects have included the re-building of a village in Sri Lanka and the rebuilding of parts of Grenada following the hurricanes of 2004.

Brit was delighted to receive the Charity Initiative of the Year Award from its peers in the Insurance Day Awards for 2005 in respect of its Tsunami appeal work.

The UK Community

Brit has made substantial contributions, both financially and in staff time and expertise, in many 'grass roots' projects in the UK relating to youth, education and disability relief:

- ▲ We have some 20 volunteers from Brit who work on a "buddy" system, visiting Blue Gate Fields School in Tower Hamlets on an alternate week basis during a lunch hour, to help pupils learn basic IT skills. The pupils are aged 7-11 and have been selected because they are either lacking in confidence or need some extra support. Despite its close proximity to the City, Tower Hamlets is the most deprived Borough in the country. This scheme is operated by the Tower Hamlets Education Business Partnership. The management of this scheme for Brit is greatly assisted by personnel from the Lloyd's Community Programme
- ▲ Brit has contributed to a number of cricket-related charities, including the Lord's Taverners, which funds sporting facilities for the young and underprivileged, Bunburys, which raises funds for a broad range of UK charities and Surrey County Cricket Club's Development Programme, which includes provisions for disabled players and which has links with the ECB Playground Marking Scheme and Kennington Park Summer Schools
- ▲ Brit's sponsorship of the Birmingham Business School (part of Birmingham University) Lecturer in Insurance and Risk Management continued in 2005 and further links continued to be forged through guest lecturing and workshops run at the School by Brit staff
- ▲ Brit encourages staff participation, by individuals and teams, in charitable initiatives at a number of levels. This includes an employee grant-matching scheme, support for national initiatives such as Comic Relief and Jeans for Genes and a number of specific donations at the discretion of its internal charity committee.





Paul Gildersleeves
Deputy Finance Director
& Head of Investor Relations

Investor Relations Activity

A substantial programme of investor meetings has been held in the past 12 months, principally involving the Chief Executive Officer, the Finance Director and the Head of Investor Relations. This has been targeted at the two main interest groups of fund managers and market analysts.

In 2005 the Group held in excess of 100 meetings with current and prospective shareholders and market analysts, principally on a one-to-one basis. In November 2005 the Group also held its first in-house "Analyst day" (other than those which regularly accompany financial results announcements) at which analysts were given the opportunity to meet line management of our key operating divisions and gain a better understanding of the workings of the business.

In addition, the Group met with 38 prospective investors as part of its new subordinated debt issue.

Dividend

The Group has proposed a final dividend of three pence per share payable on 28 April 2006 to shareholders on the register on 24 March 2006. The shares will go ex-dividend on 22 March 2006.

Analysis of equity investors by type

Type of Investor	Holding (%)
Pension schemes	47.9
Mutual funds	25.0
Insurance sector	8.3
Other	8.1
Investment trusts	5.5
Retail sector	5.2
	100.0

Investor Return Statistics

Cumulative percentage total shareholder returns to 1 March 2006

Period	Brit	FTSE 250	FTSE Insurance Index
1 year	33.8	34.1	43.2
3 years	52.3	156.5	61.2
5 years	36.0	66.2	(39.7)

Source: Thomson Financial Datastream calculated on basis of dividends reinvested when received.

During the 12 months ended 1 March 2005, Brit's total shareholder return on the basis of the calculation set out above comprised 5.9% yield and 27.9% capital growth, including on reinvested dividends.

New issues of shares

During 2005 a total of 5,932,443 shares were issued on conversion of the convertible loan stock 2008 in the period until 21 November 2005 while it remained convertible. In addition, 938,000 shares were issued on exercise of share options during 2005.

Proposed Share Consolidation

A resolution to consolidate the ordinary 25p shares will be proposed to shareholders at the forthcoming Annual General Meeting. Subject to shareholder approval, shareholders will receive one consolidated ordinary share of 75p (nominal value) for every existing three ordinary 25p (nominal value) shares they own. The consolidation will not affect the rights currently enjoyed by shareholders or materially affect the proportion of the issued share capital they hold in the Company. The Board believes the consolidation will benefit shareholders by facilitating a more appropriate trading range and also make the Company's shares more attractive to investors.

Further information on the proposed consolidation is provided in the Notice of Annual General Meeting.

Extraordinary General Meeting

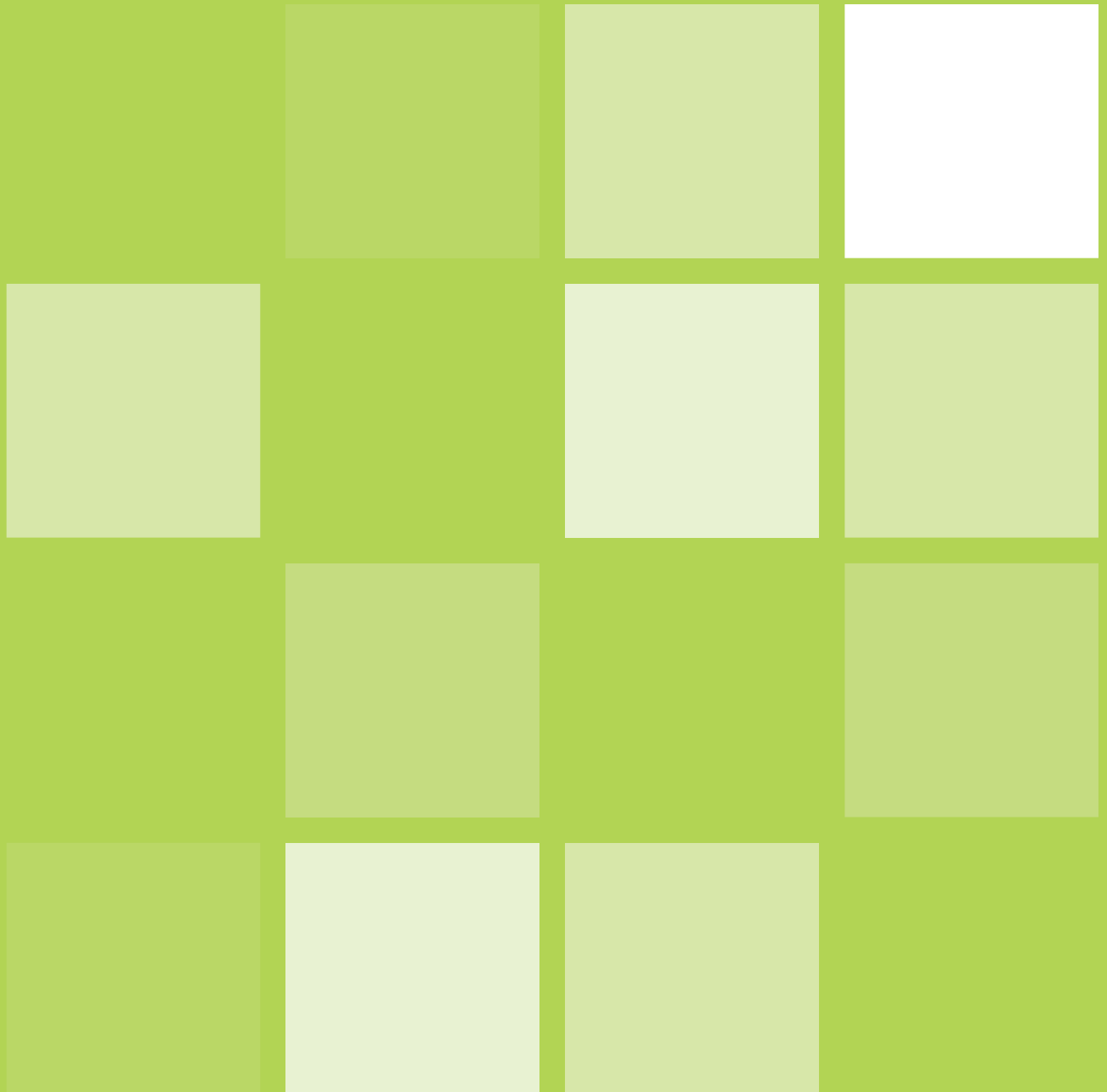
Since the last annual report there has been one extraordinary general meeting. On 3 March 2006 shareholders approved a proposal to reduce the Company's share premium account and increase distributable reserves by £180m, as set out more fully on page 17.

In 2005 the Group held in excess of 100 meetings with current and prospective shareholders and market analysts.

2006 has started satisfactorily. Gross premium written in January and February has increased by 2.7% to £277.7m over the same period last year, despite a reduced appetite for higher risk catastrophe business which generally incepts early in the calendar year. Claims experience has been benign.

It is never possible to predict insurance results with accuracy over short periods. By its very nature it is a fortuity business. However, we remain realistic and positive for the future, based on a general market environment offering pricing improvements in a number of areas and the following key aspects of the way we are managing Brit's business:

- ▲ Top quality underwriting, which has to be the basis for any quality insurance group
- ▲ Continued capital strength, high liquidity and continued resilience to large industry losses, with an improved capital mix
- ▲ Reduced peak zone aggregates and reduced volatility; increasing quantities of lower risk business
- ▲ Diversity of underwriting classes to reduce concentration of risk and allow some flexing of business mix as market conditions change
- ▲ Unstinting discipline and adherence to our core values and standards in all key areas – underwriting, finance and operations
- ▲ Top quality staff and management.



// Board of Directors



Clive Frederick Coates
Chairman

Born 1944. Clive has been Chairman of the Company since September 2002, having previously been Deputy Chairman and a Non-Executive Director since April 2002, and is a member of the Nomination Committee.

He was a Non-Executive Director of Brit Insurance Limited from 1998 to 2004, and was the Chairman of that company from 1999 to August 2004.

He is a fellow of the Chartered Association of Certified Accountants and has approximately 40 years' experience in the insurance industry. Clive was formerly Chief Executive Officer of Eagle Star Insurance Company Limited, Group Deputy Chairman of Eagle Star Holdings PLC and Finance Director of British American Financial Services Limited until his retirement in December 1997. He is a director of Eagle Star Executives' Pension Trustees Limited.



Dane Jonathan Douetil
Chief Executive Officer

Born 1960. Dane was appointed Chief Executive Officer of the Company in April 2005 having been Deputy Chief Executive Officer since March 2004 and an Executive Director since 1999.

He joined Brit Insurance Limited ("BIL") in August 1998 and was appointed Chief Executive Officer of BIL in December 1998. He was appointed Chief Executive Officer of Brit Syndicates Limited in July 2002 and Head of Underwriting for the Brit Group in August 2002.

After joining the Willis Faber Group in 1982, Dane was appointed Executive Director of the Political & Financial Risk Division in 1988. He was a founder shareholder and director of insurance broker, Special Risk Services Limited, from 1989 to 1994. Between 1994 and 1998 he acted as a consultant on the sale of a number of mortgage operations and as a risk consultant for several financial institutions. He was appointed a full time consultant to The Benfield Group in July 1997 prior to joining BIL.

He is Chairman of the Market Reform Group and sits on the Lloyd's Market Association.



Matthew Scales
Finance Director

Born 1954. Matthew joined the Board as Finance Director in 1999.

He has been Finance Director of Brit Insurance Limited since its establishment in 1993 and was appointed Finance Director of Brit Syndicates Limited in August 2004.

Matthew is a fellow of the Institute of Chartered Accountants and joined the C T Bowring Group in 1979, transferring within that group to English & American Group in 1982. He was the Finance Director of English & American Group plc from 1991 to 1993 and was Group Financial Controller of Benfield Group plc from 1996 to 1999.

He is a member of the Finance Committee of the Lloyd's Market Association.



Neil David Eckert
Non-Executive Director

Born 1962. Neil is a founder Director of the Company and, prior to becoming a Non-Executive Director on 1 January 2006, he was Chief Executive Officer from 1999 until April 2005.

Neil joined the Benfield Group in 1986 and was a director of Benfield Greig Group PLC from 1991 to 2000.

He is non-executive chairman of Design Technology & Innovation Limited, a patenting and intellectual property company and a director of RI3K, an internet hub for reinsurance.

He is also a founder director of Climate Exchange plc and chairman of the European Climate Exchange, an exchange set up to trade carbon and other emissions permits. He is a director of Ebix Inc, chairman of Trading Emissions plc, Eonergy International PLC and a trustee of "Pure" The Clean Planet Trust and The Oval Cricket Relief Trust.



Peter Frank Hazell
Non-Executive Director

Born 1948. Peter joined the Board in April 2004 and he is Chairman of the Company's Audit Committee and a member of the Remuneration and Nomination Committees.

He was previously UK Managing Partner of PricewaterhouseCoopers. He spent his early career at Deloitte Haskins & Sells starting in their Management Consultancy Division and later advising on competition policy, investment appraisal and strategic planning. He was also involved in founding the Corporate Finance Practice, specialising in privatisation, regulation and mergers and acquisitions.

Peter is chairman of Argent Group PLC, a non-executive director of UK Coal PLC and of Smith & Williamson Holdings Limited and chairman of both companies' audit committees. He is a member of the Competition Commission, and the Natural Environment Research Council and chairs the audit committee of the latter. He is also a trustee of The Oval Cricket Relief Trust.



Joseph Patrick MacHale
Non-Executive Director

Born 1951. Joe was appointed to the Board on 9 November 2005 and is a member of the Remuneration Committee.

He held a number of senior executive positions with J P Morgan between 1979 and 2001 and was most recently Chief Executive of J P Morgan Europe, Middle East and Africa Region.

He is currently a non-executive director and member of the audit committee of Royal Bank of Scotland Group PLC, non-executive director and chairman of the audit committee of Morgan Crucible plc, chairman of Prytania Group and a trustee of Macmillan Cancer Relief.



Donald Cecil McCrickard
Non-Executive Director

Born 1936. Don has been a Non-Executive Director of the Company since its flotation in 1995 and is Senior Independent Director, Chairman of the Remuneration and Nomination Committees and a member of the Audit Committee.

He was previously a director of American Express International Inc from 1978 to 1983, Group Chief Executive Officer of TSB Group Plc from 1990 to 1992, Chief Executive of TSB Bank Plc from 1989 to 1992 and Chairman of Hill Samuel Bank from 1991 to 1992. He was also a member of the executive committee of the British Bankers Association from 1988 to 1992 and a member of the Bank of England's Deposit Protection Board from 1989 to 1992.

He is a fellow of the Chartered Institute of Bankers and a director of The Equity Partnership Investment Company PLC, National Counties Building Society Limited and Verdandi Limited.



Cornelis Antonius Carolus Maria Schrauwers "Cees"
Non-Executive Director

Born 1947. Cees joined the Board on 1 June 2005 and is a member of the Audit Committee.

He has some 30 years' industry experience, most recently as Managing Director of Aviva International and Managing Director of CGU Insurance.

He previously held a number of senior positions in Commercial Union covering both the general insurance and life sectors. Prior to this Cees was a partner with Coopers & Lybrand in charge of insurance consultancy.

He is chairman of CMGL Holdings Limited, Drive Assist UK Limited and Alio Limited.



Michael Gordon Smith
Non-Executive Director

Born 1945. Michael joined the Board in March 2004 and is a member of the Nomination and Remuneration Committees.

He is a former senior partner of Titmuss Sainer & Webb (now Dechert), the international law firm. He was a specialist corporate lawyer and from the early 1990's he focused on the Lloyd's insurance market and built a team of lawyers concentrating solely on this area.

He is a trustee of the Foyle Foundation, the Batty Charitable Trust and the National Hospital for Neurology and Neurosurgery Development Foundation and The Oval Cricket Relief Trust.



John Anthony Victor Townsend "Anthony"
Non-Executive Director

Born 1948. Anthony joined the Board in 1999 and is a member of the Audit, Remuneration and Nomination Committees.

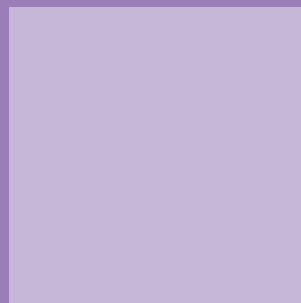
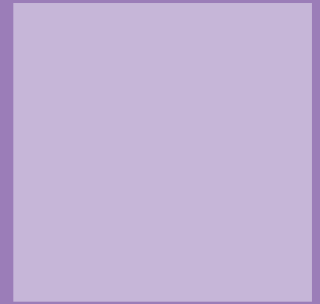
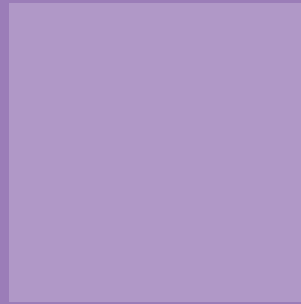
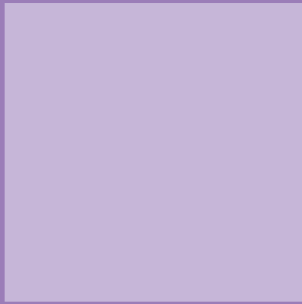
He has been a Non-Executive Director and Chairman of Brit Syndicates Limited since 1999 and joined the Board of Brit Insurance Limited in August 2004. He serves on the Council of Lloyd's, representing Brit UW Limited.

Anthony's career has spanned merchant banking, Lloyd's broking and investment banking and he was with Rea Brothers Group from 1988 to 1999.

He is chairman of British & American Investment Trust PLC, iimia Investment Trust PLC and The Ukraine Opportunity Trust plc. He is also a non-executive director of F & C Global Smaller Companies PLC, Finsbury Emerging Biotechnology Trust PLC, Finsbury Growth & Income Trust PLC, Finsbury Technology Trust PLC and Finsbury Worldwide Pharmaceutical Trust PLC.

Corporate Governance //

Report of the Directors	42
Directors' Remuneration Report	45
Corporate Governance Report	54
Report of the Audit Committee	59
Report of the Nomination Committee	61



The Directors present their report and financial statements for the year ended 31 December 2005.

Results and Dividends

The results are considered in detail in the Operating and Financial Review on pages 8 to 36.

Details of dividends in respect of 2005 are set out in Note 29 on page 102. The Directors recommend a final dividend of 3p per ordinary share for the year ended 31 December 2005. If approved, this dividend will be paid on 28 April 2006 to shareholders on the register on 24 March 2006.

Principal Activity and Business Review

The Company is a holding company and through its subsidiaries, is engaged in insurance and reinsurance. A detailed review of the activities and operations of the Group during 2005, together with the events since the end of the financial year and likely future developments, is included in the Operating and Financial Review.

Directors

The names of the Directors as at the date of this report are shown on page 135. Neil Eckert became a Non-Executive Director on 1 January 2006, having been Chief Executive Officer until 19 April 2005 and then an Executive Director until 31 December 2005. Dane Douetil became Chief Executive Officer on 19 April 2005. Cees Schrauwers and Joe MacHale joined the Board on 1 June 2005 and 9 November 2005 respectively. Glyn MacAulay was a Director from 1 January 2005 until 19 April 2005.

Substantial Shareholdings

	Number of Shares	Percentage of Issued Share Capital
Invesco	179,888,889	18.32
Third Avenue	74,675,407	7.61
Jupiter Asset Management	60,448,659	6.16
F&C Asset Management	42,077,449	4.29
Legal & General Investment Management	37,230,306	3.79
JP Morgan Asset Management	35,250,813	3.59
Schroder Investment Management	35,224,383	3.59
Liontrust Asset Management	31,864,810	3.25

In accordance with the Combined Code and the Company's Articles of Association, Dane Douetil, Joe MacHale, Don McCrickard, Matthew Scales and Cees Schrauwers retire this year and, being eligible, offer themselves for re-election at the forthcoming Annual General Meeting ("AGM").

The interests of the Directors and their families in the Company's ordinary shares of 25p each and 8.5% Unsecured Subordinated Loan Stock 2008 ("ULS"), together with details of the Directors' interests in share incentive schemes are set out in Note 37 on page 112.

At no time during the year did any Director hold a material interest in any contract of significance with the Company or any of its subsidiary undertakings other than service contracts between each Executive Director and a Group company, details of which are disclosed in the Directors' Remuneration Report.

The Company has purchased and maintained throughout the year directors' and officers' liability insurance in respect of itself and its Directors. The Directors also have the benefit of the indemnity provision contained in the Company's Articles of Association.

Substantial Shareholdings

As at 10 March 2006 the Directors had been advised of the following interests of 3% or more in the Company's issued share capital:

Employment Policy

Details of employees, and their remuneration are included in Note 10 on page 84.

The Group's Human Resource policies on recruitment, learning and development and reward continue to evolve whilst maintaining the core aims of attracting and retaining high calibre personnel.

Emphasis is placed on the development of existing staff and a comprehensive learning and development programme is in operation allowing all employees to study for professional, competency or technical qualifications to aid them in their careers. There are also incentivised learning schemes to encourage continuous professional development. Vacancies are advertised internally and externally to allow staff the opportunity for career growth and/or diversification.

The reward structure is continuously reviewed to ensure it supports the Group's objectives and values and motivates employees. The employee share ownership plan, share incentive schemes and profit related bonus are designed for good staff retention and new benefits proposals, including those suggested by staff, are frequently developed by the HR team.

The Group's culture encourages employee involvement and employee feedback is sought on the way the Group works and supports community initiatives. Methods used to consult employees include feedback via the Group's Intranet, "Britnet", employee surveys, briefings and lunches attended by Directors, members of the Executive Management Committee and selected employees. These arrangements also enable the development of a common awareness among employees of the financial and strategic factors affecting the performance of the business.

The Group has robust policies and procedures to offer employment opportunities that are free from discrimination on any grounds relating to recruitment, training, promotion, career development, appraisal and any other employment matters, and to consider the aptitudes and abilities of disabled persons.

If existing employees become disabled, it is the Group's policy, wherever practicable, to provide continuing employment under normal terms and conditions and to provide any necessary equipment or adjustments. The Group offers training and career development and promotions to disabled employees wherever appropriate.

Creditors Payment Policy

It is the policy of the Company to settle all expenses on a timely basis in the ordinary course of business. At 31 December 2005, trade creditors of the Company had an average of approximately five days outstanding (31 December 2004: five days). It is the Group's policy to agree appropriate terms and conditions in advance with its suppliers and to make payment in accordance with those terms and conditions, provided that the supplier has complied with them.

Donations

During the period, the Group made UK charitable donations amounting to £559,477 (2004: £86,259), of which £426,686 was made in respect of the Tsunami relief efforts in South East Asia.

No donations were made to any political organisations (2004: nil).

Post Balance Sheet Events

On 12 January 2006 Brit announced a tender offer to purchase all of the outstanding ULS at 109 pence for every £1 nominal amount of ULS. 19,584,970 ULS units were validly tendered and following subsequent market purchases at 109p, 20,011,551 ULS units remain outstanding as at 14 March 2006.

On 8 February 2006, Brit announced a proposed capital reorganisation and shareholders passed a resolution to reduce the share premium account of the Company by £180 million at an Extraordinary General Meeting on 3 March 2006. It is expected that the reorganisation will be completed by the end of March 2006, subject to High Court approval.

Own Shares

Details of shares held by the trustees of the Brit Performance Share Plan 2003 and Brit Executive Share Option Scheme 2003, by the trustees of the Brit Employee Share Ownership Plan 2001 and by Brit Insurance Limited are provided in Note 31 on page 103.

Auditor

Mazars LLP resigned as the Company's Auditor on 24 May 2005 and the Directors appointed Ernst & Young LLP to fill the casual vacancy created by the resignation. Special notice of the resolution proposing the reappointment of Ernst & Young LLP has been received by the Company in accordance with the Companies Act 1985 and this resolution will be put to the AGM.

Annual General Meeting

The AGM will be held at 10 o'clock on 25 April 2006 at the Company's offices at 55 Bishopsgate, London EC2N 3AS. A booklet containing the Notice of the Meeting, Explanatory Notes and a Proxy Form is enclosed.

Going Concern

After making due enquiries, the Directors have a reasonable expectation that the Group has adequate resources to continue in operation for the foreseeable future. For this reason, they continue to adopt the going concern basis for preparing financial statements.

Statement of Directors' Responsibilities

The Directors are required to prepare accounts for each accounting period that comply with the relevant provisions of the Companies Act 1985 and of the International Financial Reporting Standards ("IFRS") as adopted by the European Union, and which present fairly the financial position, financial performance and cash flows of the Group at the end of the accounting period. A fair presentation of the financial statements in accordance with IFRS requires the Directors to:

- ▲ select suitable accounting policies and verify they are applied consistently in preparing the accounts, on a going concern basis unless it is inappropriate to presume that the Group will continue in business;
- ▲ present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- ▲ provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Group's financial position and financial performance; and
- ▲ state that the Group has complied with applicable IFRS, subject to any material departures disclosed and explained in the accounts.

The Directors are responsible for maintaining proper accounting records which are intended to disclose with reasonable accuracy, at any time, the financial position of the Group. They are also responsible for ensuring the Annual Report and Accounts includes information required by the Listing Rules of the Financial Services Authority. The Directors are also ultimately responsible for the systems of internal control maintained by the Group for safeguarding the assets of the Group and for the prevention and detection of fraud and other irregularities. Further details of the systems of internal controls maintained by the Group are more fully described in the Corporate Governance Report.

By Order of the Board

Peter Goddard

Secretary

14 March 2006

Directors' Remuneration Report

This report has been prepared by the Remuneration Committee in accordance with the Companies Act 1985, as amended, and has been approved by the Board for submission to shareholders. Ernst & Young LLP have audited this report to the extent required by the Directors' Remuneration Report Regulations 2002, namely sections numbered 1, 2 and 3. The Chairman of the Committee will attend the AGM and will be available to answer shareholders' questions regarding remuneration.

Composition

During the year, the Committee comprised the following:

Don McCrickard*†	Chairman of the Committee
Clive Coates	until 27 September 2005
Peter Hazell*	from 11 January 2005
Glyn MacAulay*	until 19 April 2005
Joe MacHale*	from 9 November 2005
Michael Smith*	
Anthony Townsend*	

* considered independent by the Board.

† Don McCrickard's independence is covered in more depth in the Corporate Governance Report.

Governance

Clive Coates ceased to be a member of the Committee during 2005 to reflect best practice.

The Committee met on four occasions during 2005 and details of attendance are disclosed in the Corporate Governance Report.

Summary Terms of Reference

The Remuneration Committee:

- ▲ ensures the broad policy for the remuneration of the Group's senior executives provides senior executives with appropriate incentives to encourage enhanced performance, attracts and rewards senior executives in a fair and responsible manner for their individual contributions to the success of the Group, reflects a strong link between performance and reward and aligns the interests of senior executives and shareholders;
- ▲ analyses current trends in remuneration, benefits and rewards for senior executives, and in particular as applied in competitors;
- ▲ approves the design of, and determines targets for, any performance related pay schemes operated by the Group;
- ▲ determines the policy for, and scope of, pension arrangements for senior executives; and
- ▲ ensures that contractual terms on termination, and any payments made, are fair and recognise the duty to mitigate loss.

The Committee's full terms of reference are available on the Company's website, www.britinsurance.com and from the Company Secretary at the registered office.

Advisers

The Committee consults regularly with the HR Director and the Company Secretary. During 2005, it consulted with the Company's former auditor, Mazars LLP, in connection with performance conditions attaching to the 1999 Long Term Incentive Plan. In addition, as described in this report, the Chief Executive Officer advises the Committee in connection with the annual salary review, bonus payments and grant of awards under the Group's share incentive schemes (save in respect of his own remuneration).

// Directors' Remuneration Report

Remuneration Consultants

The Committee has appointed New Bridge Street Consultants LLP ("NBSC") as its remuneration consultants. NBSC has no other connection with the Company other than in the provision of advice on executive and employee remuneration. NBSC advises the Committee directly on matters within the Committee's terms of reference on which the Committee chooses to consult NBSC. NBSC also advises the Company generally on aspects of executive and employee remuneration, typically on the implementation and ongoing operation of executive remuneration schemes. Such advice is usually provided through the HR Director. NBSC advises the Board (or those Directors charged by the Board to make recommendations) from time to time on the remuneration of Non-Executive Directors, including the Chairman.

Remuneration Policy

The Group operates in personnel-orientated markets and its performance is dependent on the skill and experience of motivated employees.

The remuneration policy aims to attract, retain and motivate high calibre executives, rewarding outstanding performance with packages that are aligned with the interests of shareholders. The level of Executive Directors' remuneration takes account of practice in comparable companies and Executive Directors are rewarded on the basis of responsibility, competence and contribution. Components of these packages include salary, on which pension and other benefits are calculated, an annual bonus and long-term incentives. Therefore, a material element of senior executives' remuneration is performance-related.

The Committee assesses whether the reward strategies are achieving their objectives. It reviews independent market data regularly and assesses, with advisers, whether any adjustments to policy and practices are necessary.

Elements of Remuneration

As indicated in the table below, the principal elements of executive remuneration currently comprise the following:

- a) Base salary (fixed);
- b) Annual incentives (variable); and
- c) Long-term incentives (variable).

Elements of Remuneration

	Objective	Participation	Period	Performance Conditions
Base Salary	To reflect the value of the individual, their role and their skills	All employees	Not applicable but salaries are reviewed annually on 1 April	Not applicable but salaries are determined by taking a number of factors into account including individual performance, level of experience, scope of responsibility, market practice and competitiveness of total remuneration
Annual Bonus	To reward exceptional performance and incentivise delivery of short term objectives	All Brit Group Services Limited employees as at 31 December are eligible to be considered for a bonus	1 year	Achievement of Group profit and exceptional individual performance
Share Options	To incentivise generation of long-term shareholder returns and to encourage a share ownership culture	Generally targeted at senior executives	3 years	Achievement of Total Shareholder Return conditions using a FTSE 250 comparator group
Share Awards	To incentivise generation of long-term shareholder returns and to encourage a share ownership culture	Generally targeted at senior executives	3 years	Achievement of Total Shareholder Return conditions using a sector based comparator group
Share Incentive Plan	To develop wider share ownership amongst employees to align their interests with those of shareholders	Employees of Brit Group Services Limited with one year's service	3 years	None
Pension	To provide post-retirement remuneration	All employees of Brit Group Services Limited aged 18 and above	N/A	None

Executive Directors' Salaries

The salaries of all Group employees, including the Executive Directors, are formally reviewed annually (with due regard given to pay and conditions throughout the Group) and from 2006, are effective from 1 April. During 2005, at the request of the Committee, to ensure that the Executive Directors' remuneration packages remained competitive, NBSC refreshed the benchmarking exercise of senior executives' and Executive Directors' remuneration in the sector and the wider FTSE 250 which was originally conducted in 2004. As part of this exercise, which coincided with the annual salary review, the salaries of senior executives and the Executive Directors were reviewed against their performance and contribution and adjusted accordingly with effect from 1 April 2006.

Dane Douetil became Chief Executive Officer on 19 April 2005 and his salary was adjusted with effect from this date to £442,008 per annum (from £338,000 per annum) to reflect his new responsibilities.

Following the conclusion of the review of the Executive Directors' remuneration packages and personal performance and contribution, the Committee increased the salaries of Dane Douetil and Matthew Scales with effect from 1 April 2006 to £473,004 per annum (£8,000 of which is in respect of the cessation of the company car scheme, further details of which are disclosed on page 49) and £320,424 per annum respectively (2005: £442,008 per annum and £312,000 per annum respectively). These base salary increases are considered appropriate by the Committee as they were set after a full review of the responsibilities, skills and experience of the individuals against a benchmark determined by reference to other insurance companies and FTSE 250 organisations.

Annual Bonuses

Participation in the Group's annual bonus scheme is open to all Group employees (save for RI3K employees in respect of whom separate arrangements are operated), including Executive Directors. The scheme aims to reinforce the relationship between individual and Group performance and reward and is dependent on profit. Under this scheme, a bonus pool equalling no more than 7% of Group profit before tax can be distributed to participants, save that no bonus payable to any Executive Director may be greater than 80% of basic salary.

If the Committee determines that it is not appropriate for the entire bonus pool to be allocated, any unallocated portion can be retained and paid out in subsequent years as the Committee deems appropriate.

The Committee reviewed the performance of the senior executives and Executive Directors against their individual personal objectives for 2005 and their contribution to the Group's performance and achievements during 2005. The Committee strongly believes that the bonuses awarded to these individuals truly reflect the level of their achievement and contribution during 2005.

Long-Term Incentives

The operation and appropriateness of the Group's share incentive schemes are monitored throughout the year by the HR team and the Committee. The Committee continues to review the appropriateness of the performance conditions which are covered in depth below.

The Group operates two active long-term share incentive schemes:

(i) The Brit Executive Share Option Scheme 2003 ("ESOS")

Under the ESOS, options may be granted each year over shares with an aggregate exercise price normally no greater than 100% of basic salary. These options will only become exercisable if a performance condition is satisfied. For the November 2003 grant of options the performance condition was based on the Company's Total Shareholder Return ("TSR") performance over a period of at least three years from grant compared with the TSR of the constituents of the FTSE Mid 250 Index. No portion of an option will vest for median performance. If the Company's TSR is immediately above that of the median company, 50% of the options will vest, with full vesting for upper quartile performance (with straight-line vesting between these two points). If the performance condition is not met in full over years 0-3, performance can be re-tested once over years 0-4. The same performance conditions apply to all subsequent grants of options made under the ESOS, save that retesting does not apply to grants made after 31 December 2003.

(ii) The Brit Performance Share Plan 2003 ("PSP")

Under the PSP, awards may be granted each year over shares with a value of up to 100% of basic salary. The extent to which awards vest is determined by the extent to which performance conditions are satisfied over the three-year period following grant. For the grant of all awards made under the PSP to date, the performance condition was based on the TSR performance of the Company compared with the constituents of the FTSE All Share Insurance Index as follows:

Brit's ranking	Percentage of award that vests
Below median	0
Median to upper quartile	20 – 100 (with straight line vesting)
Upper quartile	100

Performance Conditions

The Committee intends to continue to use the same performance conditions to any future awards granted under the ESOS and the PSP with the exception that, following the changes to FTSE sector classifications, the TSR comparator group for the PSP will be changed to the FTSE All Share Non-life Insurance sector. The Committee believes these conditions are appropriate as they provide participants with the incentive to deliver returns to shareholders that are greater than the market generally and the Company's specific industry peers. All TSR calculations will be performed by an independent third party thereby ensuring that the calculations are performed independently and will be reviewed by the Committee.

Options and Awards Outstanding

As at 31 December 2005, there were a total of 30,773,405 options outstanding under all executive option schemes and potential dilution amounted to 3.14% of the issued share capital of the Company. Obligations under the PSP are settled by an offshore employee benefit trust from shares purchased in the market. As at 31 December 2005, the employee benefit trust held 8,809,106 shares.

Fees of the Chairman and Non-Executive Directors

Non-Executive Directors receive an annual fee which is reviewed once per annum and, from 2005, is effective from 1 April. They are not entitled to participate in any of the Group's short and long-term incentive and pension arrangements, save in respect of Neil Eckert whose existing long-term incentives and pension benefits arise from his former employment by the Group. Fees paid to Non-Executive Directors are determined by the Executive Management Committee (the "EMC") which comprises the two Executive Directors and four senior executives as detailed in the Corporate Governance Report. Fees are not set by reference to the number of meetings held. During 2005, the EMC commissioned an analysis of fees paid to Non-Executive Directors by NBSC and used other market survey data to ensure that the fees paid were both comparable to those of similar organisations and also reflected the time devoted by Brit's Non-Executive Directors to the Group's affairs. Accordingly, the EMC strongly believes that the increases to the fees of the Chairman and the Non-Executive Directors made during the year were appropriate, given their roles, time commitment requirements and the significant work required on the Board refreshment and succession plans.

With effect from 1 April 2006, the fees paid to Non-Executive Directors will be as follows:

Fee	£ per annum ¹
Directorship Fee	£34,750
Committee Fee	£8,250 per committee
Board Chairman Fee	£86,250 ²
Committee Chairman Fee	£10,500 per committee
Senior Independent Director Fee	£13,750

¹ this reflects a general increase of 3% over 2005 fees following the annual review

² this reflects a benchmarking exercise and the increased time commitments

Anthony Townsend chairs the Board of Brit Syndicates Limited, represents that Board on the Investment Committee and also sits on the Board of Brit Insurance Limited for which he receives an additional total annual fee of £46,000. He was elected to serve on the Council of Lloyd's (the "Council"), representing Brit UW Limited from 1 February 2006. The fee of £25,000 is remitted to that Group company which then pays Anthony an additional £2,000 per Council meeting attended. Six Council meetings are scheduled for 2006.

1. Emoluments and Compensation

	2005							2004
	Fees & salaries £'000	Benefits in kind £'000	Bonus £'000	Car Allowance £'000	Pension £'000	Salary Supplement ¹ £'000	Total £'000	Total (restated) ² £'000
Current Directors								
Chairman								
Clive Coates	127	–	–	–	–	–	127	120
Executive Directors								
Dane Douetil	412	1	221	8	21	26	689	640
Matthew Scales	312	12	140	–	31	26	521	606
Non-Executive Directors								
Neil Eckert ³	346	10	95	–	41	–	492	851
Peter Hazell	65	–	–	–	–	–	65	30
Joe MacHale ⁴	6	–	–	–	–	–	6	–
Don McCrickard	91	–	–	–	–	–	91	88
Cees Schrauwers ⁵	25	–	–	–	–	–	25	–
Michael Smith	53	–	–	–	–	–	53	36
Anthony Townsend	101	–	–	–	–	–	101	84
Former Directors								
Glyn MacAulay ⁶	20	–	–	–	–	–	20	65
Total for the Year	1,558	23	456	8	93	52	2,190	2,520

¹ see pension section of this report

² totals restated to reflect remuneration of the Directors who were in office on 1 January 2005 and not those who served for part of 2004

³ Neil Eckert served as an Executive Director during 2005

⁴ with effect from appointment, 9 November 2005

⁵ with effect from appointment, 1 June 2005

⁶ until cessation of directorship, 19 April 2005

Executive Directors are offered a number of benefits, namely a car, private medical insurance, permanent health insurance and life assurance. The Group has closed the company car scheme to other than essential users and with effect from 1 April 2006, the company car scheme is commuted to pensionable salary. Dane Douetil and Matthew Scales have a death benefit equal to ten times annual salary (subject to the HM Revenue & Customs cap) as they participate in the Group Stakeholder Pension Plan.

2. Share-based Incentives

Share Options

The interests of the Directors in share options in the Company are as follows:

	Scheme	1 January 2005	No. options granted in year	As at 31 December 2005	Exercise price at date of grant/rollover	Date from which exercisable	Expiry date
Current Directors							
Dane Douetil	A	–	398,205	398,205	83.25p	12/10/08	11/10/15
	A	414,023	–	414,023	78.50p	18/10/07	17/10/14
	A	357,520	–	357,520	76.92p	03/11/06	02/11/13
	B	749,224	–	749,224	62.50p	23/10/05	22/10/12
	B	450,000	–	450,000	70.83p	31/05/05	30/05/12
	B	250,000	–	250,000	66.00p	24/05/03	23/05/10
Neil Eckert*	A	541,406	–	541,406	78.50p	18/10/07	17/10/14
	A	487,520	–	487,520	76.92p	03/11/06	02/11/13
	B	525,000	–	525,000	80.25p	06/12/02	05/12/09
	B	589,473	–	589,473	142.50p	10/09/01	09/09/08
Matthew Scales	A	–	281,081	281,081	83.25p	12/10/08	11/10/15
	A	382,166	–	382,166	78.50p	18/10/07	17/10/14
	A	357,520	–	357,520	76.92p	03/11/06	02/11/13
	B	172,646	–	172,646	62.50p	23/10/05	22/10/12
	B	400,000	–	400,000	70.83p	31/05/05	30/05/12
	B	300,000	–	300,000	66.00p	24/05/03	23/05/10

A Options granted to Directors under the ESOS.

B Options granted to Directors under the Brit 1998 Unapproved Executive Share Option Scheme.

* options granted when Neil Eckert was an Executive Director.

All of the above options were granted for nil consideration, save in respect of 749,224 options granted to Dane Douetil and 172,646 options granted to Matthew Scales on 23 October 2002, further details of which are disclosed in this report.

The Remuneration Committee has applied performance conditions to all of the above options, except in the special circumstances detailed in this report. The performance conditions for options granted under the ESOS are explained on page 47.

The performance conditions applied to options granted under the Brit 1998 Unapproved Executive Share Option Scheme (the "1998 Scheme") were determined following discussions with the Company's advisers and consideration of market practice at that time. The full performance conditions for options granted in 1998, 1999, 2000 and 2002 stated that options were only exercisable if the Company's ranking in terms of TSR was higher than the average TSR growth of the FTSE Actuaries (Insurance) Index and the FTSE 100 Index over a performance period of three years.

Additional phased vesting performance conditions based on TSR were applied to any options granted to senior executives and Directors in May 2002 in excess of 1 x salary whereby vesting of the options in excess of 1 x salary was contingent on the Company's TSR exceeding the FT Actuaries (Insurance) Index over a performance period of three years. For the amount of options granted in excess of 1 x salary to vest in full, the TSR must have exceeded the FT Insurance Index by 25% or more. The calculations required by the performance conditions for options granted in 1998, 1999, 2000 and 2002 were performed by NBSC and were reviewed by the Committee. These performance conditions have been met and accordingly such options have vested in full.

In 2002, the Committee agreed to use the 1998 Scheme to satisfy in part a commercial settlement which had been agreed with the participants of the Brit Insurance Phantom Share Option Scheme (the "Phantom Scheme"). On 23 October 2002 a total of 1,353,913 options at a strike price of 62.50p were awarded to Group employees who were participants of the Phantom Scheme, of which 749,224 options were awarded to Dane Douetil and 172,646 options were awarded to Matthew Scales. Performance conditions were not applied to these options as they were awarded as part of a commercial settlement, but all other normal vesting criteria were applied. Full details of the settlement are disclosed in the Company's Report and Accounts 2002.

No further grants will be made under the 1998 Scheme.

No options were exercised by the Directors during 2005 (nor 2004) and no options expired unexercised during the year.

Share Awards

The interests of the Directors in share awards made under the PSP are as follows:

	Performance Period ended	Award date	Plan Interest (shares) as at 1 January 2005	No. of plan shares allocated in 2005	Plan Interest (shares) vested in 2005	Plan Interest (shares) as at 31 December 2005	Value Vested 2005	Vesting date
Dane Douetil	2008	12/10/05	-	398,205	-	398,205	-	12/10/08
	2007	18/10/04	308,188	-	-	308,188	-	18/10/07
	2006	03/11/03	360,113	-	-	360,113	-	03/11/06
Neil Eckert*	2007	18/10/04	403,009	-	-	403,009	-	18/10/07
	2006	03/11/03	491,055	-	-	491,055	-	03/11/06
Matthew Scales	2008	12/10/05	-	281,081	-	281,081	-	12/10/08
	2007	18/10/04	284,475	-	-	284,475	-	18/10/07
	2006	03/11/03	360,113	-	-	360,113	-	03/11/06

* awards granted when Neil Eckert was an Executive Director.

The share price as at 12 October 2005 was 83.5p. The Remuneration Committee has applied performance conditions to all awards and these are explained on page 48.

The share price at 30 December 2005 (being the last day of dealing prior to 31 December 2005) was 89.0p (31 December 2004: 78.75p). The highest and lowest closing prices during the financial year were 92.0p and 77.5p respectively.

// Directors' Remuneration Report

Brit Employee Share Ownership Plan 2001 ("ESOP")

The ESOP was approved by HM Revenue & Customs and shareholders in June 2001 and is generally available to all Group employees and subject to vesting periods of three to five years. The interests of the Directors in the ESOP are as follows:

	As at 1 January 2005	Free shares granted in year	Partnership shares acquired in year	Matching shares granted in year	As at 31 December 2005
Dane Douetil	11,751	500	1,779	886	14,916
Neil Eckert*	11,751	500	1,779	886	14,916
Matthew Scales	11,751	500	1,779	886	14,916

* Neil Eckert participated in the ESOP until 31 December 2005 when he ceased to be an employee of the Group.

3. Directors' Pension Benefits

No Director who held office during 2005 was a member of a defined benefit pension scheme.

A funded unapproved retirement scheme ("FURBS") is run by the Company. Contributions are paid annually in arrears.

Matthew Scales is a member of the FURBS scheme and the Brit Insurance Limited defined contribution scheme. Dane Douetil is a member of the FURBS scheme and the defined contribution Brit Group Services Limited stakeholder scheme. Only basic salary of the Executive Directors is pensionable and this is capped at double the HM Revenue & Customs earnings cap. The equivalent of the pension contribution in excess of this cap is offered as a FURBS contribution or salary supplement at no material extra cost to the Company. During 2005 the Executive Directors chose to receive a salary supplement. The Chairman and the Non-Executive Directors do not have any pension benefits, save for Neil Eckert whose pension benefits under the Brit Insurance Limited defined contribution scheme arise as a result of his former employment by the Group.

Service Contracts

Copies of the Executive Directors' service contracts and Chairman and Non-Executive Directors' letters of appointment are available for inspection at the registered office of the Company.

Executive Directors

Dane Douetil and Matthew Scales have service contracts with Brit Group Services Limited ("BGS") dated 30 July 1998 and 10 December 1998 respectively with no fixed terms. The Committee's policy on the length of notice periods is that they should be set so as to reflect appropriately the interests of the Company and the senior executives, while also reflecting best practice. Consequently, these Executive Directors have notice periods of twelve months, which can be given by either party.

In the event of early termination, when determining the amount of compensation that is paid, the Committee will take into account the departing Executive Director's duty to mitigate his loss. Compensation payments will not exceed the total of 12 months' remuneration and accrued benefits.

Executive Directors are permitted to accept appointments on external boards or committees provided these are not deemed to interfere with the business of the Group. Any fees received in respect of these appointments are remitted to the Group and any such fees are reflected in the remuneration package of the individual Director concerned.

Chairman and Non-Executive Directors

The Chairman and Non-Executive Directors have letters of appointment with the Company under which there is no fixed term, a nil notice period on behalf of both the Company and the Chairman/Non-Executive Directors and no provision for compensation for loss of office.

Appointment Details

Name	Date of most recent letter of appointment	Date of appointment to the Board	Date of last reappointment at an AGM
Clive Coates	30 April 2002	29 April 2002	19 April 2005
Neil Eckert	20 December 2005	30 October 1995	19 April 2005
Peter Hazell	1 March 2004	1 April 2004	27 May 2004
Joe MacHale*	8 November 2005	9 November 2005	–
Don McCrickard	27 April 2000	3 November 1995	19 April 2005
Cees Schrauwers*	31 May 2005	1 June 2005	–
Michael Smith	1 March 2004	8 March 2004	27 May 2004
Anthony Townsend	18 May 1999	2 August 1999	27 May 2004

* Appointed by the Board during 2005.

Neil Eckert had a service contract with BGS dated 8 May 2000 which during 2005 was converted to a fixed term expiring on 31 December 2005. This agreement provided that if BGS terminated his employment because he became a patient as defined under the Mental Health Act 1983, was prevented by illness or otherwise from performing his duties for a consecutive period of 203 days or an aggregate of 203 days in any period of 365 days, or was, in the reasonable opinion of the Board, based on a medical report, unfit to perform his duties, BGS would pay to him by way of compensation for loss of employment, within fourteen days of such termination, a sum equal to twelve months' salary.

Glyn MacAulay had a letter of appointment from the Company dated 27 April 2000, under which there was no fixed term, a nil notice period on behalf of both the Company and Glyn MacAulay and no provision for compensation for loss of office.

Performance Graph

As required by the Directors' Remuneration Report Regulations 2002, Graph 1 illustrates the performance of Brit and a "broad equity market index" over the past five years. Brit is a constituent of the FTSE Mid 250 Index and therefore that index is considered the most appropriate form of "broad equity market index" against which the Group's performance should be graphed. Performance, as required by the legislation, is measured by Total Shareholder Return (share price growth plus dividends paid). Graph 2 illustrates the Group's performance compared with the FTSE All Share Insurance Index, the index used for the purposes of performance conditions attaching to the Performance Share Plan 2003.

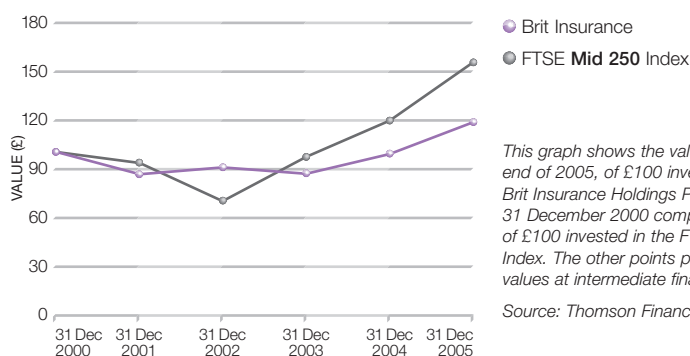
On Behalf of the Board

D C McCrickard

Chairman of the Remuneration Committee

14 March 2006

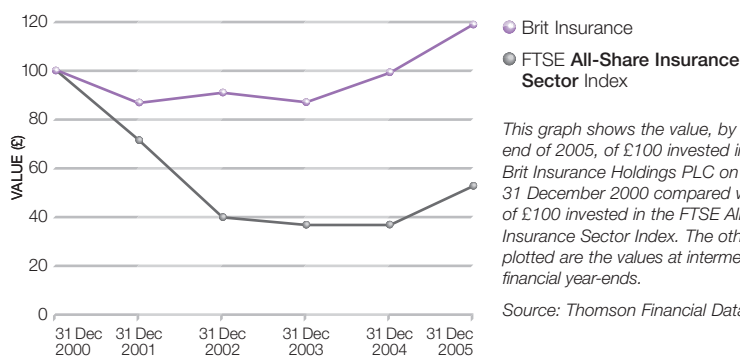
Graph 1 - Total Shareholder Return



This graph shows the value, by the end of 2005, of £100 invested in Brit Insurance Holdings PLC on 31 December 2000 compared with that of £100 invested in the FTSE Mid 250 Index. The other points plotted are the values at intermediate financial year-ends.

Source: Thomson Financial Datastream.

Graph 2 - Total Shareholder Return



This graph shows the value, by the end of 2005, of £100 invested in Brit Insurance Holdings PLC on 31 December 2000 compared with that of £100 invested in the FTSE All Share Insurance Sector Index. The other points plotted are the values at intermediate financial year-ends.

Source: Thomson Financial Datastream.

Combined Code Compliance

The Board of Brit Insurance Holdings PLC is committed to business integrity, ethics and professionalism across its activities and as an essential part of this commitment, the Board promotes the highest standards of corporate governance. This report summarises how the Board is applying all principles of good governance in the Combined Code on Corporate Governance (the "Code").

During the year, the Company carried out a review of its corporate governance practices and further measures were implemented in order for the Company to be in a position to report its substantial compliance with the requirements of the Code. These include Clive Coates ceasing to be a member of the Remuneration Committee and appointing two further independent Non-Executive Directors.

The Board considers that the Company has complied with the provisions set out in Section 1 of the Code throughout the period under review (and subsequently up to the date of this report) with the following exceptions:

- ▲ Don McCrickard may not be presumed wholly independent under the Code because of his duration in office. The Board, mindful of stakeholders' interests, does not consider that his independence in character or judgement has been compromised by the expiration of an arbitrary time period. However, the number of independent Non-Executive Directors has been further increased in 2005 by two to six and, in addition to further improving Board balance, independent Non-Executive Directors joined the Audit and Remuneration Committees. In addition, it has been agreed that Don will step down at the end of 2006.
- ▲ Clive Coates, the Chairman, was a member of the Remuneration Committee for part of 2005. Along with the Non-Executive Directors, his remuneration is set by the Executive Management Committee (the "EMC") to preserve independence of contribution. In line with market practice, he ceased to be a member of the Remuneration Committee on 27 September 2005.

Relations with Shareholders

During the year, the Chief Executive Officer, the Finance Director and Head of Investor Relations held meetings with the Company's principal institutional shareholders to discuss the Company's strategy and financial performance. In addition, the policy of the Chairman and Senior Independent Director is to hold meetings with major shareholders, as recommended by the Code. The Board received reports on the items discussed at these meetings and matters arising.

In 2005, the Company's investor relations team organised meetings with major investors and stakeholders in the UK and abroad and disseminated information through various media subject to a control framework to ensure compliance with the Disclosure Rules. A programme of meetings was initiated after the release of final and interim results and other significant announcements. The investor relations section on the Company's website www.britinsurance.com displays shareholder presentations and the terms of reference for the Audit, Nomination and Remuneration Committees. Shareholders are encouraged to contact the Company directly with questions or concerns and, subject to price sensitivity, the investor relations team seek to provide an efficient and timely response.

The Board receives regular reports from the Head of Investor Relations about significant shareholdings and changes to the shareholder register.

At the **Annual General Meeting** ("AGM"), shareholders have an opportunity to meet the Chairman and other Directors, and to receive an update on the development of the business and to ask questions of the Board. The Chairmen of the Audit, Nomination and Remuneration Committees attend the meeting and are available to answer relevant questions. The Annual Report and Accounts and the Notice of Meeting are sent to shareholders at least 20 working days prior to the date of the AGM. The Company proposes a separate resolution for each substantially different item of business, giving shareholders the opportunity to vote on each substantially different issue. The results of the proxy votes received by the Company, including abstentions, are made available at the meeting, following votes by shareholders on a show of hands.

The Board

Composition

The Board comprises a part-time Chairman, the Chief Executive Officer, the Finance Director and seven Non-Executive Directors, of whom six are considered by the Board to be independent, reflecting Brit's policy that a majority of the Board should be made up of independent Non-Executive Directors. The Board is satisfied that the executive and non-executive elements of the Board are well-balanced, that no individual or group of individuals is or has been in a position to dominate the Board's decision-making and that the Board, as currently constituted, has strongly independent and diverse characteristics.

Role

The Board is responsible for the system of corporate governance and is ultimately accountable for strategy, delivering shareholder value and financial performance. The Board therefore sets risk appetite and core values, approves strategic plans, annual budgets, extraordinary capital and investment expenditure, the risk management framework for internal controls, governance and compliance.

The Chairman

Clive Coates is responsible for leading an effective Board, ensuring that the Board adheres to its role, maintaining effective communications with major shareholders and, with the assistance of the Company Secretary, ensuring timely delivery to the Board of accurate and relevant information on financial, business and corporate issues.

The Chief Executive Officer

Dane Douetil is responsible for the executive management of the Company, building long-term shareholder value and directing the implementation of the strategy, budget and overall policies set by the Board.

The Non-Executive Directors

Independence

As explained on page 54, the Board continues to regard Don McCrickard as independent. The Board also considers Peter Hazell, Joe MacHale, Cees Schrauwers, Michael Smith and Anthony Townsend to be independent. Each of them brings to the Board wide experience and an objective viewpoint and none of the factors implying a lack of independence as set out in the Code applies.

The Board does not consider Neil Eckert to be independent due to his former employment by the Group.

The Senior Independent Director

Don McCrickard is available to shareholders if contact through the channels of Chairman and Chief Executive Officer fails to resolve an issue. He meets with major shareholders from time to time to gain a balanced understanding of their views.

Meetings of Non-Executive Directors

During 2005, the Non-Executive Directors met formally without executive management on two occasions with the Chairman and once without the Chairman present.

Time Commitment

The Board is satisfied that the Chairman and Non-Executive Directors commit sufficient time to the fulfilment of their duties as Directors of the Company. The external commitments of the Chairman did not change during 2005. The Chairman and Non-Executive Directors have specified terms of office.

Election and Re-election

Directors are initially appointed by the Board and, in accordance with the Company's Articles of Association (the "Articles"), retire and seek re-election at the next AGM. Thereafter, in accordance with the Articles, one-third of the Directors retires by rotation and seeks re-appointment at each AGM. Directors are re-elected at intervals of no more than three years as required under the Code. Non-conflicted members of the Nomination Committee reviewed those individuals due for re-election at the 2006 AGM (Dane Douetil, Joe MacHale, Don McCrickard, Matthew Scales and Cees Schrauwers) and, in light of the breadth and relevance of their experience and skills and the contributions they each make to the Board and its committees, the Committee made recommendations to the Board that they be put forward for re-election.

Don McCrickard's tenure in office has exceeded nine years and he is therefore subject to annual re-election. As the recruitment process for additional Non-Executive Directors took longer than originally envisaged, in order to ensure continuity and a planned handover of roles, the Nomination Committee has recommended that Don should stand down at the end of 2006 (and not at the 2006 AGM as previously planned) when the handover to his successor as chair of the Remuneration and Nomination Committees and as Senior Independent Director should be completed. The Board therefore recommends Don's continuance in office until the end of 2006 to complete the succession process in accordance with the Company's own needs in the best interests of shareholders.

Board Effectiveness

Performance Evaluation

Peter Goddard the Company Secretary monitors progress on behalf of the Board, which will use external consultants every third year.

At the end of 2005, the Chairman commenced the second internal review. This process was delayed to enable the enlarged Board membership to participate in order to provide a more effective review. The first stage of the review comprised a series of independently-produced questionnaires extracted from the Code to deal with the effectiveness of the Board, its committees and individual Directors.

The responses have been analysed in the first quarter of 2006 and no matters of significance were identified. There was a consensus that the Board and its committees were working effectively. The second stage will be selected interviews with Board members conducted by the Chairman to understand any particular variances from the consensus views. The final stage will be a full report and recommendations reviewed by the Chairman with individual Directors and the Board as a whole.

Chairman's Performance

A separate process involving a meeting of Non-Executive Directors led by the Senior Independent Director without the Chairman present was held in the year and this took into account the views of the Executive Directors.

Continuing Professional Development

Brit has reviewed the continuing professional development needs of each Director and a programme has been made available to all Directors of the Company in 2005 and monitored by Human Resources. Non-Executive Directors have attended specific courses on remuneration, pension and accounting issues. In addition, the Directors receive regular updates and briefings on activities concerning the business and particular topics affecting their duties.

Induction

Newly appointed Directors (including those on the boards of the operating subsidiaries) receive induction on the Group's operations and activities and risks, responsibilities of a Director, role of the Board and committees, governance policies and procedures.

How the Board Operates

Meetings

The Board holds at least six scheduled meetings a year and other meetings on an ad hoc basis as and when required. The Board met on eleven occasions in 2005 of which ten were scheduled meetings. Papers are usually distributed five business days in advance of each meeting.

Company Secretary

All Directors have access to Peter Goddard, who, together with the Deputy Secretary, Lucie Gilbert, is responsible for supporting and advising the Chairman and Board on all corporate governance matters, Board procedures and compliance with applicable rules and regulations. The Company Secretary can only be removed by the Board.

Independent Professional Advice

The procedure for Directors, in the furtherance of their duties, to seek advice at the Company's expense is co-ordinated through the Company Secretary.

Insurance

The Company maintains directors and officers' liability insurance on such terms and level of cover which the Board considers appropriate.

External Directorships

External directorships held by Executive Directors are approved by the Chairman.

Delegation

The Board has a formal schedule of matters reserved to it for decision which include the approval of the financial results, strategy and corporate objectives, significant transactions and matters affecting share capital. Subject to this, the Board delegates certain powers to the following committees within written terms of reference:

- ▲ the **Executive Management Committee** comprises Dane Douetil, Roger Field, Peter Goddard, Kathy Lisson, Matthew Scales and Mike Sibthorpe. This Committee, chaired by the Chief Executive Officer, is the primary vehicle for implementing Board decisions and managing the Group's business on a day-to-day basis. It normally meets twice a week.
- ▲ the **Audit Committee** reviews the financial and internal reporting process, the system of internal control, risk management and the external and internal audit process. It meets at least four times a year and entirely comprises independent Non-Executive Directors. The Report of the Audit Committee is at page 59.
- ▲ the **Nomination Committee** reviews the structure, size and composition of the Board and recommends appointees to the Board, as well as establishing, approving and monitoring the succession planning for Board and senior management. It meets at least twice a year and comprises a majority of independent Non-Executive Directors. The Report of the Nomination Committee is at page 61.
- ▲ the **Remuneration Committee** determines the terms of service and remuneration of Executive Directors and senior management, using input from external advisers and sets policy in this area. It meets at least four times a year and comprises a majority of independent Non-Executive Directors.
- ▲ the **Risk Management Group** assesses the corporate risks affecting the Group and the effectiveness of the control environment. It meets every two months and is chaired by the Company Secretary and comprises appropriate senior management who control risk categories.

Attendance at Meetings

Attendance by individual Directors at Board and Committee meetings which they were eligible to attend was as follows:

Current Directors	Board	Audit Committee	Nomination Committee	Remuneration Committee
Chairman				
Clive Coates ¹	11/11	–	7/7	4/4
Executive Directors				
Dane Douetil	11/11	–	–	–
Matthew Scales	11/11	–	–	–
Non-Executive Directors				
Neil Eckert	9/11	–	–	–
Peter Hazell ²	9/11	7/7	6/7	2/4
Joe MacHale ³	0/0	–	–	0/0
Don McCrickard	10/11	7/7	7/7	4/4
Cees Schrauwers ⁴	6/6	4/5	–	–
Michael Smith	11/11	–	7/7	4/4
Anthony Townsend	11/11	7/7	6/7	4/4
Former Director				
Glyn MacAulay ⁵	2/3	1/1	2/3	2/2

1 ceased to be a member of the Remuneration Committee on 27 September 2005

2 joined the Remuneration Committee on 11 January 2005 and became Audit Committee Chairman on 19 April 2005

3 appointed to the Board and joined the Remuneration Committee on 9 November 2005. There were no Board or Remuneration Committee meetings between his date of appointment and 31 December 2005

4 appointed to the Board and joined the Audit Committee on 1 June 2005

5 resigned from the Board and all Committees on 19 April 2005

Internal Control and Risk Management

The Board is ultimately responsible for the Group's systems of internal control and for reviewing their effectiveness. These systems manage the risks of the Group's business, ensure that financial information on which business decisions are made and which is published is reliable, and ensure that Group assets are safeguarded. The systems of internal control are designed to manage rather than eliminate the risk of failure to achieve business objectives. In pursuing these objectives, internal controls aim to provide reasonable and not absolute assurance against material misstatement or loss.

Control and Risk Framework

The corporate governance framework is a key feature of the control environment with its matters reserved to the Board, terms of reference for each committee, delegation of authority to management, and policies and procedures for the operations. Through the Risk Management Group the Group has developed a risk management framework to support a consistent and transparent risk management process across the Group.

The Risk Management Group is chaired by the Company Secretary and the membership is drawn from senior managers across the Group. The independent risk management function evaluates, monitors and reports significant risks and risk related issues. The Risk Management Group reviews this work to identify and objectively assess a risk in terms of impact, likelihood and the effectiveness of the relevant internal control.

The Risk Management Group reports to the Executive Management Committee, the Audit Committee and ultimately the Board and is responsible for monitoring the controls relating to Group insurance, credit, liquidity, market and operational risks.

Board Review

Prior to producing this internal control statement, the Board undertook a formal assessment of the risk management and control environment in order to form a view on the overall effectiveness of the system of internal control. The assessment considered issues dealt with in reports received by the Executive Management Committee and the Board during the year together with any additional information necessary to ensure that the Board has taken account of significant aspects of internal controls for the Group.

Risk Management

The Group applies a number of techniques to manage and mitigate its risks. Details are provided in Note 4 on page 74.

Assurance

Internal Audit and Review ("IAR"), the Group's internal audit function, is responsible for providing independent assurance directly to the Audit Committee on the adequacy and effectiveness of the Board's system of risk management and internal control. The effectiveness of controls are communicated to the relevant business unit with IAR conducting the follow-up review programme. The process has been in place for the year under review and up to date of the approval of the Annual Report and Accounts.

Combined Code Compliance

The Company has complied during the year with the Code provisions on internal control and has maintained policies and procedures necessary to implement the guidance therein.

Peter Goddard
Secretary

14 March 2006

Report of the Audit Committee

Composition

During the year, the Committee comprised the following:

Peter Hazell*	Chairman of the Committee
Glyn MacAulay*	until 19 April 2005
Don McCrickard*	
Cees Schrauwens*	appointed 1 June 2005
Anthony Townsend*	

* considered independent by the Board

Governance

The Committee met seven times during the year and details of attendance are disclosed in the Corporate Governance Report. The Finance Director and other non-members attend by the invitation of the Chairman. The Company Secretary attends all meetings.

Glyn MacAulay retired and Peter Hazell replaced him as Chairman of the Committee on 19 April 2005. Peter Hazell and Cees Schrauwens are considered by the Board to possess relevant and recent financial experience and their biographies are on pages 38 to 40. Other Committee members sit on the audit committees of other listed companies, and bring a wide range of business experience.

Summary Terms of Reference

The Audit Committee:

- ▲ reviews the annual and interim financial statements of the Company and principal operating subsidiaries along with their accounting policies;
- ▲ monitors compliance with the financial reporting requirements of Accounting Standards (including International Financial Reporting Standards), the Financial Services Authority's Listing, Prospectus and Disclosure Rules and the Companies Act 1985;
- ▲ agrees the nature, scope and planning of the audit with the external auditors;
- ▲ reviews matters arising from the audit with the external auditors (including difficulties, reservations, cost effectiveness and fees);
- ▲ reviews the independence and objectivity of the external auditors, including a review of non-audit fees;
- ▲ reviews the reports of internal audit and review;
- ▲ recommends to the Board the appointment, re-appointment or removal of the external auditors;
- ▲ approves the plans and reviews the effectiveness of the internal audit function;
- ▲ liaises with the Risk Management Group as regards the effectiveness of the Company's internal control policies and risk management framework;
- ▲ monitors compliance with important regulations relevant to the activities of the Group and its subsidiaries; and
- ▲ reviews and monitors whistle blowing procedures.

The Committee's terms of reference are available on the Company's website at www.britisurance.com or from the Company Secretary at the registered office.

Activity

The Committee focused on the following activities during the year:

- ▲ review of external auditors;
- ▲ annual audit and interim review planning;
- ▲ monitoring the integrity of the financial statements;
- ▲ the introduction of International Financial Reporting Standards ("IFRS");
- ▲ the relationship with the external auditors and their independence;
- ▲ internal audit reporting;
- ▲ risk management; and
- ▲ succession planning.

External Auditors

During the year the Committee proposed, and the Board approved, a change in auditors. Previously Ernst & Young LLP audited Syndicate 2987 whilst Mazars LLP audited Brit Insurance Limited ("BIL") and the consolidated results of the Group. With effect from 24 May 2005, Mazars LLP resigned their position and Ernst & Young LLP were appointed additionally as Auditor of the Group, BIL and other Group subsidiaries. The Group will put the external audit to tender in 2007.

Audit

The Committee has worked closely with the Company's financial team and its external auditors to ensure that the audit processes adopted in connection with the financial statements of the Group and of the Company accord with best practice. The Chairman of the Committee has regular meetings with the Company's Finance Director and the external Auditor.

International Financial Reporting Standards

The Committee monitored the completion of the Group's project for adopting IFRS (which the external Auditor has reviewed) and has convened specific meetings dedicated to understanding issues, assess progress and report on these to the Board.

Integrity

The Committee has examined in detail with the Company's finance team and its external auditors the integrity of the annual financial statements.

Independence of External Auditors

The Company's external auditors are generally prohibited from carrying out work falling outside their permitted services and other accounting firms are utilised for such work to preserve the auditors' independence (see breakdown in Note 12 on page 85). If there is uncertainty as to whether a matter falls within the permitted services, the matter is referred to the Finance Director who will consult with the Chairman of the Committee.

The Committee has examined with the external auditors how their independence from the Company can be assured and reviewed the connections, if any, with Directors of the Company. Joe MacHale retains Ernst & Young LLP for private taxation advice.

The Committee has reviewed the policy on non-audit work and the permitted services which substantially follows APB and Combined Code guidelines. This includes audit work; further assurance services; tax compliance services; and such other ancillary services that raise no questions as to the auditors' independence.

Ernst & Young LLP report regularly to the Committee on the actions taken to comply with professional and regulatory requirements in order to maintain their auditor independence.

Internal Audit

The internal audit function reports to the Committee. The Head of Internal Audit and Review was appointed by the Committee and Committee members have individually met regularly with him during the year to review work plans and findings. The internal audit function presents a report at each regular meeting of the Committee.

Risk Management

During the year, the Committee has reviewed progress of the risk management framework along with the internal controls assurance mechanisms in the Group. The Committee has reviewed the Annual Report on Internal Controls on page 58.

Peter Hazell

Chairman of the Audit Committee

14 March 2006

Report of the Nomination Committee

Composition

During the year, the Committee comprised the following:

Don McCrickard*	Chairman of the Committee
Clive Coates	Chairman of the Board
Peter Hazell*	from 11 January 2005
Glyn MacAulay*	until 19 April 2005
Michael Smith*	
Anthony Townsend*	

* considered independent by the Board

Summary Terms of Reference

The Nomination Committee:

- ▲ reviews the structure, size and composition of the Board;
- ▲ assesses the independence of Non-Executive Directors;
- ▲ evaluates the skills, knowledge and experience on the Board, identifying any gaps;
- ▲ ensures that a performance evaluation is conducted;
- ▲ makes recommendations to the Board on the appointment of Executive and Non-Executive Directors;
- ▲ ensures that procedures are in place for Board appointments; and
- ▲ ensures that succession plans are in place.

The Committee's full terms of reference are available on the Company's website www.britinsurance.com and from the Company Secretary at the registered office.

Governance

The Committee met on seven occasions during the year and details of attendance are disclosed in the Corporate Governance Report.

Activity

The Committee focused on three principal activities during the year:

- ▲ the composition and balance of the Board and the appointment of two Non-Executive Directors;
- ▲ the implementation of the Group's succession planning requirement; and
- ▲ the phasing of director appointments to meet the requirements of the business.

Board Appointments

In the first half of 2005 following its recommendation on Board refreshment, the Committee was tasked by the Board with identifying further Non-Executive Directors for appointment and the time commitment required. The Committee retained Russell Reynolds as external consultants to find suitable candidates for the detailed profile which was jointly developed for each vacancy. Interviewing was completed by May and October following which the Committee made final recommendations to the Board on the appointees and the committees of the Board that they should sit on. Cees Schrauwers and Joe MacHale were appointed to the Board on 1 June 2005 and 9 November 2005 respectively.

Board Evaluation

The Committee recommended that the board evaluation requirements under the Combined Code were best addressed by the Chairman of the Company acting as sponsor with the final report being considered by the whole Board. This is examined in the Corporate Governance Report and has proved useful to the Committee's work in examining the roles and responsibilities of each Director, assessing Non-Executive Directors' independence and gaining a better understanding of the time commitment and attributes required of each of the Non-Executive Directors.

Succession Planning

Board evaluation has assisted the Committee in implementing a succession plan for the Group covering directors, executives and senior management.

The first element of the succession plan resulted in Dane Douetil being appointed Chief Executive Officer following Neil Eckert on 19 April 2005.

The second element was to agree the profile for an additional Non-Executive Director; Russell Reynolds completed the search and Cees Schrauwers joined the Board on 1 June 2005.

Thirdly, the profile to complete the Board refreshment of Non-Executive Directors was completed in the second quarter and Joe MacHale joined the Board on 9 November 2005.

Finally, the Committee's general recommendation resulted in the appointment of Kathy Lisson as Chief Operating Officer on 26 September 2005.

Independence

At the end of 2005 the Committee again considered my independence in light of my tenure in office and this is discussed in detail in the Corporate Governance Report on page 54. I abstained from this review and discussions which were led by Clive Coates.

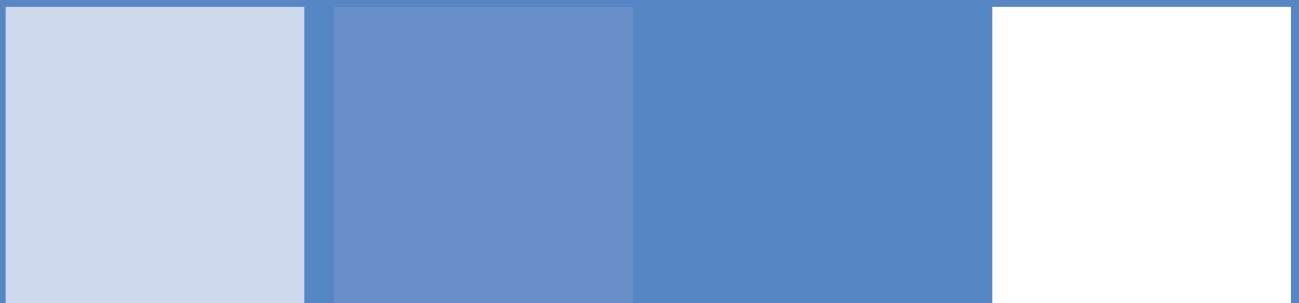
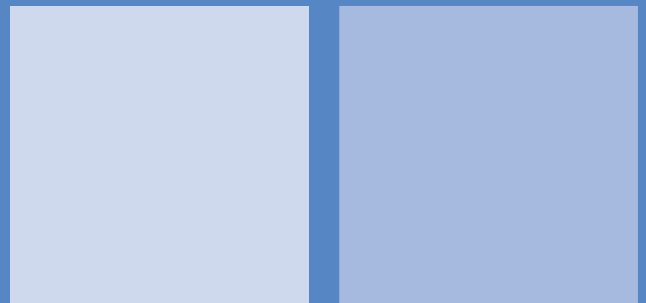
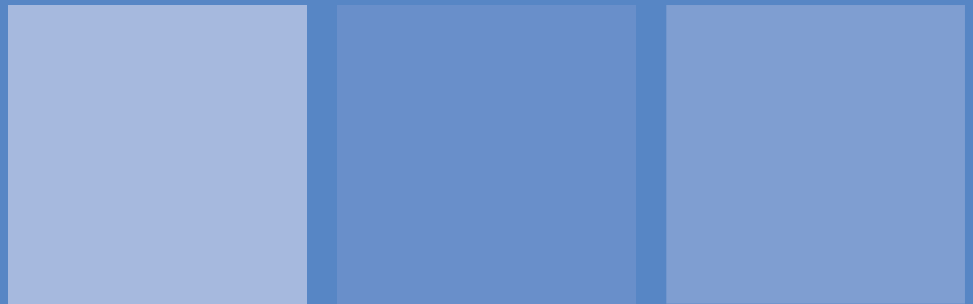
The Committee has reviewed the independence of all other Non-Executive Directors and this is examined in detail in the Corporate Governance Report.

Don McCrickard

Chairman of the Nomination Committee

14 March 2006

Consolidated Income Statement	64
Consolidated Statement of Recognised Income and Expense	64
Consolidated Balance Sheet	65
Consolidated Cash Flow Statement	66
Notes to the Financial Statements	67
Independent Auditor's Report	121
Statement of Directors' Responsibilities in Respect of the Company	122
Balance Sheet of the Company	123
Notes to the Financial Statements of the Company	124
Independent Auditor's Report in Respect of the Company	134
Company Information	135



Consolidated Income Statement

for the year ended 31 December 2005

	Note	Year ended 31 December 2005 £'000	Year ended 31 December 2004 £'000
Revenue			
Gross premiums written		1,202,503	1,086,731
Less premiums ceded to reinsurers		(231,616)	(176,300)
Premiums written, net of reinsurance		970,887	910,431
Gross amount of change in provision for unearned premiums		(29,078)	(56,477)
Reinsurers' share of change in provision for unearned premiums		738	8,715
Net change in provision for unearned premiums		(28,340)	(47,762)
Net change in other technical provisions		–	(5,254)
Earned premiums, net of reinsurance		942,547	857,415
Fees, commissions and other income	6	13,434	3,840
Investment income	7	85,504	63,347
Net realised gains/(losses) recorded in the income statement	8	2,595	(10,258)
Net fair value gains recorded in the income statement		33,729	22,962
Total revenue		1,077,809	937,306
Expenses			
Claims incurred:			
Claims paid:			
Gross amount		(487,687)	(309,077)
Reinsurers' share		87,358	57,293
Claims paid, net of reinsurance		(400,329)	(251,784)
Change in the provision for claims:			
Gross amount		(604,564)	(361,621)
Reinsurers' share		303,499	67,760
Net change in the provision for claims		(301,065)	(293,861)
Claims incurred, net of reinsurance		(701,394)	(545,645)
Acquisition costs	9	(247,067)	(214,498)
Other operating expenses	9	(61,142)	(55,931)
Total expenses excluding finance costs		(1,009,603)	(816,074)
Operating profit		68,206	121,232
Finance costs	11	(5,941)	(5,472)
Share of profit after tax of associated undertakings	18	138	348
Profit on ordinary activities before tax		62,403	116,108
Income tax expense	13(i)	(14,771)	(31,642)
Profit attributable to equity holders of the parent		47,632	84,466
Basic earnings per share (pence per share)	14	4.93p	8.73p
Diluted earnings per share (pence per share)	14	4.92p	8.54p

Consolidated Statement of Recognised Income and Expense

for the year ended 31 December 2005

	Note	Year ended 31 December 2005 £'000	Year ended 31 December 2004 £'000
Actuarial losses on defined benefit pension scheme		(3,901)	(2,938)
Tax on items taken to equity	13(ii)	1,170	881
Net expense recognised directly in equity		(2,731)	(2,057)
Profit for the period		47,632	84,466
Total recognised income and expense for the period attributable to equity holders of the parent		44,901	82,409

Consolidated Balance Sheet

as at 31 December 2005

	Note	31 December 2005 £'000	31 December 2004 £'000
Assets			
Property, plant and equipment	15	8,236	3,522
Intangible assets:			
Goodwill	16	70,991	70,991
Syndicate participations	16	–	502
Software	16	15,250	7,672
Deferred acquisition costs	17	125,097	111,933
Investments in associated undertakings	18	–	1,594
Deferred taxation	20	1,648	–
Reinsurance contracts	21	653,182	326,901
Financial investments	22	1,845,710	1,213,725
Trade and other receivables	23	597,883	499,372
Assets held for sale	18	1,380	–
Cash and cash equivalents	24	526,638	629,190
Total assets		3,846,015	2,865,402
Liabilities and Equity			
Liabilities			
Insurance contracts	21	2,596,660	1,859,632
Employee benefits	25	22,818	18,470
Borrowings	26	194,213	68,449
Current taxation		14,263	1,456
Deferred taxation	20	–	4,512
Provisions	27	489	533
Trade and other payables	28	292,912	189,690
Total liabilities		3,121,355	2,142,742
Equity			
Called up share capital	30 & 33	245,236	243,518
Share premium account	33	314,758	311,145
Capital redemption reserve	33	586	586
Equity portion of convertible debt	33	–	1,681
Own shares	31 & 33	(7,550)	(7,493)
Retained earnings	33	171,630	173,223
Total equity attributable to equity holders of the parent		724,660	722,660
Total liabilities and equity		3,846,015	2,865,402

The financial statements were approved by the Board of Directors on 14 March 2006 and were signed on its behalf by

Clive Coates
Chairman

Matthew Scales
Finance Director

Consolidated Cash Flow Statement

for the year ended 31 December 2005

	Note	Year ended 31 December 2005 £'000	Year ended 31 December 2004 £'000
Cash generated from operations			
Cash flows provided by operating activities	34	337,460	457,526
Income tax (paid)/recovered		(6,954)	1,621
Interest paid		(5,303)	(2,758)
Interest received		82,727	60,535
Dividends received		2,777	2,812
Net cash inflows from operating activities		410,707	519,736
Cash flows from investing activities			
Net purchase of investments		(595,646)	(188,833)
Purchase of property, plant and equipment and related exchange adjustments		(6,408)	(1,738)
Purchase of intangible assets		(10,278)	(7,999)
Proceeds from disposal of property, plant and equipment		10	402
Investments in associated undertakings		–	(341)
Repayment of loan from/(payment of loan to) associated undertakings		352	(652)
Net cash outflows from investing activities		(611,970)	(199,161)
Cash flows from financing activities			
Proceeds from exercised share options		655	9
Equity dividends paid		(48,462)	(38,762)
Net proceeds from issue of lower tier two debt		147,054	–
Net proceeds from issue of floating rate notes		–	7,984
Repayment of bank loan		–	(15,000)
Acquisition of own shares for employee incentive schemes		(107)	(2,750)
Net cash inflows/(outflows) from financing activities		99,140	(48,519)
Net (decrease)/increase in cash and cash equivalents		(102,123)	272,056
Cash and cash equivalents at beginning of the period		610,969	348,279
Effect of exchange rate fluctuations on cash and cash equivalents		17,792	(9,366)
Cash and cash equivalents at the end of the year	24	526,638	610,969

Notes to the Financial Statements

1 General information

Brit Insurance Holdings PLC is a company registered in England and Wales under the Companies Act 1985. The address of the registered office is provided in the Company information page. The nature of the Group's operations and its principal activities are included in the Report of the Directors and the operating and financial review.

2 Accounting policies

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") adopted for use by the European Union ("EU") and as issued by the International Accounting Standards Board.

The solus accounts of the parent company are presented in a separate section of the annual report.

First time adoption of International Financial Reporting Standards

In common with other European listed companies, the Group is required to prepare its consolidated financial statements for the year ending 31 December 2005 in accordance with IFRS endorsed by the European Commission ("EC"). The Group has accordingly restated its previously reported 2004 consolidated results and financial position.

The Group is required to determine its IFRS accounting policies and in general apply them retrospectively to establish its opening balance sheet under IFRS. However, IFRS 1, "First-time adoption of International Financial Reporting Standards" has a number of required exceptions and allowed exemptions on adoption of IFRS for the first time. The Group has taken advantage of the following exemptions:

Business combinations

Brit has elected to apply IFRS 3 "Business Combinations" to all business combinations entered into from 1 January 2003. Accordingly, all business combinations from this date have been restated.

Share-based payment plans

The provisions of IFRS 2 "Share-based payments" have not been applied to options and awards granted on or before 7 November 2002 or to those granted after this date which had vested by 1 January 2005.

Employee defined benefit obligations

All cumulative actuarial gains and losses have been recognised in equity at the date of transition to IFRS.

Designation of previously recognised financial assets

IAS 39, "Financial Instruments: Recognition and Measurement" permits a financial asset to be designated on initial recognition as a financial asset at fair value through profit or loss. The Group has taken advantage of an exemption to designate previously recognised assets as held at fair value through profit or loss at the date of transition.

Basis of preparation

The Group's consolidated income statement, consolidated opening and closing IFRS balance sheet, consolidated statement of recognised income and expense and the consolidated cash flow statement have been prepared in accordance with IFRS and those parts of the Companies Act 1985 applicable to companies reporting under IFRS. IFRS comprises standards issued by the International Accounting Standards Board ("IASB") and interpretations issued by the International Financial Reporting Interpretations Committee ("IFRIC") and as adopted by the EU.

At the date of authorisation of these financial statements, the following accounting standard has been issued but has not been early adopted.

IFRS 7 "Financial Instruments: Disclosures" – effective 1 January 2007

Management do not believe that the adoption of this standard will have a material effect on the financial statements of the Group as its requirement is only for additional disclosures.

In accordance with IFRS 4, "Insurance Contracts", the Group continues to apply existing accounting policies to its insurance contracts. Applying existing accounting policies includes complying with the recommendations of the Statement of Recommended Practice on Accounting for Insurance Businesses issued by the Association of British Insurers in December 2005. However the Group has the option to make improvements to its policies if the changes make the financial statements more relevant to decision making needs of the users.

The Group has early adopted the amendments to IAS 39 "The Fair Value Option" published by the IASB in June 2005 and the amendments to IAS 19, "Employee Benefits" published in December 2004. The amendments to IAS 19 permit the recognition of all actuarial gains and losses immediately in equity through the statement of recognised income and expense.

Certain amounts recorded in the IFRS financial information include estimates and assumptions made by management, particularly about insurance liability reserves, investment valuations, interest rates and other factors. Actual results may differ from the estimates made. Where estimates had previously been made under UK GAAP, consistent estimates (after adjustments to reflect any difference in accounting policies) have been made on transition to IFRS. Judgements affecting the Group's balance sheet have not been revisited with the benefit of hindsight. For further information on the use of estimates and judgements, refer to Note 3.

Basis of consolidation

The consolidated financial statements include the accounts of the Company, its subsidiaries and the Group's participation in Lloyd's syndicates' assets, liabilities, revenues and expenses. Subsidiaries are those entities (including special purpose entities) in which the Group directly or indirectly has the power to govern the operating and financial policies in order to gain economic benefits and includes the Group's Employee Benefit Trusts and its open ended investment company ("OEIC"). The financial statements of subsidiaries are prepared for the same reporting year as the parent company. Consolidation adjustments are made to convert subsidiary accounts prepared under UK GAAP into IFRS so as to remove any dissimilar accounting policies that may exist. Subsidiaries are consolidated from the date control is transferred to the Group and cease to be consolidated from the date control is transferred out. All significant inter-company balances, profits and transactions are eliminated. Shares held by third parties in the Group's OEIC are treated as a liability to the Group.

Associated undertakings are those entities over which the Group has the power to exercise significant influence but not control. The Group's investment in associated undertakings is accounted for under the equity method of accounting whereby associated undertakings are carried in the balance sheet at cost plus post-acquisition changes in the Group's share of net assets of the associate, less any impairment in value. The Group's investment in associated undertakings also includes goodwill identified on acquisition less any accumulated impairment loss. The income statement reflects the Group's share of the post-acquisition results of operations of the associated undertakings. The financial statements of associated undertakings are prepared for the same reporting year as the parent company.

Product classification

Insurance contracts are those contracts that transfer significant insurance risk at the inception of the contract. Insurance risk is transferred when an insurer agrees to compensate a policyholder if a specified uncertain future event adversely affects the policyholder. The significance of insurance risk is dependent on both the probability of an insured event and the magnitude of its potential effect.

Once a contract has been classified as an insurance contract, it remains an insurance contract for the remainder of its lifetime, even if the insurance risk reduces significantly during this period.

Other accounting policies

(i) Insurance contracts

a Premiums

Premiums written relate to business incepted during the year, together with any differences between booked premiums for prior years and those previously accrued, and include estimates of premiums due but not yet receivable or notified, less an allowance for cancellations. Premiums are accreted to the income statement on a pro rata basis over the term of the related policy, except for those contracts where the period of risk differs significantly from the contract period. In these circumstances, premiums are recognised over the period of risk in proportion to the amount of insurance protection provided. Reinstatement premiums are accreted to the income statement on a pro rata basis over the term of the original policy to which it relates.

Premiums are shown net of premium taxes and other levies on premiums.

b Deferred acquisition costs

Commission and other acquisition costs incurred during the financial period that vary with and are related to securing new insurance contracts and/or renewing existing insurance contracts, but which relate to subsequent financial periods, are deferred to the extent that they are recoverable out of future revenue margins. Deferred acquisition costs are capitalised and amortised on a straight line basis over the life of the contract.

c Claims incurred

Claims incurred comprise claims and claims handling costs paid in the year and changes in the provisions for outstanding claims, including provisions for claims incurred but not reported ("IBNR") and related expenses, together with any adjustments to claims from prior years. Claims handling costs are mainly those external costs related to the negotiation and settlement of claims.

d Outstanding claims provisions

Claims outstanding represent the estimated ultimate cost of settling all claims (including direct and indirect claims settlement costs) arising from events which have occurred up to the balance sheet date, including provision for claims incurred but not reported, less any amounts paid in respect of those claims. The Group does not discount its liabilities for unpaid claims. Significant delays can be experienced in the notifications and settlement of certain claims, the ultimate cost of which cannot therefore be known with certainty at the balance sheet date.

e Provision for unearned premiums

The proportion of written premiums that relate to unexpired terms of policies in force at the balance sheet date is deferred as a provision for unearned premiums, generally calculated on a time apportioned basis. The movement in the provision is taken to the income statement in order that revenue is recognised over the period of the risk.

f Liability adequacy tests

At each balance sheet date, liability adequacy tests are performed, to ensure the adequacy of unearned premiums net of related deferred acquisition costs assets, employing the current estimates of future cash flows under its insurance contracts. If as a result of these tests, the carrying amount of the Group's insurance liabilities is found to be inadequate in comparison to the value of these future cash flows, the deficiency is charged to the income statement for the period by establishing an unexpired risk provision.

g Reinsurance

The Group assumes and cedes reinsurance in the normal course of business. Premiums and claims on reinsurance assumed are recognised in the income statement along the same basis as direct business, taking into account the product classification. Reinsurance premiums ceded and reinsurance recoveries on claims incurred are included in the respective income and expense accounts. Reinstatement premiums on both inwards and outwards business are accreted to the income statement on a pro rata basis over the term of the original policy to which it relates.

Reinsurance assets include amounts recoverable from reinsurance companies for paid and unpaid losses and loss adjustment expenses, and ceded unearned premiums. Amounts recoverable from reinsurers are calculated with reference to the claims liability associated with the reinsured risks. Revenues and expenses arising from reinsurance agreements are therefore recognised in accordance with the underlying risk of the business reinsured.

Gains or losses on buying reinsurance are recognised immediately in the income statement and are not subject to amortisation.

If a reinsurance asset is impaired, the Group reduces its carrying amount accordingly, and will immediately recognise the impairment loss in the income statement. A reinsurance asset will be deemed to be impaired if there is objective evidence, as a result of an event that occurred after initial recognition of the asset, that the Group may not receive all amounts due to it under the terms of the contract, and that the event has a reliably measurable impact on the amounts that the Group will receive from the reinsurer.

h Syndicate assets and liabilities

For each managed syndicate on which the Group participates, the Group's proportion of the syndicate's assets and liabilities has been reflected in its Consolidated Balance Sheet. Syndicate assets are held subject to trust deeds for the benefit of the Syndicate's insurance creditors.

(ii) Revenue recognition**a Fee and commission income**

Fee and commission income consists mainly of administration and broking fees charged to third parties. They are recognised in the accounting period in which the service is rendered by reference to completion of the specific transaction, assessed on the basis of the actual service provided as a proportion of the total services to be provided.

b Investment return

Investment return comprises all interest and dividend income. Interest income is recognised using the effective interest method. Dividend income is recognised when the shareholders' right to receive the payment is established.

c Realised gains and losses

Realised gains and losses on investments are calculated as the difference between net sales proceeds and cost and are recognised when the sale transaction occurs.

(iii) Recognition and derecognition of financial assets and financial liabilities

Financial assets and financial liabilities are recognised when the Group becomes a party to the contractual provisions of the contract.

A financial asset is derecognised when either the contractual rights to the asset's cash flows expire, or the asset is transferred and the transfer qualifies for derecognition under a combination of risks and rewards and control tests.

A financial liability is derecognised when it is extinguished which is when the obligation in the contract is discharged, cancelled or expired.

All "regular way purchases" and sales of financial assets are recognised on the trade date, i.e. the date that the Group commits to purchase or sell the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the marketplace.

(iv) Impairment

Goodwill is not subjected to amortisation but is tested annually for impairment as it is an asset with an indefinite useful life. Other assets, except for assets arising from insurance contracts, are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

If the carrying value of an asset is impaired, it is reduced to the recoverable amount by an immediate charge to the income statement. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use.

Impairment reviews are made by comparing carrying value to value in use. Value in use is based on discounting cash flows at the Group's weighted average cost of capital which is loaded where significant uncertainties exist. Assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash generating units).

(v) Investments

The Group has designated its financial assets held for investment purposes ("investments") at fair value through profit and loss (FVTPL) which is in accordance with the Group's documented investment strategy. Information relating to investments is provided internally to the Group's Directors and key managers on this basis.

The fair values of quoted financial investments are based on current bid prices. If the market for an investment is not active, the Group establishes fair value by using valuation techniques such as recent arm's length transactions, reference to similar listed investments, discounted cash flow models or option pricing models.

Unquoted equity investments are initially carried at cost as the best estimate of fair value and are adjusted thereafter whenever events or changes in circumstances indicate that the carrying amount may not approximate to fair value.

Gains and losses on investments designated as FVTPL are recognised through the income statement. Investments are held on the balance sheet at fair value.

(vi) Derivatives

Derivative financial instruments include foreign exchange contracts, forward rate agreements and other financial instruments that derive their value mainly from underlying interest rates, foreign exchange rates, commodity values or equity instruments. All derivatives are initially and subsequently measured at their fair value with movements in the fair value being immediately recognised in the income statement. Fair values are obtained from quoted market prices, discounted cash flow models and option pricing models as appropriate.

Where the risks and characteristics of derivatives embedded in other contracts are not closely related to those of the host contract, the derivative is separated from that host contract and measured at fair value.

(vii) Intangible assets

a Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets, liabilities and reliably measured contingent liabilities of the acquired subsidiary or associated undertaking at the date of the acquisition. Goodwill on acquisition of subsidiaries is included in intangible assets. Goodwill on acquisition of associates is included in investments in associates. Goodwill is treated as an indefinite life asset and is carried at cost less any accumulated impairment losses.

As at the acquisition date, any goodwill acquired is allocated to each of the cash generating units expected to benefit from the combination's synergies.

All goodwill created prior to 1 January 2003 is recorded at UK GAAP carrying amount at 1 January 2004 less any subsequent impairments.

b Syndicate participation rights

Where the Group has purchased the right to participate on managed syndicates, the cost is capitalised and amortised in equal annual instalments over their estimated useful economic lives of three years. Amortisation commences from the date the underwriting results are first recognised in the income statement.

c Computer software

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring into use the specific software. Internal development costs that are directly associated with the production of identifiable and unique software products controlled by the Group are also capitalised where the cost can be measured reliably, the Group intends to and has adequate resources to complete development and the computer software will generate future economic benefits.

All computer software costs are treated as intangible finite life assets and amortised on a straight-line basis over their expected useful lives, not exceeding a period of five years.

(viii) Property, plant and equipment

Property, plant and equipment are carried at cost, less accumulated depreciation and any impairment in value. Depreciation is calculated so as to write-off the cost over their estimated useful economic lives on a straight-line basis having regard to the residual value of each asset, as follows:

Freehold property	2% per annum
Office refurbishment costs, computers (except personal computers), office machinery, furniture and equipment	20% per annum
Motor vehicles	25% per annum
Personal computers	33% per annum

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

An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Gains and losses on the disposal of property, plant and equipment are determined by comparing proceeds with the carrying amount of the asset and are included in the income statement. Costs for repairs and maintenance are expensed as incurred.

(ix) Cash and cash equivalents

Cash and cash equivalents in the balance sheet include cash in hand, deposits held at call with banks and other short-term highly liquid investments with a maturity of three months or less at the date of placement or acquisition, free of encumbrances.

For the purpose of the consolidated cash flow statement, cash and cash equivalents consist of cash and cash equivalents as defined above, net of outstanding bank overdrafts.

(x) Income taxes

Income tax comprises current and deferred tax. Income tax is recognised in the income statement except where it relates to an item which is recognised in equity.

a Current income tax

Current income tax is the expected tax payable on the taxable profit for the period using tax rates (and laws) enacted or substantively enacted at the balance sheet date and any adjustment to the tax payable in respect of previous periods. The Group calculates current income tax using the current income tax rate.

b Deferred income tax

Deferred income 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 consolidated 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 income 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 income tax asset is realised or the deferred income tax liability is settled.

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

Deferred income 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.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes relate to the same fiscal authority.

Deferred tax assets and liabilities are not discounted.

(xi) Post-retirement employee benefits

The Group operates a defined contribution stakeholder pension scheme and several other defined contribution schemes. It also makes payments into a number of personal money purchase pension plans. Contributions in respect of these schemes are charged to the income statement in the period to which they relate.

The Group also operates a defined benefit pension scheme. The liability recognised in the balance sheet in respect of the defined benefit scheme is the present value of the defined benefit obligation at the balance sheet date less the fair value of plan assets. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows. The discount rate is based on market yields of high-quality corporate bonds that have terms to maturity which approximate to those of the related pension liability.

Actuarial gains and losses are recognised immediately in equity through the statement of recognised income and expense.

Past service costs arising in the period 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.

(xii) Share-based payments

The Group operates a number of equity settled share-based payment plans. The fair value of the equity instrument granted is recognised as an expense, spread over the vesting period of the instrument. The total amount to be expensed is determined by reference to the fair value of the awards made at the grant date, excluding the impact of any non-market vesting conditions. At each balance sheet date, the Group revises its estimate of the number of equity instruments that are expected to become exercisable. It recognises the impact of the revision of original estimates, if any, in the income statement, and a corresponding adjustment is made to equity over the remaining vesting period. The fair value of the awards and ultimate expense are not adjusted on a change in market vesting conditions during the vesting period.

(xiii) Own shares

Where the Company or its subsidiaries purchase the Company's share capital, the consideration paid is shown as a deduction from total shareholders' equity. No gain or loss is recognised in the income statement on the purchase, sale, issue or cancellation of own shares and any consideration paid or received is recognised directly in equity.

(xiv) Provisions

Provisions are liabilities with uncertainties in the amount or timing of payments. Provisions are recognised if there is a present obligation to transfer economic benefits, such as cash flows, as a result of past events and a reliable estimate can be made at the balance sheet date.

(xv) Leased assets

Where the Group enters into an operating lease, the payments (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the lease term. An operating lease is one in which the risks and rewards remain with the lessor.

(xvi) Foreign currency translation

The consolidated financial statements are presented in sterling which is the Group's presentation currency. Items included in the financial statements of each of the Group's entities are measured using the functional currency which is the primary economic environment in which the entity operates.

Foreign currency transactions are recorded in the functional currency for each entity using the exchange rates prevailing at the dates of the transactions or at the average rate for the period when this is a reasonable approximation. Substantially all of the Group's operations have sterling as their functional currency. Monetary assets and liabilities denominated in foreign currencies are translated at period end exchange rates. Non-monetary assets and liabilities that are measured at historical cost denominated in a foreign currency are not retranslated. The resulting exchange differences on translation are recorded in the income statement.

(xvii) Borrowings

Borrowings are initially recognised at fair value, net of transaction costs incurred and subsequently stated at amortised cost. Fair value is normally determined by reference to the fair value of the proceeds received. Any difference between the initial carrying amount and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

The fair value of the liability portion of convertible loan stock is determined by discounting contractual cash outflows using an equivalent non-convertible bond. This amount is carried as a liability on an amortised cost basis until extinguished on conversion or redemption. The remainder of the proceeds is allocated to the conversion option and is recognised and included in shareholders' equity. Transaction costs are apportioned between the liability and equity components of the convertible loan stock based on the allocation of proceeds to the liability and equity components when the instruments are first recognised.

(xviii) Segmental reporting

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment that are subject to risks and returns that are different from those of segments operating in other economic environments.

(xix) Loans and receivables

Loans and receivables are financial assets with fixed or determinable payments. Loans and receivables are measured at amortised cost, using the effective interest method.

(xx) Offsetting of financial instruments

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

(xxi) Assets held for sale

The Group treats an asset as held for sale when its carrying amount will be recovered through sale transaction rather than through continuing use, the asset is available for immediate sale in its present condition and the sale is highly probable.

(xxii) Current, non current disclosure

In the notes to the accounts, each asset and liability line item that combines amounts expected to be recovered or settled within twelve months after the balance sheet date, is classified as current at the balance sheet date and the remaining balance as non current.

(xxiii) 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 declared and appropriately approved.

3 Critical accounting estimates and judgements in applying accounting policies

The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities. Estimates and judgements are continually evaluated and based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

(i) The ultimate liability arising from claims made under insurance contracts

The estimation of the ultimate liability arising from claims made under insurance contracts is the Group's most critical accounting estimate. There are several sources of uncertainty that need to be considered in the estimate of the amounts that the Group will ultimately pay to settle such claims.

Significant areas requiring estimation and judgement include:

- Estimates of the amount of any liability in respect of claims notified but not settled and incurred but not reported claims provisions ("IBNR") included within provisions for insurance and reinsurance contracts.
- The corresponding estimate of the amount of reinsurance recoveries which will become due as a result of these estimated claims.
- The recoverability of amounts due from reinsurers.
- Estimates of the proportion of exposure which has expired in the period as represented by the earned proportion of premiums written.

The assumptions used and the manner in which these estimates and judgements are made are set out below.

Quarterly statistical data is produced in respect of gross and net premiums and claims (paid and incurred).

Projections are produced by an internal actuarial department, with appropriate adjustment for large claims.

The resulting projections are discussed with the experienced underwriting and claims personnel and claims provision recommendations made to an internal reserving panel ("the panel") consisting of senior underwriters, claims managers and finance staff.

Claims provisions are subject to independent external actuarial review at least annually. The panel then approves those estimated claims provisions to be included in the financial statements.

Some classes of business have characteristics which do not necessarily lend themselves easily to statistical estimation techniques. These classes would include Financial Risks, Casualty Treaty and Catastrophe Retrocessional. In these cases review is carried out on a policy by policy basis to support statistical estimates.

In the event of catastrophe claims and prior to detailed claims information becoming available, claims provision estimates are compiled using a combination of specific recognised modelling software and reviews of material contracts exposed to the event in question.

Overall the objectives of the estimates and judgements applied to claims provisions seek to state such provisions on a best estimate, undiscounted basis.

In addition to claims provisions the reserve for future loss adjustment expenses is subject to estimation. In arriving at this estimate regard is had to the levels of internal and third party loss adjusting expenses incurred annually and the length of time expected to be necessary to adjust all claims arising from the different classes of business. For this purpose classes of business are grouped into short, medium and long tail categories.

This result, when expressed as a percentage of net insurance provisions, is benchmarked to assess the reasonableness of the estimate.

Further judgements are made as to the recoverability of amounts due from reinsurers. Provisions for bad debts are made specifically, based on the solvency of reinsurers, payment experience with them and any disputes of which the company is aware.

The carrying value at the balance sheet date of gross claims reported and loss adjustment expenses and claims incurred but not reported was £1,992,665,000 (2004: £1,284,715,000). The amount of reinsurance recoveries estimated at the balance sheet date is £591,981,000 (2004: £266,438,000).

(ii) Impairment of goodwill

Determining whether goodwill is impaired requires an estimation of the value in use of the cash-generating units to which goodwill has been allocated. The value in use calculation requires the Group to estimate the future cash flows expected to arise from the cash-generating unit and a suitable discount rate in order to calculate present value both of which are material sources of uncertainty.

The carrying amount of goodwill at the balance sheet date was £70,991,000 (2004: £70,991,000) as set out in Note 16 to the accounts.

4 Risk management policies

The Group's activities expose the business to a number of key risks which have the potential to affect its ability to achieve its business objectives. The following describes the Group's insurance and investment risk management from a quantitative and qualitative perspective.

The Board is responsible for the Group's systems of internal control and for reviewing their effectiveness. The systems of internal control are designed to manage rather than eliminate risk and aim to provide reasonable and not absolute assurance. Group underwriting activities are co-ordinated through a system of underwriting committees as well as the Group's Finance Committee and the Boards for the regulated entities. Investment risk is managed in accordance with investment frameworks which are set by the Investment Committee which meets monthly.

(i) Financial Risk

a Credit risk

This is the risk that one party to a financial arrangement will fail to discharge an obligation and cause the other party to incur a financial loss. The following is an overview of how the Group manages its significant credit risk exposures.

Investment securities

Credit risk relating to investment securities is monitored daily. The Group's investment guidelines specify the maximum percentage of the portfolios that can be invested in any single counterparty – these limits are determined using the Standard and Poor's credit rating of each asset. In addition the Group's Investment Committee will from time to time impose special limits on assets that are deemed more at risk than the rating agencies currently imply.

Derivative products

The Group may use derivatives from time to time, with prior approval from the Investment Committee. The four main derivative classes are credit derivatives, foreign exchange forwards and options, interest rate derivatives and equity index options. Derivatives are only used for the purposes of efficient portfolio management and/or reduction in investment risk.

Credit risk with respect to derivatives is controlled with the implementation of collateral agreements with derivative counterparties that puts a finite limit on the credit risk of each transaction.

Reinsurance

Reinsurance is placed in line with policy guidelines and concentration of risk is managed by reference to counterparties' limits that are set each year and are subject to regular reviews. On a regular basis management performs assessment of creditworthiness of reinsurers to update reinsurance purchase strategy and to ascertain suitable allowance for impairment of reinsurance assets.

Insurance receivables

The Group credit risk is in respect of balances with both customers and intermediaries. The Group seeks to reduce its credit exposure to intermediaries through application of its internal credit vetting processes and its active credit control procedures. Wherever possible, the Group includes premium payment warranties in its terms and conditions which gives it the right to cancel policies in the event of non-payment.

Credit Risk Table

The following credit risk table in respect of financial investments, insurance and reinsurance receivables, provides information regarding the credit risk exposure of the Group by classifying the assets according to credit ratings of the counterparties. AAA is the highest possible rating.

As at 31 December 2005

		AAA £'000	AA £'000	A £'000	BBB £'000	B £'000	Equities £'000	Not rated £'000	Total £'000
Reinsurance assets	a	2,222	175,562	370,718	11,993	594	–	30,892	591,981
Financial investments		740,924	738,917	141,116	1,938	–	219,018	3,797	1,845,710
Insurance receivables	b,c	–	–	–	–	–	–	558,941	558,941
Cash and cash equivalents		190,495	336,143	–	–	–	–	–	526,638
		933,641	1,250,622	511,834	13,931	594	219,018	593,630	3,523,270

a Amounts recoverable from reinsurers on claims reported and loss adjustment expenses and IBNR. See Note 21 to Financial Statements

b Trade receivables arising out of direct and reinsurance operations. See Note 23 to Financial Statements

c Insurance receivables are generally due from customers and intermediaries who are unlikely to seek ratings as part of their normal course of business

As at 31 December 2004

		AAA £'000	AA £'000	A £'000	BBB £'000	B £'000	Equities £'000	Not rated £'000	Total £'000
Reinsurance assets	a	3,197	56,751	184,109	1,066	–	–	21,315	266,438
Financial investments		515,174	409,372	55,426	1,248	–	231,205	1,300	1,213,725
Insurance receivables	b,c	–	–	–	–	–	–	466,100	466,100
Cash and cash equivalents		169,881	459,309	–	–	–	–	–	629,190
		688,252	925,432	239,535	2,314	–	231,205	488,715	2,575,453

a Amounts recoverable from reinsurers on claims reported and loss adjustment expenses and IBNR. See Note 21 to Financial Statements

b Trade receivables arising out of direct and reinsurance operations. See Note 23 to Financial Statements

c Insurance receivables are generally due from customers and intermediaries who are unlikely to seek ratings as part of their normal course of business

(ii) Liquidity Risk

The Group has defined Liquidity Risk as “the risk that the Group, although solvent, either does not have available sufficient financial resources to enable it to meet its obligations as they fall due, or can secure them only at excessive cost.”

The major liquidity risk confronting the Group is the daily calls on its available cash resources in respect of claims arising from insurance contracts. In respect of US regulated business the liquidity risk is increased by the requirement to collateralise the US Credit for Reinsurance Trust Fund (“CRIF”) in respect of gross outstanding claims and IBNR for the Group’s Lloyd’s business and two Letter of Credit (“LOC”) collateral accounts in respect of LOCs issued by Brit Insurance Limited.

The Group manages this risk by maintaining sufficient liquid assets or assets that can be translated into liquid assets at short notice and without capital loss to meet the expected cash flow requirements. The Group’s Investment Guidelines also set out various short term cash balances to be held by external fund managers.

The Group has determined the minimum proportion of funds required to ensure that the Group has sufficient liquid assets to withstand loss scenarios at the extreme end of business plan projections by reference to modelled Realistic Disaster Scenario (“RDS”) events.

The table below analyses monetary assets and liabilities of the Group into their relevant maturing groups based on the remaining period at the balance sheet date to their contractual maturities or expected repayment dates.

As at 31 December 2005

Assets	Up to a year £'000	1-3 years £'000	3-5 years £'000	Over 5 years £'000	Equities £'000	Total £'000
Reinsurance assets	276,337	168,300	73,702	73,642	–	591,981
Financial investments	628,288	567,084	421,120	10,200	219,018	1,845,710
Insurance receivables	558,941	–	–	–	–	558,941
Cash and cash equivalents	526,638	–	–	–	–	526,638
	1,990,204	735,384	494,822	83,842	219,018	3,523,270
Liabilities	Up to a year £'000	1-3 years £'000	3-5 years £'000	Over 5 years £'000	Equities £'000	Total £'000
Insurance contract liabilities	746,253	600,788	322,812	322,812	–	1,992,665
Borrowings	–	38,644	–	155,569	–	194,213
Trade and other payables	292,912	–	–	–	–	292,912
	1,039,165	639,432	322,812	478,381	–	2,479,790

As at 31 December 2004

Assets	Up to a year £'000	1-3 years £'000	3-5 years £'000	Over 5 years £'000	Equities £'000	Total £'000
Reinsurance assets	73,125	94,308	40,704	58,301	–	266,438
Financial investments	471,502	283,543	222,728	4,747	231,205	1,213,725
Insurance receivables	466,100	–	–	–	–	466,100
Cash and cash equivalents	629,190	–	–	–	–	629,190
	1,639,917	377,851	263,432	63,048	231,205	2,575,453
Liabilities	Up to a year £'000	1-3 years £'000	3-5 years £'000	Over 5 years £'000	Equities £'000	Total £'000
Insurance contract liabilities	342,061	429,518	206,982	306,154	–	1,284,715
Borrowings	18,221	42,689	–	7,539	–	68,449
Trade and other payables	189,690	–	–	–	–	189,690
	549,972	472,207	206,982	313,693	–	1,542,854

The nature of insurance is that the requirements of funding cannot be predicted with absolute certainty as the theory of probability is applied on insurance contracts to ascertain the likely provision and the time period when such liabilities will require settlement. The amounts and maturities in respect of insurance liabilities are thus based on management's best estimate based on statistical techniques and past experience.

(iii) Collateral

Part of the Group's underwriting is carried out through its Syndicate 2987 at Lloyd's. This Syndicate writes regulated US and Canadian business. As a result the syndicate is required to collateralise a number of Lloyd's trust funds in respect of outstanding claims relating to this business. Collateral is provided in the form of cash and approved investments in accordance with the terms of the trust deed. The total amount of collateral provided at 31 December 2005 was £282,698,851 (2004: £184,931,217).

In addition Brit Insurance Ltd maintains two letter of credit ("LOC") facilities in respect of its US regulated business. The company is obliged to collateralise any LOCs issued under these facilities. The total amount of collateral provided at 31 December 2005 was £10,657,000 (2004: £2,656,000).

(iv) Market Risk

Market risk is the risk to change in fair value of financial instruments from fluctuation in foreign exchange rates (currency risk), market interest rates (interest rate risk) and market prices (price risk), whether such changes are caused by factors specific to the individual instrument or its issuer or factors affecting all instruments traded in the market.

Currency Risk

The Group's main exposure to foreign exchange risk arises from insurance business originating overseas, primarily denominated in US Dollars and Euros. Transactions denominated in these currencies form a significant part of the Group's operations.

This risk is mitigated by the Group maintaining financial assets denominated in the same currencies as its major insurance liabilities. The Finance Committee monitors the Group's foreign currency exposure.

The table below summarises the Group's exposure to foreign currency exchange rate risks at year end by categorising monetary assets and liabilities by major currencies.

As at 31 December 2005

Assets	Sterling equivalent				Total £'000
	US Dollars £'000	Canadian Dollars £'000	Euros £'000	Sterling and others £'000	
Reinsurance assets	409,915	14,526	23,086	144,454	591,981
Financial investments	441,251	26,234	85,543	1,292,682	1,845,710
Insurance receivables	278,624	11,802	34,767	233,748	558,941
Cash and cash equivalents	119,476	38,119	39,656	329,387	526,638
Total	1,249,266	90,681	183,502	2,000,271	3,523,270
Liabilities					
	US Dollars £'000	Canadian Dollars £'000	Euros £'000	Sterling and others £'000	Total £'000
Insurance contract liabilities	1,105,228	53,603	136,740	697,094	1,992,665
Borrowings	8,508	–	–	185,705	194,213
Trade and other payables	130,564	2,699	7,220	152,429	292,912
Total	1,244,300	56,302	143,960	1,035,228	2,479,790

As at 31 December 2004

Assets	Sterling equivalent				Total £'000
	US Dollars £'000	Canadian Dollars £'000	Euros £'000	Sterling and others £'000	
Reinsurance assets	177,978	5,336	18,997	64,127	266,438
Financial investments	283,549	19,399	56,172	854,605	1,213,725
Insurance receivables	234,198	17,543	46,875	167,484	466,100
Cash and cash equivalents	201,131	14,405	65,823	347,831	629,190
Total	896,856	56,683	187,867	1,434,047	2,575,453
Liabilities					
	US Dollars £'000	Canadian Dollars £'000	Euros £'000	Sterling and others £'000	Total £'000
Insurance contract liabilities	603,124	22,183	101,753	557,655	1,284,715
Borrowings	7,539	–	–	60,910	68,449
Trade and other payables	102,164	6,664	15,212	65,650	189,690
Total	712,827	28,847	116,965	684,215	1,542,854

Interest rate risk

Interest rate risk is the risk that the value and future cash flows of a financial instrument will fluctuate because of changes in interest rates.

The Group monitors interest rate risk on a currency by currency basis. The modified duration of the fixed income investments in each currency is used as an indicator of the sensitivity of the assets to changes in current interest rates. The maximum duration of the investments is set by the Investment Committee and specified in the investment managers' guidelines.

The following tables set out the average effective interest rates for Group's financial instruments exposed to interest rate risk:

As at 31 December 2005

GBP	Up to a year	1-2 years	2-3 years	3-4 years	4-5 years	>5 years
Financial investments	4.84%	4.69%	4.40%	4.36%	4.58%	4.61%
Borrowings	–	–	8.50%	–	–	6.84%

USD	Up to a year	1-2 years	2-3 years	3-4 years	4-5 years	>5 years
Financial investments	4.17%	4.73%	4.66%	4.58%	4.43%	4.39%
Borrowings	–	–	–	–	8.00%	–

Euro	Up to a year	1-2 years	2-3 years	3-4 years	4-5 years	>5 years
Financial investments	2.37%	2.93%	2.95%	3.15%	3.02%	–
Borrowings	–	–	–	–	–	–

As at 31 December 2004

GBP	Up to a year	1-2 years	2-3 years	3-4 years	4-5 years	>5 years
Financial investments	3.86%	4.89%	4.56%	4.80%	4.52%	–
Borrowings	6.25%	–	–	8.50%	–	–

USD	Up to a year	1-2 years	2-3 years	3-4 years	4-5 years	>5 years
Financial investments	2.46%	3.13%	3.22%	3.53%	3.72%	–
Borrowings	–	–	–	–	–	6.10%

Euro	Up to a year	1-2 years	2-3 years	3-4 years	4-5 years	>5 years
Financial investments	0.99%	–	–	–	–	–
Borrowings	–	–	–	–	–	–

Price risk

The Group's price risk exposure relates to financial assets and liabilities whose value will fluctuate as a result of changes in market prices, principally in investment securities.

Fixed income security price risk is managed by daily monitoring of the interest rate movements, the credit spreads and the liquidity of each group of assets. Equity portfolios are managed to ensure that risks are spread by means of systematic diversification in different sectors.

(v) Insurance risk

The risk under any one insurance contract is the possibility that the insured event occurs and the claim results. By the very nature of an insurance contract, risk is based on fortuity and is therefore unpredictable.

The principal risks that the Group faces under its insurance contracts are that the business will be under-priced or under-reserved.

Experience shows that the larger the portfolio of similar insurance contracts, the smaller the relative variability about the expected outcome will be. In addition, a more diversified portfolio is less likely to be affected across the board by a change in any subset of the portfolio. The Group has developed its insurance underwriting strategy to diversify the type of insurance risks accepted to achieve a sufficiently large population of risks to reduce the variability of the expected outcome.

The reinsurance arrangements include excess, proportional, stop-loss and catastrophe coverage. Reinsurance is purchased in accordance with the Group's risk appetite.

The concentration of insurance risk before and after reinsurance by territory in relation to the type of insurance risks accepted is summarised below:

Year ended 31 December 2005

	Gross written premium £'000	Premium ceded to reinsurers £'000	Net written premium £'000
UK	393,833	(50,330)	343,503
Europe	60,112	(13,080)	47,032
US	325,922	(84,313)	241,609
Other (including worldwide)	422,636	(83,893)	338,743
	1,202,503	(231,616)	970,887

Year ended 31 December 2004

	Gross written premium £'000	Premium ceded to reinsurers £'000	Net written premium £'000
UK	419,712	(69,852)	349,860
Europe	96,565	(13,627)	82,938
US	228,589	(36,941)	191,648
Other (including worldwide)	341,865	(55,880)	285,985
	1,086,731	(176,300)	910,431

The Group is organised into three underwriting centres details of which are set out in Note 5.

Risk control measures

The Group has developed underwriting guidelines, limits of authority and business plans which are binding upon all staff authorised to underwrite. These are detailed and specific to underwriters and classes of business as well as establishing more general principles and conditions. A proportion of the Group's insurance risks are written by third parties under delegated underwriting authorities. The third parties are closely vetted in advance and are subject to tight reporting requirements. In addition the performance of these contracts is closely monitored by underwriters and regular audits are carried out.

Compliance is checked through both a peer review process and, periodically, by the Group's internal audit department which is entirely independent of the underwriting units.

The Group carries out an annual business planning process for each of its underwriting units. The resulting plans set out premium, territorial and aggregate limits for all classes of business. Performance against the plans is monitored on a regular basis through a system of underwriting committees as well as regularly by the Group's Finance Committee and the Boards for the regulated entities.

Given the nature of certain classes of business underwritten by the Group, aggregate exposures to certain catastrophic events are managed on a gross and net basis. The Group defines overall limits for its risk appetite in terms of the aggregate exposure to predetermined RDSs.

5 Segmental information

(i) Primary reporting format – business segments

As at 31 December 2005 the Group is organised into three underwriting centres with each representing a strategic business unit that offers varying products and serves different markets. The three centres are London Market, UK and Reinsurance.

The London Market Underwriting Centre underwrites Brit's international and US business other than reinsurance. In the main, London Market deals with wholesale buyers of insurance, not individuals. Risks are large and usually syndicated by several underwriters – the subscription market.

The UK Underwriting Centre is developing business opportunities within the UK general commercial insurance markets through both wholesale and retail brokers and has opened offices in key locations across the UK.

Reinsurance is essentially the insurance of insurance and reinsurance companies and includes providing non-proportional cover for major events such as earthquakes or hurricanes. These insurance companies calculate how much risk they want to bear and pass on the remaining exposure to reinsurers in return for a premium.

"Other underwriting" is made up of Syndicate 389 (Life – final year of account 2003), and historic participations on external managed syndicates in run off (final year of account 2000).

RI3K functions as an autonomous business function supplying electronic infrastructure to the insurance and reinsurance industry. Certain revenues and expenses are incurred relating to central functions which along with certain related assets and liabilities are retained at the corporate centre level.

"Other corporate" is made up of residual income and expenditure attaching to the corporate centre not allocated to other segments.

This is the basis on which the Group reports its primary segment information.

a Income statement by segment

Year ended 31 December 2005

	London Market Underwriting Centre £'000	Reinsurance Underwriting Centre £'000	UK Underwriting Centre £'000	Other underwriting £'000	Total underwriting £'000	RI3K £'000	Other corporate £'000	Total £'000
Gross premiums written	558,568	328,807	317,862	(2,734)	1,202,503	–	–	1,202,503
Less premiums ceded to reinsurers	(112,447)	(100,716)	(18,486)	33	(231,616)	–	–	(231,616)
Premiums written, net of reinsurance	446,121	228,091	299,376	(2,701)	970,887	–	–	970,887
Gross earned premiums	522,570	322,315	323,897	4,643	1,173,425	–	–	1,173,425
Reinsurers' share	(110,434)	(98,116)	(21,302)	(1,026)	(230,878)	–	–	(230,878)
Earned premiums, net of reinsurance	412,136	224,199	302,595	3,617	942,547	–	–	942,547
Fees, commissions and other income	7,408	4,786	317	(368)	12,143	1,775	(484)	13,434
Investment income, net realised gains and net fair value gains	44,949	22,374	46,651	135	114,109	7	7,712	121,828
Total revenue	464,493	251,359	349,563	3,384	1,068,799	1,782	7,228	1,077,809
Gross claims incurred	(448,809)	(460,036)	(182,206)	(1,200)	(1,092,251)	–	–	(1,092,251)
Reinsurers' share	185,836	191,479	13,219	323	390,857	–	–	390,857
Claims incurred, net of reinsurance	(262,973)	(268,557)	(168,987)	(877)	(701,394)	–	–	(701,394)
Acquisition costs – commission	(117,313)	(43,946)	(45,207)	(971)	(207,437)	–	–	(207,437)
Acquisition costs – other	(19,235)	(9,592)	(10,803)	–	(39,630)	–	–	(39,630)
Other insurance related expenses	(20,791)	(10,384)	(12,262)	(239)	(43,676)	–	–	(43,676)
Other expenses	–	–	–	–	–	(5,274)	(12,192)	(17,466)
Total expenses excluding finance costs	(420,312)	(332,479)	(237,259)	(2,087)	(992,137)	(5,274)	(12,192)	(1,009,603)
Operating profit	44,181	(81,120)	112,304	1,297	76,662	(3,492)	(4,964)	68,206
Finance costs								(5,941)
Share of profit of associated undertakings								138
Profit on ordinary activities before tax								62,403
Income tax expense								(14,771)
Profit attributable to equity holders of the parent								47,632
Claims ratio	63.8%	119.8%	55.8%		74.4%			
Expense ratio	38.2%	28.5%	22.6%		30.8%			
Combined ratio	102.0%	148.3%	78.4%		105.2%			

Year ended 31 December 2004

	London Market Underwriting Centre £'000	Reinsurance Underwriting Centre £'000	UK Underwriting Centre £'000	Other underwriting £'000	Total underwriting £'000	RISK £'000	Other corporate £'000	Total £'000
Gross premiums written	431,613	279,994	345,401	29,723	1,086,731	–	–	1,086,731
Less premiums ceded to reinsurers	(67,993)	(60,969)	(40,250)	(7,088)	(176,300)	–	–	(176,300)
Premiums written, net of reinsurance	363,620	219,025	305,151	22,635	910,431	–	–	910,431
Gross earned premiums	434,989	242,850	340,703	11,712	1,030,254	–	–	1,030,254
Reinsurers' share	(67,579)	(57,718)	(39,755)	(2,533)	(167,585)	–	–	(167,585)
Net change in other technical provisions	–	(5,254)	–	–	(5,254)	–	–	(5,254)
Earned premiums, net of reinsurance	367,410	179,878	300,948	9,179	857,415	–	–	857,415
Fees, commissions and other income	625	(99)	461	902	1,889	1,640	311	3,840
Investment income, net realised losses and net fair value gains	29,235	14,237	29,849	–	73,321	14	2,716	76,051
Total revenue	397,270	194,016	331,258	10,081	932,625	1,654	3,027	937,306
Gross claims incurred	(285,209)	(160,324)	(211,699)	(13,466)	(670,698)	–	–	(670,698)
Reinsurers' share	72,141	38,783	6,827	7,302	125,053	–	–	125,053
Claims incurred, net of reinsurance	(213,068)	(121,541)	(204,872)	(6,164)	(545,645)	–	–	(545,645)
Acquisition costs – commission	(94,810)	(29,634)	(49,728)	(2,370)	(176,542)	–	–	(176,542)
Acquisition costs – other	(20,943)	(7,405)	(8,747)	(861)	(37,956)	–	–	(37,956)
Other insurance related expenses	(11,063)	(12,232)	(13,578)	1,519	(35,354)	–	–	(35,354)
Other expenses	–	–	–	–	–	(4,363)	(16,214)	(20,577)
Total expenses excluding finance costs	(339,884)	(170,812)	(276,925)	(7,876)	(795,497)	(4,363)	(16,214)	(816,074)
Operating profit	57,386	23,204	54,333	2,205	137,128	(2,709)	(13,187)	121,232
Finance costs								(5,472)
Share of profit of associated undertakings								348
Profit on ordinary activities before tax								116,108
Income tax expense								(31,642)
Profit attributable to equity holders of the parent								84,466
Claims ratio	58.0%	68.5%	68.1%		63.9%			
Expense ratio	34.5%	26.6%	23.9%		29.0%			
Combined ratio	92.5%	95.1%	92.0%		92.9%			

5 Segmental information continued

b Balance sheet by segment

As at 31 December 2005

	London Market Underwriting Centre £'000	Reinsurance Underwriting Centre £'000	UK Underwriting Centre £'000	Other underwriting £'000	Total underwriting £'000	RISK £'000	Other corporate £'000	Total £'000
Assets held for sale	–	–	–	–	–	–	1,380	1,380
Reinsurance contracts	340,378	264,343	44,226	4,235	653,182	–	–	653,182
Intangible assets	4,357	2,762	59,899	133	67,151	7,454	11,636	86,241
Other assets	1,325,366	860,951	705,646	20,755	2,912,718	925	191,569	3,105,212
Total assets	1,670,101	1,128,056	809,771	25,123	3,633,051	8,379	204,585	3,846,015
Insurance contracts	1,228,131	778,713	567,016	22,800	2,596,660	–	–	2,596,660
Other liabilities	146,082	104,781	39,154	2,190	292,207	705	231,783	524,695
Total liabilities	1,374,213	883,494	606,170	24,990	2,888,867	705	231,783	3,121,355

As at 31 December 2004

	London Market Underwriting Centre £'000	Reinsurance Underwriting Centre £'000	UK Underwriting Centre £'000	Other underwriting £'000	Total underwriting £'000	RISK £'000	Other corporate £'000	Total £'000
Investments in associated undertakings	–	–	–	–	–	–	1,594	1,594
Reinsurance contracts	175,757	107,071	37,308	6,765	326,901	–	–	326,901
Intangible assets	4,007	1,895	54,103	148	60,153	7,376	11,636	79,165
Other assets	1,100,275	588,317	642,908	30,670	2,362,170	1,204	94,368	2,457,742
Total assets	1,280,039	697,283	734,319	37,583	2,749,224	8,580	107,598	2,865,402
Insurance contracts	911,407	431,306	483,232	33,687	1,859,632	–	–	1,859,632
Other liabilities	98,593	55,869	30,735	3,748	188,945	745	93,420	283,110
Total liabilities	1,010,000	487,175	513,967	37,435	2,048,577	745	93,420	2,142,742

c Other information by segment

Year ended 31 December 2005

	London Market Underwriting Centre £'000	Reinsurance Underwriting Centre £'000	UK Underwriting Centre £'000	Other underwriting £'000	Total underwriting £'000	RISK £'000	Other corporate £'000	Total £'000
Depreciation	761	379	427	9	1,576	72	–	1,648
Amortisation	1,535	766	862	19	3,182	20	–	3,202
Capital expenditure	4,710	2,408	9,402	–	16,520	145	–	16,665

Year ended 31 December 2004

	London Market Underwriting Centre £'000	Reinsurance Underwriting Centre £'000	UK Underwriting Centre £'000	Other underwriting £'000	Total underwriting £'000	RISK £'000	Other corporate £'000	Total £'000
Depreciation	480	563	598	23	1,664	93	–	1,757
Amortisation	887	1,042	1,107	42	3,078	9	–	3,087
Capital expenditure	4,784	2,264	2,536	–	9,584	159	–	9,743

(ii) Secondary reporting format – geographical segments

The Group's business sectors operate mainly in four geographical areas, though the business is managed on a worldwide basis. The segmental split shown below is based on the location of the underlying risk insured. This is the basis on which the Group reports its secondary segmental information.

Gross premiums written

	Year ended 31 December 2005 £'000	Year ended 31 December 2004 £'000
United Kingdom	393,833	419,712
Europe	60,112	96,565
United States	325,922	228,589
Other (including worldwide)	422,636	341,865
	1,202,503	1,086,731

All capital expenditure during 2004 and 2005 has been made in the United Kingdom.

The majority of the total assets of the Group are located in the United Kingdom, United States, Europe and Canada.

6 Fees, commissions and other income

	Year ended 31 December 2005 £'000	Year ended 31 December 2004 £'000
Electronic infrastructure design and development	1,775	1,640
Other fees and commissions	32	1,212
Exchange gains	11,627	988
	13,434	3,840

7 Investment income

	Year ended 31 December 2005 £'000	Year ended 31 December 2004 £'000
Financial investments at fair value through the profit and loss:		
Dividend income	2,777	2,812
Interest income	57,304	39,184
Interest income on cash and cash equivalents	25,423	21,351
	85,504	63,347

8 Net realised gains/(losses) recorded in the income statement

	Year ended 31 December 2005 £'000	Year ended 31 December 2004 £'000
Realised appreciation/(depreciation) on investments	2,610	(10,258)
Loss on sale of property, plant and equipment	(15)	–
	2,595	(10,258)

9 Acquisition costs and other operating expenses

	Year ended 31 December 2005 £'000	Year ended 31 December 2004 £'000
Commissions	219,570	188,889
Movement on related acquisition cost deferral	(12,133)	(12,347)
	207,437	176,542
Staff costs (note 10)	45,110	41,672
Other staff related costs	4,423	3,775
Accommodation costs	5,741	4,073
Legal and professional charges	6,218	3,050
IT costs	4,727	4,084
Marketing and communications	3,261	2,613
Irrecoverable VAT	1,691	2,299
Depreciation of property, plant and equipment	1,648	1,757
Amortisation of intangible assets	3,202	3,087
Printing, stationery, postage and telephone	1,056	1,148
Travel and entertaining	2,557	2,174
Insurance	1,419	1,413
Regulatory levies and charges	14,777	14,096
Investment management expenses	3,066	2,744
Other	2,907	1,679
Movement on insurance related acquisition cost deferral	(1,031)	4,223
	100,772	93,887
Acquisition costs and other operating expenses	308,209	270,429

The amounts above have been allocated as follows:

Acquisition costs	247,067	214,498
Other operating expenses	61,142	55,931
	308,209	270,429

10 Staff costs

	31 December 2005 £'000	31 December 2004 £'000
Wages and salaries	36,976	34,644
Social security costs	3,304	2,853
Pension costs	4,830	4,175
	45,110	41,672

The average monthly number of employees during the year, including Executive Directors, was as follows:

	31 December 2005 £'000	31 December 2004 £'000
Management	29	29
Administration	159	131
Underwriting	380	354
	568	514

11 Finance costs

	31 December 2005 £'000	31 December 2004 £'000
Interest expense on current borrowings:		
Bank borrowings	463	918
Interest expense on non-current borrowings:		
Unsecured subordinated loan stock	4,180	4,362
US dollar floating rate unsecured subordinated loan notes	692	192
Lower Tier Two subordinated debt	606	–
	5,478	4,554
	5,941	5,472

12 Auditors' remuneration

	31 December 2005		31 December 2004	
	Ernst & Young LLP £'000	Other auditors £'000	Mazars LLP £'000	Other auditors £'000
Audit services:				
Statutory audit				
Corporate	384	109	309	12
Syndicate	226	20	–	316
Audit-related regulatory reporting :				
Corporate regulatory reports	23	–	79	–
Interim review	63	–	43	46
IFRS reporting	106	–	–	–
Further assurance services:				
IFRS advisory	87	–	–	85
Projects	5	–	–	20
Capital reorganisation	–	–	90	–
Capital raising	35	–	26	–
Tax services:				
Compliance services	46	103	60	11
Advisory services	15	56	36	48
Other services:				
Actuarial services	110	–	–	–
Printing services	–	–	17	–
Other advisory	5	–	2	16
	1,105	288	662	554

Ernst & Young LLP was appointed as auditor on 24 May 2005, following the resignation on that date of Mazars LLP.

13 Income tax expense

(i) Tax charged to income statement

	Year ended 31 December 2005 £'000	Year ended 31 December 2004 £'000
Current tax:		
For the year	(19,900)	(1,060)
Adjustments in respect of prior years	139	998
Total current tax	(19,761)	(62)
Deferred tax:		
Origination and reversal of timing differences	4,990	(31,580)
Total tax charged to income statement	(14,771)	(31,642)

An amount of tax relating to the associated company of £59,000 (2004: £253,000) has been charged to the income statement within the Group's share of profit after tax of associated undertakings.

(ii) Tax credited to equity

	Year ended 31 December 2005 £'000	Year ended 31 December 2004 £'000
Deferred tax	1,170	881

(iii) Tax reconciliation

The tax on the Group's profits before tax differs from the theoretical amount that would arise from using the current standard rate for corporation tax applicable in the UK of 30% (2004: 30%).

	Year ended 31 December 2005 £'000	Year ended 31 December 2004 £'000
Profit on ordinary activities before tax	62,403	116,108
Tax calculated at standard rate for corporation tax	(18,721)	(34,832)
Expenses not deductible for tax purposes	(638)	(1,599)
Equity dividends not subject to corporation tax	833	735
Underwriting results not previously recognised for tax purposes	(60)	2,302
Utilisation of previously unrecognised deferred tax assets on capital losses and capital allowances	3,676	754
Adjustments to tax charge in respect of prior years	139	998
	(14,771)	(31,642)

14 Earnings per share

The calculations of the basic and diluted earnings per share are based on the following figures :

	Year ended 31 December 2005 £'000	Year ended 31 December 2004 £'000
Profit on ordinary activities after tax	47,632	84,466
Dilutive post tax effect on profits:		
Convertible unsecured subordinated loan stock	–	2,885
Diluted profit on ordinary activities after tax	47,632	87,351

	Year ended 31 December 2005 Number	Year ended 31 December 2004 Number
Basic weighted average number of shares	965,307,765	967,295,848
Dilutive potential ordinary shares:		
Convertible unsecured subordinated loan stock	–	54,347,727
Employee share options	2,666,287	1,293,871
Diluted weighted average number of shares	967,974,052	1,022,937,446

In accordance with International Accounting Standard 33 "Earnings per Share", convertible unsecured subordinated loan stock and employee share options have only been treated as dilutive when their conversion to ordinary shares would decrease earnings per share or increase loss per share from continuing operations. The convertible unsecured subordinated loan stock issued by the Group ceased to be convertible on 21 November 2005 and thereafter changed its name to unsecured subordinated loan stock.

For further information relating to the unsecured subordinated loan stock see Note 26.

15 Property, plant and equipment

	Freehold property £'000	Office refurbishment £'000	Computers and office machinery, furniture and equipment £'000	Motor vehicles £'000	Total £'000
Cost:					
At 1 January 2004	509	2,931	6,706	76	10,222
Additions	–	276	1,468	–	1,744
Disposals	(509)	–	(49)	(76)	(634)
Exchange adjustments	–	–	(6)	–	(6)
At 31 December 2004	–	3,207	8,119	–	11,326
At 1 January 2005	–	3,207	8,119	–	11,326
Additions	–	5,006	1,381	–	6,387
Disposals	–	(1)	(2,617)	–	(2,618)
Exchange adjustments	–	1	20	–	21
At 31 December 2005	–	8,213	6,903	–	15,116
Amortisation:					
At 1 January 2004	327	1,545	4,535	62	6,469
Charge for the year	5	602	1,136	14	1,757
Disposals	(332)	–	(29)	(76)	(437)
Exchange adjustments	–	1	14	–	15
At 31 December 2004	–	2,148	5,656	–	7,804
At 1 January 2005	–	2,148	5,656	–	7,804
Charge for the year	–	482	1,166	–	1,648
Disposals	–	–	(2,593)	–	(2,593)
Exchange adjustments	–	2	19	–	21
At 31 December 2005	–	2,632	4,248	–	6,880
Carrying amount:					
At 31 December 2004	–	1,059	2,463	–	3,522
At 31 December 2005	–	5,581	2,655	–	8,236

The depreciation charge for the year is included in "Other operating expenses" in the income statement.

16 Intangible assets

	Goodwill £'000	Syndicate participations £'000	Software £'000	Total £'000
Cost:				
At 1 January 2004	80,408	9,025	4,614	94,047
Additions	–	–	7,999	7,999
At 31 December 2004	80,408	9,025	12,613	102,046
At 1 January 2005	80,408	9,025	12,613	102,046
Additions	–	–	10,278	10,278
Disposals	–	–	(3,388)	(3,388)
At 31 December 2005	80,408	9,025	19,503	108,936
Amortisation:				
At 1 January 2004	9,417	6,789	3,588	19,794
Charge for the year	–	1,734	1,353	3,087
At 31 December 2004	9,417	8,523	4,941	22,881
At 1 January 2005	9,417	8,523	4,941	22,881
Charge for the year	–	502	2,700	3,202
Disposals	–	–	(3,388)	(3,388)
At 31 December 2005	9,417	9,025	4,253	22,695
Carrying amount:				
At 31 December 2004	70,991	502	7,672	79,165
At 31 December 2005	70,991	–	15,250	86,241

Software additions in the year are £10,183,000 of internally developed software and £97,000 of externally purchased software.

The amortisation charge for the year is included in "Other operating expenses" in the income statement.

Goodwill has been allocated to individual cash generating units ("CGUs") as follows:

	31 December 2005 £'000	31 December 2004 £'000
UK Underwriting Centre	51,979	51,979
Managing Agency	11,636	11,636
RI3K	7,376	7,376
	70,991	70,991

The recoverable amounts of goodwill

The recoverable amounts of goodwill for each CGU have been determined based on value in use calculations using internal Group forecasts covering a period of five years and the following discount rates:

	31 December 2005 %	31 December 2004 %
UK Underwriting Centre	8.88	8.70
Managing Agency	8.88	8.70
RI3K	13.32	13.05

The discount rates are the Group's weighted average cost of capital and have been loaded where significant uncertainties exist. The projected cash flows are based on past performance and management expectations for market developments.

17 Deferred acquisition costs

	31 December 2005 £'000	31 December 2004 £'000
At 1 January	111,933	103,809
Cost deferred during the year	103,122	69,230
Amortisation charge for the year	(89,958)	(61,106)
At 31 December	125,097	111,933

18 Investments in associated undertakings

Assets held for sale

Investments in associated undertakings have consisted entirely of the Group's interest in EPIC Investment Partners Limited ("EIP") (formerly The Equity Partnership Limited) during 2004 and 2005. On 15 November 2005 the Group appointed financial advisors to facilitate the proposed disposal of the Group's interest in EIP and the Directors believe that there is a high probability that such a disposal will be completed within one year from this date. In accordance with IFRS 5 "Non-current Assets Held for Sale and Discontinued Operations" the Group has reclassified EIP as an asset held for sale and ceased to account for this asset using the equity method of accounting.

	2005 £'000	2004 £'000
Income statement, Group share:		
Income	2,176	2,833
Profit on ordinary activities before tax	197	601
Tax charge on profit	(59)	(253)
Profit on ordinary activities after tax	138	348
Balance sheet, Group share:		
Investments	260	260
Current assets	2,254	2,071
Current liabilities	(1,596)	(1,407)
Long-term loan	(123)	(267)
Net assets	795	657

The movements in the Group's investments in associated undertakings are as follows:

	2005 £'000	2004 £'000
Balance at 1 January 2005	1,594	253
Share of profit after tax arising in the year	138	348
Net assets acquired on additional share purchase	–	56
	1,732	657
Loans (repaid from)/made to associated undertaking	(352)	652
Goodwill	–	285
	1,380	1,594
Less amount transferred to "assets held for sale"	(1,380)	–
	–	1,594

The carrying value is made up as follows:

	2005 £'000	2004 £'000
Share of net assets	–	657
Loans to associated undertaking	–	652
Goodwill arising on acquisition	–	285
Balance at 31 December 2005	–	1,594

EPIC Investment Partners Limited

The Group owns 40.9% of the ordinary share capital of EPIC Investment Partners Limited ("EIP"). As at the balance sheet date, EIP had issued £440,000 of preference shares to a third party. Since 10 March 2004, these preference shares pay a dividend of 5% per annum. EIP is prevented from paying a dividend on the ordinary shares until the preference shares have been repaid in full. The company's principal activity is that of an investment manager. The company's accounting reference date is 31 December. It is registered in England and Wales.

19 Significant interests in other companies

At 31 December 2005, the Group had holdings in the companies listed below which exceeded 20% of any class of equity share capital. As at 31 December 2005 the Group did not have the power to exercise significant influence over the activities of these companies and therefore the holdings have not been equity accounted. Significant influence did not exist as the Group did not have the power to participate in the financial and operating policy decisions of the investee.

Name of undertaking	Country of incorporation and registration	Class of capital	Percentage of class held by Group	Latest available accounts	Aggregate capital and reserves £'000	Profit after tax for the year £'000
Ebix Inc	USA	Common stock	34.0%	31 Dec 2004	7,035	1,224
The Equity Partnership Investment Company PLC	Isle of Man	Capital shares	34.7%	31 Jul 2005	36,219	7,568
The Equity Partnership Investment Company PLC	Isle of Man	Income shares	4.8%	31 Jul 2005	36,219	7,568

20 Deferred taxation and Deferred income tax

(i) The movement in deferred tax assets and liabilities during the year, taking into consideration the offsetting of balances within the same tax jurisdiction is as follows:

	Unrealised (profits)/losses on investments £'000	Pensions £'000	Foreign exchange (profit)/losses on non-monetary items £'000	Trading losses carried forward £'000	Declared underwriting results £'000	Other £'000	Total £'000
Deferred tax balances							
As at 1 January 2004	1,144	4,655	4,133	–	16,388	(135)	26,185
Charged/(credited) to income statement (Note 13)	(957)	3	(2,403)	6,476	(34,894)	195	(31,580)
Credited to equity	–	883	–	–	–	–	883
At 31 December 2004	187	5,541	1,730	6,476	(18,506)	60	(4,512)
Charged/(credited) to income statement (Note 13)	(4,748)	134	(4,004)	(6,476)	19,140	944	4,990
Credited to equity	–	1,170	–	–	–	–	1,170
At 31 December 2005	(4,561)	6,845	(2,274)	–	634	1,004	1,648

The Directors consider that the overall level of the deferred tax assets is recoverable over the future years in the light of the Group's current trading and prospects.

(ii) Deferred income tax assets are recognised for timing differences to the extent that the realisation of the related tax benefit through the future taxable profits is probable.

The Group did not recognise deferred tax assets on capital losses (realised and unrealised) and other timing differences as follows:

	31 December 2005 £'000	31 December 2004 £'000
Capital losses	1,834	1,270
Other timing differences	–	2,146
	1,834	3,416

21 Insurance and reinsurance contracts

(i) Balances on insurance and reinsurance contracts

	31 December 2005 £'000	31 December 2004 £'000
Gross		
Insurance contracts		
Claims reported and loss adjustment expenses	1,050,175	579,594
Claims incurred but not reported	942,490	705,121
	1,992,665	1,284,715
Unearned premiums	603,995	574,917
Total insurance contracts	2,596,660	1,859,632
Recoverable from reinsurers		
Reinsurance contracts		
Claims reported and loss adjustment expenses	355,861	151,717
Claims incurred but not reported	256,810	124,823
Impairment provision	(20,690)	(10,102)
	591,981	266,438
Unearned premiums	61,201	60,463
Total reinsurance contracts	653,182	326,901
Net		
Claims reported and loss adjustment expenses	694,314	427,877
Claims incurred but not reported	685,680	580,298
Impairment provision	20,690	10,102
	1,400,684	1,018,277
Unearned premiums	542,794	514,454
Net insurance and reinsurance contracts	1,943,478	1,532,731

Insurance contracts – assumptions, change in assumptions and sensitivity**a Process used to decide on assumptions required**

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

The Group uses several statistical methods to incorporate the various assumptions made in order to estimate the ultimate costs of claims. The two methods more commonly used are the chain-ladder and the Bornhuetter-Ferguson methods.

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 most appropriate for mature classes of business that have a relatively stable development pattern. Chain-ladder techniques are less suitable in cases in which the insurer does not have a developed claims history for a particular class of business.

Bornhuetter-Ferguson 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).

The choice of selected results for each 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 year or groups of accident years within the same class of business.

Claims for a number of classes of business, including Financial Risk, Mortgage Indemnity Guarantee, Catastrophe Retrocession and Casualty Treaty, do not always conform to the statistical distribution expected. For these classes claims reserves are additionally reviewed on a policy by policy basis by Underwriters and Claims Managers and these reviews take account of market intelligence in addition to notified claims.

In addition to the estimation of claims reserves certain estimates are produced for unearned premiums. All inwards premiums are deemed to earn out on a pro rata basis over the term of the related policy, except for those contracts where the period of risk differs significantly from the contract period. For open market business earned premium is calculated at policy level. However, premium derived from delegated underwriting authorities is calculated by applying the 1/144ths method to estimated premiums applied to the master policy. This implies that attachments to master policies arise evenly throughout the period of that master policy.

Reinsurance outwards premiums are earned according to the nature of the cover. "Losses occurring during" policies are earned evenly over the policy period. "Risks attaching" policies are expensed on the same basis as the inwards business being protected.

b Sensitivity

Claims loss ratios are the area to which the Group's results are most sensitive.

The Group profit on ordinary activities before tax is sensitive to a 1% change in the net claims ratios by £9,425,470 (2004: £8,574,150).

Claims development tables

The tables below show the development of claims over a period of time on a gross and net of reinsurance basis. The tables show the cumulative incurred claims, including both notified and IBNR claims, for each successive accident year at each balance sheet date, together with cumulative claims as at the current balance sheet date.

The claims have been adjusted to make them comparable on a year by year basis. They have been grossed up to include 100% of the managed syndicate claims rather than the claims that reflect the Brit percentage ownership of each syndicates' capacity during the respective accident years. In addition, claims in currencies other than sterling have been retranslated at 31 December 2005 exchange rates.

Ultimate gross claims

Accident year	2001 and prior years £'000	2002 £'000	2003 £'000	2004 £'000	2005 £'000	Total £'0000
At end of accident year	1,961,803	262,425	452,600	739,801	1,220,765	
One year later	2,001,444	269,548	417,555	678,017	–	
Two years later	2,016,191	261,137	385,977	–	–	
Three years later	2,019,350	265,041	–	–	–	
Four years later	2,017,412	–	–	–	–	
Estimate of cumulative claims	2,017,412	265,041	385,977	678,017	1,220,765	4,576,212
Cumulative paid claims						(2,583,014)
Less third party participations on syndicates						(533)
Gross liability as per the balance sheet (Note 21 (i))						<u>1,992,665</u>

Ultimate net claims

Accident year	2001 and prior years £'000	2002 £'000	2003 £'000	2004 £'000	2005 £'000	Total £'0000
At end of accident year	1,339,697	204,454	399,452	608,644	839,212	
One year later	1,379,766	207,041	367,146	538,788	–	
Two years later	1,387,924	194,827	328,155	–	–	
Three years later	1,384,722	191,138	–	–	–	
Four years later	1,386,445	–	–	–	–	
Estimate of cumulative claims	1,386,445	191,138	328,155	538,788	839,212	3,283,738
Cumulative paid claims						(1,882,521)
Less third party participations on syndicates						(533)
Net liability as per the balance sheet (Note 21 (i))						<u>1,400,684</u>

The Group has taken advantage of the exemption in IFRS 4, "Insurance Contracts" which permits an entity to not disclose information about claims development that occurred earlier than five years before the end of the first financial year in which it applies this standard.

Material Surpluses Released

The total claims provision releases from prior years amounted to £110,814,000 (2004: £47,723,000). In part this arises from the Group's reserving philosophy which requires the most recent years, with the greatest uncertainty of result, to be prudently reserved leaving a potential for subsequent release. In addition, in 2005, there were a number of one-off circumstances giving rise to additional releases as follows:

The Employers' Liability and Public Liability accounts are relatively recent and growing additions to the Group's portfolio. Following substantial rating increases and benign claims experience the Group, has felt able to release significant reserves from 2004 and prior underwriting years.

The reserving of the Space account has been amended to reflect changes in the way the business is written. The business is currently written largely on the basis of maximum policy period of 12 months compared with the multi-year exposure written previously. This has enabled the Group to recognise profits in this account at an earlier stage than was previously the case.

At 31 December 2004 significant reserves were held in respect of the Asian Tsunami. At the end of 2005 few claims only had still been notified and this enabled a substantial reduction in the Casualty Treaty account.

The Group's Property Commercial UK account has experienced very favourable claims experience in recent years.

The Group's Financial Institutions and Professional Indemnity accounts were also subject to favourable claims development patterns.

(ii) Movements in insurance and reinsurance contracts

a Claims and loss adjustment expenses

	Year ended 31 December 2005			Year ended 31 December 2004		
	Gross	Reinsurance	Net	Gross	Reinsurance	Net
As at 1 January	1,284,715	(266,438)	1,018,277	790,449	(160,972)	629,477
Cash paid for claims settled in the year	(487,687)	87,358	(400,329)	(309,077)	57,293	(251,784)
Change in syndicate ownership	10,917	(3,369)	7,548	183,689	(65,729)	117,960
Increase in liabilities	1,092,251	(390,857)	701,394	670,698	(125,053)	545,645
Net exchange differences	92,469	(18,675)	73,794	(51,044)	28,023	(23,021)
As at 31 December	1,992,665	(591,981)	1,400,684	1,284,715	(266,438)	1,018,277

b Unearned premiums

	Year ended 31 December 2005			Year ended 31 December 2004		
	Gross	Reinsurance	Net	Gross	Reinsurance	Net
As at 1 January	574,917	(60,463)	514,454	518,440	(51,748)	466,692
Premiums written in the year	1,202,503	(231,616)	970,887	1,086,731	(176,300)	910,431
Premiums earned during the year	(1,173,425)	230,878	(942,547)	(1,030,254)	167,585	(862,669)
As at 31 December	603,995	(61,201)	542,794	574,917	(60,463)	514,454

c Other technical provisions

	Year ended 31 December 2005			Year ended 31 December 2004		
	Gross	Reinsurance	Net	Gross	Reinsurance	Net
As at 1 January	–	–	–	(5,254)	–	(5,254)
Premiums earned during the year	–	–	–	5,254	–	5,254
As at 31 December	–	–	–	–	–	–

(iii) Major hurricanes in 2005

a Introduction

Set out below is a summary of:

- The net effect of claims from Hurricanes Katrina, Rita and Wilma on the Group's result for the year ended 31 December 2005;
- the assumptions upon which the Group has based such estimate;
- the methodology which the Group has adopted in arriving at that estimate; and
- the classes of business which the Group believes may give rise to potential liability.

To reach the estimate of claims for the major hurricanes in 2005, the Group has had to assess a variety of factors. For example industry estimates range between US\$40-\$60 billion for Hurricane Katrina. Katrina in particular is a complex loss, being an unusual combination of wind storm and flood, thus affecting different parts of the Group's portfolio, insurance and reinsurance, offshore and onshore.

b The net effect of claims to the Group

	London Market US\$'000	Year ended 31 December 2005 Reinsurance US\$'000	Total US\$'000
Provision for claims			
Gross amount	365,781	549,164	914,945
Reinsurers' share	(216,791)	(323,700)	(540,491)
Net claims incurred	148,990	225,464	374,454
Reinstatement premiums			
Inward reinstatements	–	(62,897)	(62,897)
Outwards reinstatements	26,700	49,715	76,415
Net reinstatements	26,700	(13,182)	13,518
Net after reinstatements	175,690	212,282	387,972
	£'000	£'000	£'000
Net after reinstatements	102,145	123,420	225,565

These estimates do not take into account, inter alia, the original premium income on the policies which have given rise to the claims arising from the hurricanes. Accordingly, the estimate is not an estimate of the Group's financial position resulting from those policies.

c Assumptions

The following is a list of the key assumptions used for the purpose of calculating the amount of the Group's expected claims from the hurricanes:

- In respect of exclusionary language for flood on certain original policies, a prudent approach was taken such that where ambiguity existed, preference was afforded to the assured.
- In respect of the Group's Catastrophe Retro reinsurance class (i.e. the Group's business, entirely written by BIL, reinsuring reinsurance companies against liabilities they have accepted as inwards reinsurance business), every policy that is not excluded by peril or location has been assumed to have a claim relating to every layer/programme insured and that the following Probable Maximum Loss ("PML") factors will apply to BIL's maximum contractual limits on such policies:
 - 60% for reinsurance of direct insurers;
 - 90% for retrocession business, where certain market-wide exclusion clauses apply; and
 - 100% for other business written under this class, predominantly Industry Loss Warranty contracts.
- No subrogation recoveries will be made by the Group.
- The Group has assumed it is one event other than in the area of potential reinsurance reinstatement mentioned below.
- Reinsurance recoveries shown in the above table as due to the Group will be made in full. Currently, the Group has no knowledge or information to suggest that any of its reinsurers may default on the payment of monies due to the Group in this context.
- Where ambiguity exists in the language of reinstatement provisions of certain reinsurance to the Group, a partial recovery was factored into the figure.

d Methodology

The Group adopted the following methodology in analysing its exposure and calculating its initial loss estimates.

- The classes of business which had potential exposure were identified and where appropriate a risk-by-risk review was undertaken.
- Information was gathered from a variety of sources, at a market level, through brokers, advisers, agents and customers. This information was evaluated using the Group's in-house expertise. The Group has conducted extensive modelling on the hurricanes supplemented with a ground up review of all exposed contracts.
- An estimate of the gross loss and (where applicable) inwards reinstatement premium for each relevant risk was established.
- Reinsurance protections were then reviewed in order to calculate the anticipated reinsurance recovery and outward reinsurance premiums and any other contractual payments due.

Regard was taken of co-insurance, coverage restrictions and previous reinsurance erosion from earlier events. The amounts due from individual reinsurers were then calculated.

The above describes the approach taken to make the initial gross estimates, however, subsequent updates to gross estimates have given more weight to the actual incurred claim development.

e Sensitivity

In respect of Hurricane Katrina, with the exception of certain quota share reinsurances on the Property Treaty and Catastrophe Retrocession accounts, reinsurance cover has been largely exhausted. Accordingly the sensitivity of the Group's net claims to movements in its gross estimated claims is high. In respect of Hurricanes Rita and Wilma the majority of reinsurance cover remains available.

22 Financial investments

	31 December 2005 £'000	31 December 2004 £'000
Shares and other variable-yield securities:		
Listed	218,025	227,552
Unlisted	993	3,653
Debt securities and other fixed income securities:		
Listed	1,156,168	701,954
Certificates of deposit	470,418	280,018
	1,845,604	1,213,177
Derivative financial instruments	106	548
	1,845,710	1,213,725

Derivative financial instruments

Non-hedge derivatives

The Group purchases currency forwards in order to match foreign currency cash flows as they relate to expected future claims in foreign currencies.

In addition the Group entered into one credit default swap in order to mitigate the risk of a specific reinsurance counterparty.

	31 December 2005		31 December 2004	
	Contract/ notional amount £'000	Fair Value £'000	Contract/ notional amount £'000	Fair Value £'000
Assets				
Exchange traded forwards	–	–	5,686	404
Credit default swap	7,500	106	7,500	144
	7,500	106	13,186	548

23 Trade and other receivables

	31 December 2005 £'000	31 December 2004 £'000
Trade debtors	14,020	15,743
Arising out of direct insurance operations	304,885	183,638
Arising out of reinsurance operations	240,036	266,719
Prepayments	10,775	2,665
Accrued income	17,717	15,025
Other debtors	10,450	15,582
	597,883	499,372

The carrying amounts disclosed above reasonably approximate fair values at year end.

All amounts are due within one year of the balance sheet date.

24 Cash and cash equivalents

	31 December 2005 £'000	31 December 2004 £'000
Cash at bank and on deposit	475,963	509,519
Cash equivalents	50,675	119,671
	526,638	629,190

The carrying amounts disclosed above reasonably approximate fair values at year end.

Included in cash and cash equivalents are amounts totalling £187,926,000 (2004: £371,135,000) not available for use by the Group which are held within the Lloyd's syndicates and as Funds at Lloyd's.

For the purposes of the consolidated cash flow statement, cash and cash equivalents consist of the amount stated in that balance sheet category less any bank overdrafts included within borrowings.

	31 December 2005 £'000	31 December 2004 £'000
Cash and cash equivalents as above	526,638	629,190
Bank overdrafts (Note 26)	–	(18,221)
Cash and cash equivalents per consolidated cash flow statement	526,638	610,969

25 Employee benefits

The Group has the following pension schemes in operation:

(i) Brit Group Services Limited – defined benefit pension scheme

The Group operates a funded pension scheme providing benefits for its employees based on final pensionable emoluments. The assets of the scheme are held in a separate trustee administered fund. This scheme closed to new entrants on 4 October 2001. The scheme is subject to a formal actuarial valuation every three years and the results of the valuation carried out as at 31 July 2003 were updated to the accounting date by an independent qualified actuary in accordance with IAS 19. As required by IAS 19, the value of the defined benefit obligation and current service cost has been measured using the projected unit credit method.

The following table sets out the key IAS 19 assumptions used for the scheme.

	31 December 2005 %	31 December 2004 %
Retail price inflation	2.80	2.90
Discount rate	4.80	5.30
Pension increases in payment	2.80	2.70
General salary increases	4.80	4.90

Notes to the Financial Statements

The post retirement mortality assumptions allow for future improvements in mortality. The mortality table used implies that a 60 year old man currently has an expected future lifetime of 24.6 years (2004: 23.3 years).

The expected rate of return on assets for the financial year ending 31 December 2005 was 6.7% pa. This rate was derived by taking the weighted average of the long-term expected rate of return on each of the asset classes that the scheme was invested in at 31 December 2004. The expected return for the individual asset classes at that date were 7.5% pa for equity investments, 4.8% pa for corporate bond investments, 4.6% pa for gilt investments and 4.5% pa for cash investments. The corresponding weighted expected rate of return for 2004 was 7.3% pa based on individual expected returns of 7.7% pa (equities), 5.4% pa (corporate bonds), 4.8% pa (gilts) and 4.6% pa (cash).

The amount included in the balance sheet arising from the Group's obligations in respect of the scheme is as follows:

	31 December 2005 £'000	31 December 2004 £'000
Present value of defined benefit obligation	95,049	79,216
Fair value of scheme assets	(72,231)	(60,746)
Net pension benefit obligation	22,818	18,470

The amounts recognised in the income statement are as follows:

	31 December 2005 £'000	31 December 2004 £'000
Current service cost	2,265	2,207
Interest cost	4,192	3,888
Expected return on scheme assets	(4,052)	(4,134)
Total expense recognised in the income statement	2,405	1,961

The above charges have been recognised in the acquisition costs and other operating expenses lines of the income statement:

The actual return on the scheme's assets over the year was £12,044,000 (2004: £4,705,000).

The allocation of the scheme's assets was as follows:

	31 December 2005		31 December 2004	
	Allocation %	Fair value £'000	Allocation %	Fair value £'000
Equity instruments	71	51,023	72	43,367
Debt instruments	28	20,760	28	17,101
Other	1	448	–	278
	100	72,231	100	60,746

A reconciliation of the present value of the defined benefit obligation is as follows:

	31 December 2005 £'000	31 December 2004 £'000
Opening defined benefit obligation	79,216	72,171
Current service cost	2,265	2,207
Interest cost	4,192	3,888
Actuarial losses	11,893	3,509
Benefits paid	(2,517)	(2,559)
Closing defined benefit obligation	95,049	79,216

A reconciliation of the fair value of the scheme assets is as follows:

	31 December 2005 £'000	31 December 2004 £'000
Opening fair value of scheme assets	60,746	56,655
Expected return on scheme assets	4,052	4,134
Difference between expected and actual return on scheme assets	7,992	571
Contributions by the employer	1,958	1,945
Benefits paid	(2,517)	(2,559)
Closing fair value of scheme assets	72,231	60,746

During 2005, Brit Group Services Limited has been making regular contributions of 24.7% of eligible salaries plus an additional lump sum contribution of £390,000. During 2006, the Group expects to make similar regular contributions and an additional lump sum contribution of £2,000,000.

A summary of the scheme's experience is as follows:

	31 December 2005 £'000	31 December 2004 £'000	31 December 2003 £'000
Defined benefit obligation	(95,049)	(79,216)	(72,171)
Scheme assets	72,231	60,746	56,655
Deficit	(22,818)	(18,470)	(15,516)

The following amounts are recognised outside the income statement within the Statement of Recognised Income and Expense:

	31 December 2005 £'000	31 December 2004 £'000
Difference between expected and actual return on scheme assets:		
Amount – gain	7,992	571
Percentage of scheme assets	11%	1%
Experience gains and losses on obligations:		
Amount – loss	(686)	(843)
Percentage of the present value of the obligations	(1%)	(1%)
Total amount recognised outside income statement		
Amount – loss	(3,901)	(2,938)
Percentage of the present value of the obligations	(4%)	(4%)

The cumulative amount recognised in the Statement of Recognised Income and Expense is a loss of £6,839,000 (2004: £2,938,000).

(ii) Brit Group Services Limited – Defined Contribution Stakeholder Scheme

From 5 October 2001, Brit Group Services Limited has operated a defined contribution stakeholder pension scheme. The assets of the scheme are held separately from those of the Company in an independently administered fund. The pension cost charge represents contributions payable by the Company to the fund and amounted to £2,352,000 (2004: £1,974,000). At 31 December 2005 no contributions were payable to the fund (2004: £nil).

(iii) Brit Group Services Limited – Funded Unapproved Retirement Benefits Scheme ("FURBS")

Brit Group Services Limited also operates a defined contribution FURBS, into which additional contributions are paid in respect of certain employees. The assets of the scheme are held separately from those of the Company in an independently administered fund.

The pension cost charge represents contributions payable by the Company to the fund and amounted to £24,000 (2004: £52,000). At 31 December 2005, no contributions were payable to the fund (2004: £30,000).

(iv) Brit Insurance Limited

For Brit Insurance Limited employees, the Group operates a defined contribution pension scheme. The assets of the scheme are held separately from those of the Company in an independently administered fund.

The pension cost charge represents contributions payable by the Company to the fund and amounted to £26,000 (2004: £16,000). At 31 December 2005, no contributions were payable to the fund (2004: £nil).

26 Borrowings

	Maturity	Effective interest rate %	31 December 2005 Amortised cost £'000	31 December 2005 Fair value £'000	31 December 2004 Amortised cost £'000	31 December 2004 Fair value £'000
Current						
Bank overdrafts	On demand	Base Rate + 1.5	–	–	18,221	18,221
Non-current						
8.5% unsecured subordinated loan stock	2008	9.50	38,644	43,131	42,689	47,822
US dollar floating rate unsecured subordinated loan notes	2034	US dollar 3 month LIBOR + 3.5	8,508	8,721	7,539	7,812
Lower Tier Two subordinated debt	2030	6.84	147,061	152,207	–	–
			194,213	204,059	68,449	73,855

Fair values of the non-current borrowings represent the trading market values at the balance sheet date.

Bank overdraft

As at 31 December 2005 the Group had an undrawn overdraft facility of £40,000,000 (2004: £21,779,000) available for working capital finance requirements. Security provided by the Group in relation to the bank overdraft is described in Note 38. The facility was cancelled on 4 January 2006 following the issue of the Lower Tier Two subordinated debt in December 2005.

8.5% unsecured subordinated loan stock

The unsecured subordinated loan stock ("ULS") was formerly known as convertible unsecured subordinated loan stock ("CULS") until all conversion rights ceased to be exercisable from 21 November 2005. The loan stock was convertible at the rate of 123.46 ordinary shares for every £100 nominal of loan stock.

The ULS pays interest to holders at a rate of 8.5%. The amount charged to the income statement using the effective interest method and the fair value of the liability element shown above have been determined using an interest rate of 9.5%.

The movement in the ULS during the year is as follows:

	31 December 2005 £'000	31 December 2004 £'000
Liability component brought forward	42,689	42,169
Interest expense	4,180	4,362
Interest paid	(3,549)	(3,836)
Conversions	(4,676)	(6)
Liability component at year end	38,644	42,689

On 12 January 2006, the Group announced a tender offer to purchase all of the outstanding ULS at 109p for every £1 nominal amount of ULS. 19,584,970 ULS units were validly tendered and following subsequent market purchases at 109p, 20,011,551 ULS units remain outstanding as at 14 March 2006.

US dollar floating rate unsecured subordinated loan notes

The US dollar floating rate unsecured subordinated loan notes amounted to US\$15,000,000 and were issued by the Group on 28 June 2004.

Lower Tier Two subordinated debt

The Lower Tier Two subordinated debt was issued by the Group on 9 December 2005. It is callable in whole by the Group on 9 December 2020 or following this date the interest rate resets at 340 basis points above the 10-year gilt rate prevailing at the time. The effective interest rate method of accounting has been applied over the term up to this call date.

27 Provisions

	Provision for lease shortfall £'000
At 1 January 2005	533
Amounts utilised during the year	(44)
At 31 December 2005	489

The provision for lease shortfalls is in respect of a property which is leased by Wren Underwriting Agencies Limited and sublet to third parties. The Directors anticipate a loss arising over the period of the lease which expires in 2014 and this has been recognised as a provision.

28 Trade and other payables

	31 December 2005 £'000	31 December 2004 £'000
Trade creditors	8,465	14,931
Arising out of direct insurance operations	83,828	15,824
Arising out of reinsurance operations	163,639	126,009
Other taxes and social security costs	1,087	2,133
Shares held by third parties – CF Epic Investment Funds	17,444	11,728
Accruals and deferred income	12,122	13,581
Other creditors	6,327	5,484
	292,912	189,690

Estimated fair values of amounts are the amounts recorded at year end. All amounts are payable within one year of the balance sheet date.

29 Equity dividends

	Year ended 31 December 2005 £'000	Year ended 31 December 2004 £'000
First 2004 interim dividend paid – 2.0p per ordinary share	–	19,381
Second 2004 interim dividend paid – 2.0p per ordinary share	–	19,381
Final 2004 dividend paid – 2.0p per ordinary share	19,305	–
First 2005 interim dividend paid – 3.0p per ordinary share	29,157	–
	48,462	38,762

The Directors in their meeting dated 14 March 2006 approved a proposal to be put before the Annual General Meeting of shareholders, to be held on 25 April 2006, the payment of a final dividend of 3.0p per share for the year ended 31 December 2005 to all shareholders on the register on 24 March 2006. Based on the number of shares in issue as at 14 March 2006, but excluding those owned by the Group's Employee Benefit Trust which has waived its entitlement to dividends, this would amount to £29,186,000.

30 Share capital

	31 December 2005 £'000	31 December 2004 £'000	31 December 2005 Number '000	31 December 2004 Number '000
Authorised:				
Ordinary shares of 25p each	350,000	350,000	1,400,000	1,400,000
Allotted, issued and fully paid:				
Ordinary shares of 25p each	245,236	243,518	980,942	974,072

	31 December 2005 Number '000	31 December 2004 Number '000
Number of ordinary shares of 25p each, allotted, issued and fully paid:		
Opening balance	974,071,862	974,053,647
Exercised share options	938,000	10,000
Converted unsecured subordinated loan stock	5,932,443	8,215
Closing balance	980,942,305	974,071,862

Further information relating to the exercise of share options can be found in Note 35.

Further information relating to the conversion of unsecured subordinated loan stock can be found in Note 26.

As at 31 December 2005 there were 3,799,891 shares (2004: 4,098,575) reserved for issue under options and nil shares (2004: 51,267,861) reserved for holders of unsecured subordinated loan stock (formerly convertible unsecured subordinated loan stock).

31 Own shares

The Trustees of the Brit Performance Share Plan 2003 ("PSP"), Executive Share Option Scheme 2003 ("ESOS") and Long Term Incentive Plan 1999 ("LTIP") acquire Brit Insurance Holdings PLC shares in accordance with the terms of the Trust. The number of shares held at 31 December 2005 was 8,809,106 (2004: 8,876,139) with a market value, based on mid-market value, of £7,840,104 (2004: £7,012,150).

The Trustees of the Brit All Employee Share Ownership Plan 2001 ("ESOP") acquire Brit Insurance Holdings PLC shares in accordance with the terms of that trust. The number of unvested free and matching shares held at 31 December 2005 was 951,289 (2004: 784,622) with a market value, based on mid-market value, of £846,647 (2004: £619,851).

Details of the PSP, ESOS, LTIP and ESOP are given in Note 35.

As at 31 December 2005 Brit Insurance Limited held 265,623 (2004: 265,623) Brit Insurance Holdings PLC shares with a market value, based on mid-market value of £236,404 (2004: £209,842).

	31 December 2005 £'000	31 December 2004 £'000
Performance Share Plan, Executive Share Option Scheme and Long Term Incentive Plan	6,522	6,572
All Employee Share Ownership Plan	725	618
Held by Brit Insurance Limited	303	303
	7,550	7,493

32 Commitments

Capital commitments

Capital expenditure contracted for at the balance sheet date but not yet incurred is as follows:

	31 December 2005 £'000	31 December 2004 £'000
Capital expenditure	844	2,653

Operating lease commitments

The Group has entered into a number of operating lease arrangements to lease properties, motor vehicles and office equipment.

Property leases typically have rent reviews every five years where the lease payments are increased to reflect market rates.

Operating lease payments recognised in the income statement were £5,897,000 (2004: £4,503,000).

The future minimum lease payments under non-cancellable operating leases were as follows:

	Properties 31 December 2005 £'000	Properties 31 December 2004 £'000	Other 31 December 2005 £'000	Other 31 December 2004 £'000
Not later than one year	3,168	2,011	81	95
Later than one year and not later than five years	11,973	765	141	86
Later than five years	12,357	9,559	–	–
	27,498	12,335	222	181

The Group has sublet one of the properties and the future minimum sublease receipts expected to be received under this sublease as at 31 December 2005 were £497,000 (2004: £552,000). Sublease receipts recognised in the income statement were £55,000 (2004: £55,000).

33 Reconciliation of movements in equity

For the year ended 31 December 2005

Note	Called up share capital £'000	Share premium account £'000	Capital redemption reserve £'000	Equity portion of convertible debt £'000	Own shares £'000	Retained earnings £'000	Total equity attributable to shareholders £'000
Balance at 1 January 2005	243,518	311,145	586	1,681	(7,493)	173,223	722,660
Arising in the period:							
Actuarial losses on defined benefit pension scheme	–	–	–	–	–	(3,901)	(3,901)
Tax on items taken directly to or transferred from equity	–	–	–	–	–	1,170	1,170
Profit for the year	–	–	–	–	–	47,632	47,632
Total recognised income and expense for the year	–	–	–	–	–	44,901	44,901
Acquisition of own shares	–	–	–	–	(107)	–	(107)
Vesting of own shares	–	–	–	–	50	–	50
Equity dividends	29	–	–	–	–	(48,462)	(48,462)
Share-based payments	35	–	–	–	–	1,060	1,060
Exercised share options	–	235	420	–	–	–	655
Converted unsecured subordinated loan stock	26	1,483	3,193	–	–	–	4,676
Expiry of loan stock conversion period	–	–	–	(1,681)	–	1,681	–
Acquisition of further 8.4% of RI3K Ltd	–	–	–	–	–	(773)	(773)
Balance at 31 December 2005	245,236	314,758	586	–	(7,550)	171,630	724,660

For the year ended 31 December 2004

Note	Called up share capital £'000	Share premium account £'000	Capital redemption reserve £'000	Equity portion of convertible debt £'000	Own shares £'000	Retained earnings £'000	Total equity attributable to shareholders £'000
Balance at 1 January 2004	243,513	481,135	586	1,681	(4,306)	(41,052)	681,557
Arising in the year:							
Actuarial losses on defined benefit pension scheme	–	–	–	–	–	(2,938)	(2,938)
Tax on items taken directly to or transferred from equity	–	–	–	–	–	881	881
Profit for the year	–	–	–	–	–	84,466	84,466
Total recognised income and expense for the year	–	–	–	–	–	82,409	82,409
Acquisition of own shares	–	–	–	–	(3,368)	–	(3,368)
Vesting of own shares	–	–	–	–	181	–	181
Equity dividends	29	–	–	–	–	(38,762)	(38,762)
Share-based payments	35	–	–	–	–	628	628
Exercised share options	–	3	6	–	–	–	9
Converted unsecured subordinated loan stock	26	2	4	–	–	–	6
Capital reorganisation	–	(170,000)	–	–	–	170,000	–
Balance at 31 December 2004	243,518	311,145	586	1,681	(7,493)	173,223	722,660

On 3 March 2006 the Group made an application to the High Court to transfer £180,000,000 from the share premium account to the retained earnings account.

The capital redemption reserve results from the redemption of some of the Group's own shares and its purpose is to maintain the Group's capital.

34 Cash flows provided by operating activities

	Year ended 31 December 2005 £'000	Year ended 31 December 2004 £'000
Operating profit	68,206	121,232
Adjustments for non-cash movements:		
Realised and unrealised investment (gains)/losses	(36,339)	(13,527)
Loss/(profit) on sale of property, plant and equipment	15	(205)
Amortisation of underwriting capacity	502	1,734
Amortisation of software	2,700	1,353
Depreciation of property, plant and equipment and related exchange adjustments	1,669	1,772
Foreign exchange losses/(gains) on financing items	969	(475)
Foreign exchange (gains)/losses on cash and cash equivalents	(17,792)	9,366
Charges in respect of employee share schemes	1,060	628
Charges in respect of retirement benefits	447	16
Interest income	(82,727)	(60,535)
Dividend income	(2,777)	(2,812)
Changes in working capital:		
Deferred acquisition costs	(13,164)	(8,124)
Trade and other receivables	(98,511)	(52,992)
Insurance and reinsurance contracts	410,747	424,711
Trade and other payables	102,499	35,652
Provisions	(44)	(268)
Cash flows provided by operating activities	337,460	457,526

35 Share-based payments

During the year ending 31 December 2005, the Group had a number of long-term employee incentive schemes which are all classified as equity settled share-based payment arrangements. These schemes are described below.

The compensation cost recognised in the income statement under IFRS 2 "Share-based payments" for the Group's share-based compensation plans is shown below:

	31 December 2005 £'000	31 December 2004 £'000
Brit All Employee Share Ownership Plan	104	52
Brit Executive Share Option Scheme 2003	322	192
Brit Performance Share Plan	655	363
Brit 1998 Executive Share Option Schemes	(21)	21
	1,060	628

In accordance with the transitional provisions of IFRS 2, the Group has only calculated and disclosed the fair value of shares and share options that were granted after 7 November 2002 and had not yet vested at 1 January 2005.

Lattice-based option valuation model

The fair value of share options and performance shares is estimated on the date of grant using a lattice-based option valuation model. The significant assumptions used in the valuation model are disclosed below. Expected volatilities are based on the historical volatility of the Group's share returns over the most recent period that is commensurate with the expected term of the share options and performance shares and also the long-term trend observed. Historical data was used to estimate employee termination rates within the valuation model. Under the Brit Executive Share Option Scheme 2003 and the Brit 1998 Executive Share Option Schemes it is assumed that after options have vested, one-third of participants will exercise their options when the market price is at least 20% above the exercise price of the option, one-third of participants will exercise their options at a rate of 10% per annum when the market price is at least 20% above the exercise price of the option and the remaining one-third of members exercise their options when it is financially optimal.

The expected term of options granted is derived from the output of the option valuation model and represents the period of time that options granted are expected to be outstanding. The risk-free rate used in the valuation model is equal to the yield available on zero-coupon UK government bonds at the date of grant with a term equal to the expected term of the options.

Active Schemes

(i) Brit All Employee Share Ownership Plan 2001 ("the ESOP")

Approved by members at the Annual General Meeting on 20 June 2001, the ESOP comprises a Trust Deed and Rules establishing an All Employee Share Ownership Scheme which was approved by HM Revenue & Customs, pursuant to the Finance Act 2000. All eligible employees of the Company and participating subsidiaries are entitled to participate subject to various detailed provisions. An independent Trustee holds all shares purchased under the plan and dividends are payable on shares held in the Trust.

Since the launch of the ESOP, all participating employees have had the opportunity to make contributions from their pre-tax salary each month (to a maximum of £125 per month), to buy shares in the Group at the prevailing market price ("partnership shares"). The Group provides one share for each two shares purchased by the employee ("matching shares"). Free shares are awarded depending on Group performance over the previous year (to a maximum value of £3,000). If the participant leaves within 3 years of the award of free shares and within 5 years of the award of matching shares, except under specified circumstances, the rights to these shares are forfeited. There are no performance criteria that must be satisfied before the Plan shares may be sold or transferred.

On 1 October 2005, 500 free shares were awarded to each of 400 members of staff including certain Executive Directors. At the date of award, the aggregate 200,000 shares had a market value of 81.3p each.

As at 31 December 2005, the Trust held a total of 663,000 (2004: 511,500) free shares, 476,789 (2004: 364,622) matching shares and 960,037 (2004: 733,048) partnership shares with a market value, based on mid-market value of £1,868,845 (2004: £1,267,221). This equates to 0.2% (2004: 0.2%) of the Company's issued share capital as at 31 December 2005.

A reconciliation of the free and matching shares held in the Trust which had not yet vested unconditionally is shown in the table below. All of these shares have been conditionally gifted to employees subject to reaching the relevant qualifying period. The fair value of the awards is taken to be the market value of the shares on the date of grant.

	31 December 2005		31 December 2004	
	Number of shares	Weighted Average grant-date fair value (pence)	Number of shares	Weighted Average grant-date fair value (pence)
Outstanding at start of year	784,622	71.0	618,572	68.5
Granted	352,788	82.6	311,085	74.3
Forfeited	(82,121)	72.4	(53,535)	68.1
Vested	(104,000)	62.0	(91,500)	67.0
Outstanding at end of year	951,289	76.1	784,622	71.0

The weighted average share price at date of vesting during 2005 was 83.0p (2004: 70.5p)

(ii) Brit Executive Share Option Scheme 2003 ("the ESOS")

The ESOS was approved by shareholders on 18 June 2003 and comprises two parts, namely the "Approved" part, which has been approved by HM Revenue & Customs, and the 'Unapproved' part, which is intended to be used primarily where executives have more than £30,000 worth of outstanding Approved options.

Under the terms of the ESOS, selected employees are offered a defined number of options each year at an exercise price no less than the average market price of the shares on the three dealing days preceding date of grant. Subject to a prescribed performance criterion the options may be exercised in a period commencing three years after the date of grant and ending ten years after the date of grant. The current performance criterion is for the Group's total shareholder return ("TSR") to exceed the median TSR of the companies in the FTSE Mid 250 over a period of at least three years from grant. The proportion of options that will become exercisable depends on the level of out performance (for full details refer to the Directors' Remuneration Report). If an employee leaves the Group before the beginning of the exercise period he forfeits his options. All options expire at the end of the exercise period.

Outstanding options granted at nil cost are as follows:

Date of grant	Number of shares under option	Exercise price per 25p share (pence)	Date from which exercisable	Expiry date	Weighted average fair value at grant (pence)	Implied lifetime (years)
3 November 2003	7,789,207	76.92	3 November 2006	2 November 2013	7.10	4.6
18 October 2004	5,834,904	78.50	18 October 2007	17 October 2014	6.10	4.8
4 November 2004	22,930	78.50	4 November 2007	3 November 2014	6.10	4.8
21 June 2005	162,500	88.00	21 June 2008	20 June 2015	8.60	4.5
12 October 2005	5,655,756	83.50	12 October 2008	11 October 2015	8.00	4.5
	<u>19,465,297</u>					

A summary of the status of the Executive Share Option Scheme 2003 as at 31 December 2005, changes during the year and details of awards granted during the year is presented below:

	31 December 2005		31 December 2004	
	Number of options	Weighted average exercise price (pence)	Number of options	Weighted average exercise price (pence)
Outstanding at start of year	13,874,250	77.6	8,004,738	76.9
Granted	5,859,700	83.6	5,955,035	78.5
Forfeited	(268,653)	78.5	(85,523)	76.9
Outstanding at end of year	19,465,297	79.4	13,874,250	77.6

There were no shares exercisable at the end of the year (2004: nil).

As there were no shares exercisable at the end of the year (2004: nil) a weighted average exercise price of options exercisable at the end of the year has not been presented.

As there were no options exercised during the year (2004: nil) a weighted average share price at date of exercise has not been presented.

A summary of the range of exercise prices of the outstanding options and their remaining contractual lifetimes is presented below:

	31 December 2005			31 December 2004		
	Number of options	Weighted average exercise price (pence)	Weighted average remaining contractual life (years)	Number of options	Weighted average exercise price (pence)	Weighted average remaining contractual life (years)
Range of exercise prices for outstanding options						
76.9p to 88.0p	19,465,297	79.4	8.7	13,874,250	77.6	9.3

The fair value of each award granted after 7 November 2002 was estimated on the date of grant using a lattice-based option valuation model. This incorporates an adjustment for the performance criterion based on the observed correlation of the Group's share price returns against the comparator index over recent periods of history. The impact of this adjustment as a percentage of unadjusted fair value is disclosed below. The assumptions used to value the grants made after 7 November 2002 are shown below:

Date of grant	Risk-free interest rate	Expected Volatility	Dividend Yield	Turnover	Performance adjustment
3 November 2003	5.0%	35.0%	6.0%	5.0%	60%
18 October 2004	4.7%	35.0%	6.0%	5.0%	60%
4 November 2004	4.7%	35.0%	6.0%	5.0%	60%
21 June 2005	4.3%	35.0%	6.0%	5.0%	60%
12 October 2005	4.2%	35.0%	6.0%	5.0%	60%

(iii) Brit Performance Share Plan 2003 ("the PSP")

The PSP was approved by shareholders on 18 June 2003 and details of its operation are disclosed in the Directors' Remuneration Report.

Awards will be satisfied by the transfer of shares from the Company's Employee Benefit Trust which may acquire shares for this purpose either by subscribing for new shares or by buying shares in the market. The Trustees have waived their entitlement to dividends on any shares acquired.

Outstanding PSP awards granted at nil cost are as follows:

Date of grant	Number of shares	Value of shares at date of grant £	Latest vesting date	Weighted average fair value at grant (pence)
3 November 2003	4,528,943	3,374,063	2 May 2007	22.30
18 October 2004	3,811,912	2,630,219	17 April 2008	20.70
4 November 2004	81,554	59,942	3 May 2008	20.70
21 June 2005	162,500	143,000	20 December 2008	26.40
12 October 2005	4,534,688	3,786,464	11 April 2009	25.10
	<u>13,119,597</u>			

Notes to the Financial Statements

Selected employees are awarded the right to acquire a defined number of shares in the Group at no cost to the employee. Subject to the satisfaction of prescribed criteria (Total Shareholder Return to exceed the median TSR of the other FTSE Actuaries Insurance sector on the grant date over a period of three years from that date), the right to acquire shares may be exercised on or after the third anniversary of the grant date. The right must be exercised within six months of the award becoming exercisable. Participants do not receive any dividends until after the shares have been received.

A summary of the status of the Performance Share Plan 2003 as at 31 December 2005, changes during the year and details of awards granted during the period is presented below:

	31 December 2005		31 December 2004	
	Number of shares	Weighted Average grant-date fair value (pence)	Number of shares	Weighted Average grant-date fair value (pence)
Outstanding at start of year	8,635,925	21.6	4,659,894	22.3
Granted	4,731,724	25.1	3,976,031	20.7
Forfeited	(248,052)	22.1	–	N/A
Outstanding at end of year	13,119,597	22.8	8,635,925	21.6

As there were no shares vested during the year (2004: nil) a weighted average share price at date of vesting has not been presented.

As at 31 December 2005, the Employee Benefit Trust held 8,809,106 (2004: 8,876,136) ordinary 25p shares. This equates to 0.9% (2004: 0.9%) of the issued share capital of the Company as at 31 December 2005.

The fair value of each award granted after 7 November 2002 was estimated on the date of grant using a lattice-based option valuation model. This incorporates an adjustment for the performance criterion based on the observed correlation of the Group's share price returns against the comparator index over recent periods of history. The impact of this adjustment as a percentage of unadjusted fair value is disclosed below. The assumptions used to value the grants made after 7 November 2002 are shown below:

Date of grant	Risk-free interest rate	Expected Volatility	Dividend Yield	Turnover	Performance adjustment
3 November 2003	4.9%	35.0%	6.0%	5.0%	64%
18 October 2004	4.6%	35.0%	6.0%	5.0%	64%
4 November 2004	4.6%	35.0%	6.0%	5.0%	64%
21 June 2005	4.3%	35.0%	6.0%	5.0%	64%
12 October 2005	4.2%	35.0%	6.0%	5.0%	64%

Closed Schemes

(iv) Brit 1998 Approved Executive Share Option Scheme ("the Approved Scheme") and Brit 1998 Unapproved Executive Share Option Scheme ("The Unapproved Scheme")

The Approved Scheme is a discretionary share option scheme approved by the HM Revenue & Customs and the Unapproved Scheme is a discretionary share option scheme not approved by HM Revenue & Customs. Following shareholder approval of the ESOS in 2003, no further grants of options will be made under these Schemes. Options granted under these Schemes were subject to performance criteria at the discretion of the Board and are generally exercisable between three and ten years from the date of grant.

Outstanding options granted at nil cost are as follows:

Date of grant	Approved/Unapproved Scheme	Number of shares under option	Exercise price per 25p share (pence)	Date from which exercisable	Expiry date	Weighted average fair value at grant (pence)	Implied lifetime (years)
10 September 1998	Unapproved	799,999	142.50	10 September 2001	9 September 2008	N/A	N/A
6 December 1999	Approved	99,688	80.25	6 December 2002	5 December 2009	N/A	N/A
6 December 1999	Unapproved	1,425,000	80.25	6 December 2002	5 December 2009	N/A	N/A
24 May 2000	Unapproved	550,000	66.00	24 May 2003	23 May 2010	N/A	N/A
8 June 2000	Approved	38,710	77.50	8 June 2003	7 June 2010	N/A	N/A
20 November 2000	Approved	148,650	74.00	20 November 2003	19 November 2010	N/A	N/A
20 November 2000	Unapproved	705,000	74.00	20 November 2003	19 November 2010	N/A	N/A
7 June 2001	Approved	308,377	113.50	7 June 2004	6 June 2011	N/A	N/A
7 June 2001	Unapproved	125,000	113.50	7 June 2004	6 June 2011	N/A	N/A
27 May 2002	Approved	28,368	70.50	27 May 2005	26 May 2012	N/A	N/A
31 May 2002	Unapproved	2,382,550	70.50	31 May 2005	30 May 2012	N/A	N/A
31 May 2002	Unapproved	1,860,000	70.83	31 May 2005	30 May 2012	N/A	N/A
5 June 2002	Unapproved	195,000	70.50	5 June 2005	4 June 2012	N/A	N/A
23 October 2002	Unapproved	1,353,913	62.50	23 October 2005	22 October 2012	N/A	N/A
4 November 2002	Unapproved	714,844	64.00	4 November 2005	3 November 2012	N/A	N/A
6 February 2003	Approved	111,562	75.50	6 February 2006	5 February 2013	18.40	4.10
		<u>10,846,661</u>					

A summary of the status of the 1998 Executive Share Option Approved and Unapproved Schemes as at 31 December 2005 and changes during the year is presented below:

	31 December 2005		31 December 2004	
	Number of options	Weighted average exercise price (pence)	Number of options	Weighted average exercise price (pence)
Outstanding at start of year	12,530,675	76.9	12,930,786	77.1
Forfeited	(253,514)	77.8	(18,556)	75.5
Exercised	(938,000)	69.8	(10,000)	74.0
Expired	(492,500)	73.6	(371,555)	85.0
Outstanding at end of year	10,846,661	77.70	12,530,675	76.9

The number of options exercisable at the end of the year was 10,735,099 (2004: 5,396,938).

The weighted average exercise price of options exercisable at the end of the year was 77.7p (2004: 87.8p).

The weighted average share price at date of exercise during the year was 85.8p (2004: 80.3p).

A summary of the range of exercise prices of the outstanding options and their remaining contractual lifetimes is presented below:

	31 December 2005			31 December 2004		
	Number of options	Weighted average exercise price (pence)	Weighted average remaining contractual life (years)	Number of options	Weighted average exercise price (pence)	Weighted average remaining contractual life (years)
Range of exercise prices for outstanding options						
62.5p to 95.0p	9,613,285	70.6	5.9	11,297,299	70.9	6.9
95.0p to 142.5p	1,233,376	132.3	3.7	1,233,376	132.3	4.7
62.5p to 142.5p	10,846,661	77.7	5.6	12,530,675	76.9	6.7

The fair value of each award granted after 7 November 2002 was estimated on the date of grant using a lattice-based option valuation model. No performance criteria have been applied to these particular awards so no adjustment is needed in their fair valuation. The assumptions used to value the grants made after 7 November 2002 are shown below:

Date of grant	Risk-free interest rate	Expected Volatility	Dividend Yield	Turnover	Performance adjustment
15 January 2003	4.2%	35.0%	6.0%	5.0%	0%
6 February 2003	3.9%	35.0%	6.0%	5.0%	0%

(v) Brit 1998 Approved Executive Share Option Scheme – Part B (“the Part B Approved Scheme”) (formerly Wren Approved Share Option Scheme 1998) and Brit 1998 Unapproved Executive Share Option Scheme – Part B (“the Part B Unapproved Scheme”) (formerly Wren Unapproved Share Option Scheme 1998)

The Part B Approved Scheme is a discretionary share option scheme approved by HM Revenue & Customs and the Part B Unapproved Scheme is a discretionary share option scheme not approved by HM Revenue & Customs. Options granted under the Part B Approved Scheme were not subject to performance criteria. Options granted under the Part B Unapproved Scheme were subject to performance criteria (other than those granted on 18 May 1998) determined by the board of Wren Limited. Options are generally exercisable between three and ten years from the date of grant (with the exception of those granted on 18 May 1998). All option holders accepted rollover terms granting them options over shares in the Company on 21 September 1999. It is not expected that any future options will be granted under these schemes.

Outstanding options granted at nil cost are as follows:

Date of grant	Approved/Unapproved Scheme	Number of shares under option	Exercise price per 25p share (pence)	Date from which exercisable	Expiry date
14 August 1998	Unapproved	117,500	130.50	14 August 2001	13 August 2008
10 September 1998	Approved	343,947	112.00	10 September 2001	9 September 2008
		461,447			

	31 December 2005		31 December 2004	
	Number of options	Weighted average exercise price (pence)	Number of options	Weighted average exercise price (pence)
Outstanding at start of year	834,422	117.3	1,111,587	117.4
Expired	(372,975)	118.0	(277,165)	117.6
Outstanding at end of year	461,447	116.7	834,422	117.3

The number of options exercisable at the end of the year was 461,447 (2004: 834,422).

The weighted average exercise price of options exercisable at the end of the year was 116.7p (2004: 117.3p).

As there were no options exercised during the year (2004: nil) a weighted average share price at date of exercise has not been presented.

A summary of the range of exercise prices of the outstanding options and their remaining contractual lifetimes is presented below:

	31 December 2005			31 December 2004		
	Number of options	Weighted average exercise price (pence)	Weighted average remaining contractual life (years)	Number of options	Weighted average exercise price (pence)	Weighted average remaining contractual life (years)
Range of exercise prices for outstanding options						
112.0p to 130.5p	461,447	116.7	2.7	834,422	117.3	3.7

(vi) Brit Long Term Incentive Plan 1999 ("the LTIP")

Following shareholder approval of the PSP in 2003, no further awards will be made under the LTIP.

The final award made on the LTIP vested during 2005 and hence there are no outstanding awards as at 31 December 2005.

The LTIP was controlled by the Remuneration Committee, which set performance targets in respect of all allocations. The LTIP was established under a discretionary Employee Benefit Trust set up for the provision of benefits and assistance to employees of the Company and its subsidiaries. Further details of the Trust are disclosed above.

36 Subsidiary undertakings

Details of the Group's principal subsidiaries are as follows:

Name of company	Nature of business	Proportion of ordinary shares held by the Company %	Proportion of ordinary shares held by subsidiary %
Underwriting companies			
Brit Insurance Limited	Insurance company		100
Brit Insurance (UK) Limited	Insurance company		100
Brit Syndicates Limited	Lloyd's managing agent		100
Brit UW Limited	Lloyd's corporate member		100
Investment company			
Masthead Insurance Underwriting Limited	Intermediate holding company	100	
Distribution companies			
Ri3K Limited	E-commerce solutions company	85.6	
Group services companies			
Brit Group Services Limited	Group services company		100
Open ended investment company			
CF Epic Investment Funds	Open ended investment company		78.2

All companies are registered and operate in England.

All subsidiaries are included in the Group consolidated financial statements.

37 Related party transactions

(i) Directors' interests in share capital

The interests of the Directors and their families in the ordinary shares of 25p each of the Company who held office as at 31 December 2005 are as follows:

	Shares ¹	Held at 31 December 2005		Shares ¹	Held at 31 December 2004	
		Options	PSP		Options	PSP
Chairman						
Clive Coates	190,000	–	–	190,000	–	–
Executive Directors						
Dane Douetil	937,899	2,618,972	1,066,506	934,734	2,220,767	668,301
Matthew Scales	258,768	1,893,413	925,669	255,603	1,612,332	644,588
Non-Executive Directors						
Neil Eckert	7,002,602	2,143,399	894,064	6,435,520	2,143,399	894,064
Peter Hazell	–	–	–	–	–	–
Joe MacHale	–	–	–	–	–	–
Don McCrickard	40,000	–	–	40,000	–	–
Cees Schrauwers	–	–	–	–	–	–
Michael Smith	10,000	–	–	10,000	–	–
Anthony Townsend	352,538	–	–	352,538	–	–

¹ Includes shares held through the Brit All Employee Share Ownership Plan 2001

All Directors' interests in the ordinary shares of the Company are beneficial. Anthony Townsend is also interested in 47,543 (2004: 47,543) units of 8.5% unsecured subordinated loan stock 2008.

As at 31 December 2004 Neil Eckert was interested in 456,761 units of 8.5% Unsecured Subordinated Loan Stock. These were all converted to ordinary shares during 2005. No other Director held any interest in the 8.5% Unsecured Subordinated Loan Stock 2008 as at 31 December 2005 and no Director held any interest in any other Group company.

As at 13 March 2006, the Employee Share Ownership Trust was interested in 2,163,300 ordinary 25p shares in which the Directors who are employees are deemed to be interested by virtue of section 324 of the Companies Act 1985 (see Note 35 of the financial statements).

As at 13 March 2006, the Employee Benefit Trust was interested in 8,809,106 ordinary 25p shares in which the Directors who are employees are deemed to be interested by virtue of section 324 of the Companies Act 1985 (see Note 35 of the financial statements).

(ii) Key management compensation

	Year ended 31 December 2005 £'000	Year ended 31 December 2004 £'000
Salaries and other short-term employee benefits	3,377	3,190
Post-employment benefits	143	143
Share-based payments	209	256
	3,729	3,589

For the purposes of IAS 24, "Related Party Disclosures", key managers are defined as the Board of Directors and members of the Executive Management Committee which is the primary vehicle for implementing Board decisions.

(iii) Loans to related parties

	Year ended 31 December 2005 £'000	Year ended 31 December 2004 £'000
As at 1 January 2005	652	–
Loan advanced during the year	–	652
Loan repayments received	(352)	–
Interest charged	44	–
Interest received	(44)	–
As at 31 December 2005	300	652

The loan has been made to EPIC Investment Partners Limited ("EIP"), a 40.9% owned company which is currently being accounted for as an asset held for sale. Interest has been charged on outstanding balances at an annual rate of 2% above the prevailing six month LIBOR rate.

(iv) Purchases of products and services and arising year-end balances**EPIC Investment Partners Limited and EPIC Asset Management Limited**

During the year, the Group traded with EIP and with EPIC Asset Management Limited ("EPAM") a subsidiary of EIP.

Brit Insurance Holdings PLC charged EIP £314,000 (2004: £250,000) in respect of operational office costs.

EPAM is an Investment Manager regulated by the Financial Services Authority and provided the following services to Brit Insurance Holdings PLC and its subsidiaries:

	Fees charged		Fees outstanding	
	31 December 2005 £'000	31 December 2004 £'000	31 December 2005 £'000	31 December 2004 £'000
Brit Insurance Holdings PLC	136	80	11	10
Brit Syndicates Limited	1,343	1,064	115	100
Masthead Insurance Underwriting Limited	232	255	20	20
Brit Insurance Limited	743	541	80	87
Brit Insurance (UK) Limited	183	61	15	–
	2,637	2,001	241	217

EIP and its subsidiaries also have an agreement with Brit Group Services Limited ("BGS"), a 100% subsidiary of Brit Insurance Holdings PLC, whereby BGS pays certain expenses on behalf of these companies which it then recovers in full. The total of all of these costs amounted to £4,147,000 (2004: £3,359,000), of which £453,000 (2004: £524,000) was outstanding at the balance sheet date.

38 Guarantees and contingent liabilities

(i) Lloyd's

As at 31 December 2005 the following arrangements were in place:

If any of the corporate member subsidiaries fails to meet any of its Lloyd's obligations, after having called on the Group under its guarantees, then:

- (a) Lloyd's will be entitled to require the other corporate member subsidiaries to cease or reduce their underwriting; and/or
- (b) having regard to the fact that the Central Fund or the New Central Fund may be applied to discharge the obligations of the defaulting corporate member subsidiary, Lloyd's will be entitled to require each of the other corporate member subsidiaries to make contributions to the New Central Fund up to the amount of their respective net profits held from time to time in Premium Trust Funds, sufficient to reimburse the Central Fund or the New Central Fund in full for any payment made on behalf of the defaulting member.

At the date of signing these financial statements the Group is not aware of any corporate member subsidiary failing to meet its Lloyd's obligations.

On 26 November 1999, there was a reorganisation of the Group such that:

- (i) all underwriting at Lloyd's is now conducted through one corporate member subsidiary; and
- (ii) all investments and assets supporting the underwriting at Lloyd's are held in one subsidiary, being Masthead Insurance Underwriting Limited ("Masthead").

A number of agreements were entered into in order to achieve this.

A deed of charge was entered into by Masthead with Lloyd's to support the underwriting activities of all corporate member subsidiaries within the Brit Insurance Holdings PLC Group. Masthead entered into deeds of covenant with Lloyd's to cover the run-off liabilities of these corporate members. It also entered into guarantees with respect to inter-available funds of £118,738,728. As at 31 December 2005 the value of these funds was £85,251,000 (2004: £85,251,000).

Lloyd's has the right to retain the income on charged investments, although it is not expected to exercise this right unless it considers there to be a risk that one or more of the covenants might need to be called and, if called, might not be honoured in full.

As at 31 December 2005 the parent company, Brit Insurance Holdings PLC, had given an indemnity to Lloyd's, of up to £63,333,500, in the event that Masthead fails to meet its obligations.

On 28 February 2006 the Group entered into a number of deeds of determination, release and substitution in order to reorganise the covenant and charge arrangements between Masthead, Lloyd's and the corporate members. Following the reorganisation, funds are no longer made interavailable between the ceased corporate members and Brit UW Limited. From 28 February 2006 Masthead provides standalone Funds at Lloyd's for Brit UW Limited by way of a covenant and charge arrangement for £267,014,629, and those ceased corporate members that remain in run-off by way of deposits totalling £4,348,368.

As part of the reorganisation, Brit Insurance Holdings PLC was released from the indemnity given to Lloyd's referred to above.

(ii) Bank borrowings

As detailed in Note 26, Brit Insurance Holdings PLC had an overdraft facility with Barclays Bank PLC at 31 December 2005.

The lender had the following security under the terms of the facility which has priority over those provided to Lloyd's:

- (a) A debenture which includes a fixed charge over assets including the shares held by Brit Insurance Holding PLC in Masthead Insurance
- (b) A memorandum of deposit whereby Brit Underwriting Group Limited deposited its shares in Brit Insurance Limited.

The overdraft facility and related security were cancelled with effect from 4 January 2006.

The Group's managed syndicate, syndicate 2987, maintains a US\$80,000,000 back up facility with Barclays Bank PLC. This provides additional liquidity in the event of substantial catastrophe claims which might give rise to collateralisation of the Credit for Reinsurance Trust Fund regulated trust fund, based upon gross claims. This facility has never been drawn down, however, in the event that it is drawn down the borrowings would be secured on the Syndicate's reinsurance recoveries.

(iii) Letters of Credit

As at 31 December 2005 Brit Insurance Limited had in place a Letter of Credit ("LOC") facility for US\$100,000,000 (2004: US\$100,000,000) with Barclays Bank PLC of which the company had collateralised US\$18,331,000 (2004: US\$4,568,000) at the year end. In addition, Brit Insurance Limited had a further LOC in place for US\$75,000,000 (2004: US\$ nil) with the Royal Bank of Scotland PLC. These facilities support the underwriting of US reinsurance business and aviation excess of loss and are collateralised by a mixture of cash, money market funds and government securities.

39 Reconciliations between UK GAAP and IFRS

(i) Reconciliation of UK GAAP Equity to IFRS Equity as at 31 December 2003

	UK GAAP 31 December 2003 £'000	Adjustments £'000	IFRS 31 December 2003 £'000
Assets			
Intangible assets:			
Syndicate participations	2,236	–	2,236
Software	–	897	897
Goodwill	67,732	3,259	70,991
Property, plant and equipment	4,779	(897)	3,882
Investments in associated undertakings	253	–	253
Reinsurance contracts	325,935	2,011	327,946
Financial investments	1,179,191	(167,826)	1,011,365
Deferred acquisition costs	100,481	3,328	103,809
Taxation	–	227	227
Deferred taxation	18,922	7,263	26,185
Trade and other receivables	446,607	(227)	446,380
Cash and cash equivalents	183,993	164,286	348,279
Total assets	2,330,129	12,321	2,342,450
Liabilities			
Insurance contracts	1,416,850	19,116	1,435,966
Employee benefits	–	15,516	15,516
Borrowings	58,872	(1,703)	57,169
Provisions for other risks and charges	801	–	801
Equalisation provision	5,670	(5,670)	–
Trade and other payables	141,014	10,427	151,441
Total liabilities	1,623,207	37,686	1,660,893
Equity			
Called up share capital	243,513	–	243,513
Share premium account	481,135	–	481,135
Capital redemption reserve	586	–	586
Equity portion of convertible debt	–	1,681	1,681
Own shares	(4,085)	(221)	(4,306)
Retained earnings	(23,625)	(17,427)	(41,052)
Equity shareholders' funds	697,524	(15,967)	681,557
Equity minority interests	9,398	(9,398)	–
Total equity	706,922	(25,365)	681,557
Total liabilities and equity	2,330,129	12,321	2,342,450

(ii) Analysis of adjustments to the Balance Sheet as at 31 December 2003

	Goodwill (Note a) £'000	Investment valuation (Note b) £'000	Claims equalisation provision (Note c) £'000	Share- based payments (Note d) £'000	Convertible debt accounting (Note e) £'000	Accounting for pension obligations (Note f) £'000	Taxation (Note h) £'000	Cash (Note i) £'000	Foreign exchange (Note j) £'000	Other adjustments (Note k) £'000	Total adjustments £'000
Assets											
Intangible assets:											
Syndicate participations	–	–	–	–	–	–	–	–	–	–	–
Software	–	–	–	–	–	–	–	–	–	897	897
Goodwill	3,259	–	–	–	–	–	–	–	–	–	3,259
Property, plant and equipment	–	–	–	–	–	–	–	–	–	(897)	(897)
Investments in associated undertakings	–	–	–	–	–	–	–	–	–	–	–
Taxation	–	–	–	–	–	–	227	–	–	–	227
Deferred tax assets	–	519	(1,701)	33	(376)	4,655	–	–	4,133	–	7,263
Reinsurance contracts	–	–	–	–	–	–	–	–	2,011	–	2,011
Financial investments	–	(3,540)	–	–	–	–	–	(164,286)	–	–	(167,826)
Deferred acquisition costs	–	–	–	–	–	–	–	–	3,328	–	3,328
Trade and other receivables	–	–	–	–	–	–	(227)	–	–	–	(227)
Cash and cash equivalents	–	–	–	–	–	–	–	164,286	–	–	164,286
Total assets	3,259	(3,021)	(1,701)	33	(376)	4,655	–	–	9,472	–	12,321
Liabilities											
Insurance contracts	–	–	–	–	–	–	–	–	19,116	–	19,116
Employee benefits	–	–	–	–	–	15,516	–	–	–	–	15,516
Borrowings	–	–	–	–	(1,703)	–	–	–	–	–	(1,703)
Deferred taxation	–	–	–	–	–	–	–	–	–	–	–
Provisions for other risks and charges	–	–	–	–	–	–	–	–	–	–	–
Equalisation provision	–	–	(5,670)	–	–	–	–	–	–	–	(5,670)
Trade and other payables	–	–	–	–	–	–	–	–	–	10,427	10,427
Total liabilities	–	–	(5,670)	–	(1,703)	15,516	–	–	19,116	10,427	37,686
Equity											
Called up share capital	–	–	–	–	–	–	–	–	–	–	–
Share premium account	–	–	–	–	–	–	–	–	–	–	–
Capital redemption reserve	–	–	–	–	–	–	–	–	–	–	–
Equity portion of convertible debt	–	–	–	–	1,681	–	–	–	–	–	1,681
Own shares	–	–	–	(221)	–	–	–	–	–	–	(221)
Retained earnings	3,259	(3,021)	3,969	254	(354)	(10,861)	–	–	(9,644)	(1,029)	(17,427)
Equity shareholders' funds	3,259	(3,021)	3,969	33	1,327	(10,861)	–	–	(9,644)	(1,029)	(15,967)
Equity minority interests	–	–	–	–	–	–	–	–	–	(9,398)	(9,398)
Total equity	3,259	(3,021)	3,969	33	1,327	(10,861)	–	–	(9,644)	(10,427)	(25,365)
Total liabilities and equity	3,259	(3,021)	(1,701)	33	(376)	4,655	–	–	9,472	–	12,321

(iii) Reconciliation of UK GAAP Equity to IFRS Equity as at 31 December 2004

	UK GAAP 31 December 2004 £'000	Adjustments £'000	IFRS 31 December 2004 £'000
Assets			
Intangible assets:			
Syndicate participations	502	–	502
Software	–	7,672	7,672
Goodwill	59,631	11,360	70,991
Property, plant and equipment	11,194	(7,672)	3,522
Investments in associated undertakings	1,570	24	1,594
Reinsurance contracts	326,048	853	326,901
Financial investments	1,748,970	(535,245)	1,213,725
Deferred acquisition costs	110,436	1,497	111,933
Trade and other receivables	499,372	–	499,372
Cash and cash equivalents	97,785	531,405	629,190
Total assets	2,855,508	9,894	2,865,402
Liabilities			
Insurance contracts	1,851,516	8,116	1,859,632
Employee benefits	–	18,470	18,470
Borrowings	51,654	16,795	68,449
Taxation	–	1,456	1,456
Deferred taxation	10,837	(6,325)	4,512
Provisions for other risks and charges	533	–	533
Equalisation provision	3,933	(3,933)	–
Trade and other payables	216,822	(27,132)	189,690
Total liabilities	2,135,295	7,447	2,142,742
Equity			
Called up share capital	243,518	–	243,518
Share premium account	311,145	–	311,145
Capital redemption reserve	586	–	586
Equity portion of convertible debt	–	1,681	1,681
Own shares	(5,615)	(1,878)	(7,493)
Retained earnings	160,341	12,882	173,223
Equity shareholders' funds	709,975	12,685	722,660
Equity minority interests	10,238	(10,238)	–
Total equity	720,213	2,447	722,660
Total liabilities and equity	2,855,508	9,894	2,865,402

(iv) Analysis of adjustments to the Balance Sheet as at 31 December 2004

	Goodwill (Note a) £'000	Investment valuation (Note b) £'000	Claims equalisation provision (Note c) £'000	Share- based payments (Note d) £'000	Convertible debt accounting (Note e) £'000	Accounting for pension obligations (Note f) £'000	Dividends (Note g) £'000	Taxation (Note h) £'000	Cash (Note i) £'000	Foreign exchange (Note j) £'000	Other adjustments (Note k) £'000	Total adjustments £'000
Assets												
Intangible assets:												
Software	–	–	–	–	–	–	–	–	–	–	7,672	7,672
Goodwill	11,360	–	–	–	–	–	–	–	–	–	–	11,360
Property, plant and equipment	–	–	–	–	–	–	–	–	–	–	(7,672)	(7,672)
Investments in associated undertakings	–	–	–	–	–	–	–	–	–	–	24	24
Reinsurance contracts	–	–	–	–	–	–	–	–	–	853	–	853
Financial investments	–	(3,840)	–	–	–	–	–	–	(531,405)	–	–	(535,245)
Deferred acquisition costs	–	–	–	–	–	–	–	–	–	1,497	–	1,497
Cash and cash equivalents	–	–	–	–	–	–	–	–	531,405	–	–	531,405
Total assets	11,360	(3,840)	–	–	–	–	–	–	–	2,350	24	9,894
Liabilities												
Insurance contracts	–	–	–	–	–	–	–	–	–	8,116	–	8,116
Employee benefits	–	–	–	–	–	18,470	–	–	–	–	–	18,470
Borrowings	–	–	–	–	(1,426)	–	–	–	–	–	18,221	16,795
Taxation	–	–	–	–	–	–	–	1,456	–	–	–	1,456
Deferred taxation	–	(537)	1,180	(72)	375	(5,541)	–	–	–	(1,730)	–	(6,325)
Equalisation provision	–	–	(3,933)	–	–	–	–	–	–	–	–	(3,933)
Trade and other payables	–	122	–	–	–	–	(19,305)	(1,456)	–	–	(6,493)	(27,132)
Total liabilities	–	(415)	(2,753)	(72)	(1,051)	12,929	(19,305)	–	–	6,386	11,728	7,447
Equity												
Equity portion of convertible debt	–	–	–	–	1,681	–	–	–	–	–	–	1,681
Own shares	–	–	–	(1,878)	–	–	–	–	–	–	–	(1,878)
Retained earnings	11,360	(3,425)	2,753	1,950	(630)	(12,929)	19,305	–	–	(4,036)	(1,466)	12,882
Equity shareholders' funds	11,360	(3,425)	2,753	72	1,051	(12,929)	19,305	–	–	(4,036)	(1,466)	12,685
Equity minority interests	–	–	–	–	–	–	–	–	–	–	(10,238)	(10,238)
Total equity	11,360	(3,425)	2,753	72	1,051	(12,929)	19,305	–	–	(4,036)	(11,704)	2,447
Total liabilities and equity	11,360	(3,840)	–	–	–	–	–	–	–	2,350	24	9,894

(v) Reconciliation of profit on ordinary activities after tax for the year ended 31 December 2004

	Note	Year ended 31 December 2004 £'000
Profit on ordinary activities after tax reported under UK GAAP		72,033
Reversal of goodwill amortisation	a	
Subsidiaries		8,101
Associated company		24
Valuation of investments	b	(421)
Equalisation provision	c	(1,737)
Share-based payments	d	1,029
Convertible debt	e	(277)
Employee benefits	f	(16)
Foreign exchange movements	j	8,012
Other adjustments	k	(714)
Net tax effect		(1,568)
Total adjustments net of tax		12,433
Profit on ordinary activities after tax reported under IFRS		84,466

(vi) Notes to the reconciliations between IFRS and UK GAAP

The UK GAAP consolidated balance sheets have been presented in a format consistent with IFRS. No changes have been made to the previously reported numbers for UK GAAP and the analysis of the adjustments is based on UK GAAP as at 31 December 2004.

a) Business combinations and goodwill

Brit has elected to apply IFRS 3 "Business Combinations" to all business combinations entered into from 1 January 2003. Accordingly, all business combinations from this date have been restated.

Under IAS 36 "Impairment of Assets", goodwill is no longer amortised over its useful economic life but is tested, at least annually, for impairment. The amount of goodwill carried forward as at 31 December 2003 amounted to £70,991,000.

b) Investments

Under UK GAAP, the value of financial investments is stated in the financial statements on the following basis:

- Listed investments are stated at closing middle market prices on recognised stock exchanges
- Unlisted investments are stated at cost or Directors' valuation.

All gains and losses are reflected in the income statement under UK GAAP.

As a result of applying IAS 39 "Financial Instruments: Recognition and Measurement", the Group now carries all listed investments in debt and equity securities at fair value, stated at closing bid prices on recognised stock exchanges. This change in the valuation of securities has a decrease in value at 31 December 2004 of £4,388,000.

The Group has designated its investments at fair value through the profit and loss which is in accordance with the Group's documented investment strategy. Information relating to investments is provided to the Group's Directors and key managers on this basis. Realised and unrealised gains and losses arising from changes in the fair value of investments in this category are included in the income statement in the period in which they arise.

The Group has entered into a number of derivative contracts which have been recognised on the balance sheet under UK GAAP at cost. In accordance with IAS 39 these contracts have now been recognised on the balance sheet at their fair value. This change in the valuation of derivatives increases investments by £548,000 at 31 December 2004. Changes in the fair value of derivative instruments are recognised immediately in the income statement.

c) Reversal of equalisation provision

Under UK GAAP an equalisation provision is recorded in the accounts of UK general insurance companies to eliminate or reduce the volatility in incurred claims arising from exceptional levels of claims in certain classes of business. The annual change in the equalisation provision is recorded in the UK GAAP profit and loss account. Under IFRS, no equalisation provision is recorded, as no actual liability exists at the balance sheet date. Elimination of the claims equalisation provision results in an increase to shareholders' equity of £2,753,000 at 31 December 2004. The effect on the income statement is to decrease profit before tax by £1,737,000 for the year ended 31 December 2004.

d) Share-based payments

Under UK GAAP the cost of shares awarded to participants of the Group's performance share plans are amortised on a straight-line basis over the lives of the related schemes. For the year ending 31 December 2004 this amortisation totalled £1,657,000.

Under IFRS 2 "Share-Based Payments", charges in respect of share-based compensation plans that were granted after 7 November 2002, but had not yet vested at 1 January 2005, are determined based on the fair value of the share-based compensation at grant date and are recognised in the income statement over the vesting period of the expected life of the share based instrument.

e) Convertible debt instrument

Under UK GAAP the convertible unsecured subordinated loan stock ("CULS") are recognised as a single instrument in the 31 December 2004 balance sheet of £44,115,000.

Under IAS 32 "Financial Instruments: Disclosure and Presentation" the CULS are separated into component parts, being a financial liability and equity. At 31 December 2004 the debt liability recognised in the balance sheet had reduced by £1,426,000.

Overall, this change in accounting treatment has resulted in an increase in shareholders' equity of £1,051,000 at 31 December 2004. Profit before tax decreases by £277,000 for the year ended 31 December 2004.

f) Employee benefits

Under IAS 19 "Employee Benefits", the projected benefit obligation is matched against the fair value of the underlying assets and other unrecognised actuarial gains and losses in determining the pension expense for the year. Any pension asset or obligation must be recorded in the balance sheet.

This change in accounting has resulted in the recognition of a deficit of £12,929,000 at 31 December 2004, net of deferred tax, valued in accordance with IAS 19.

g) Dividend recognition

Under UK GAAP, equity dividends are accrued in the period to which they relate regardless of when they are declared and approved. Under IAS 10 "Events after the Balance Sheet Date", shareholders' dividends are accrued only when declared and appropriately approved. This has increased shareholders' funds by £19,305,000 at 31 December 2004.

h) Taxation

Under UK GAAP, provision is made for deferred tax assets and liabilities, using the liability method, arising from timing differences between the recognition of gains and losses in the financial statements and their recognition in a tax computation. Deferred tax is recognised as a liability or asset if the transactions or events that give the entity an obligation to pay more tax in future or a right to pay less tax in future have occurred by the balance sheet date.

Under IAS 12 "Income Taxes", deferred taxes are provided under the liability method for all relevant temporary differences, being the difference between the carrying amount of an asset or liability in the balance sheet and its value for tax purposes. IAS 12 does not require a provision on all temporary differences. Deferred tax assets are recognised for unused tax losses and other deductible temporary differences to the extent that it is probable that future taxable profit will be utilised against the unused tax losses and credits.

i) Reclassification of cash

IFRS requires a number of presentational changes to cash. Amounts of the Group's investments totalling £531,405,000 at 31 December 2004 meet the definition of cash equivalents and so have been reclassified to "cash and cash equivalents" from "investments".

j) Rates of exchange

Under IFRS, functional currency is defined as the currency of the primary economic environment in which the entity operates. The functional currency for all entities of the Group has been deemed to be sterling.

Under IAS 21 "The Effects of Changes in Foreign Exchange Rates" foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions or at the average rate for the period when this is a reasonable approximation. Monetary assets and liabilities denominated in foreign currencies are translated at period end exchange rates. Non-monetary assets and liabilities that are measured at historical cost denominated in a foreign currency are not retranslated. The resulting exchange differences on translation are recorded in the income statement.

Under IFRS unearned premium and deferred acquisition costs are non-monetary liabilities and assets and are therefore not retranslated from the historic exchange rates. This change in accounting has resulted in a decrease to shareholders' equity of £9,644,000 at 31 December 2004 (2003: £4,036,000).

k) Other adjustments

Under IAS 27 "Consolidated and Separate Financial Statements" where losses attributable to the minority in a consolidated subsidiary exceed the minority interest in the subsidiary's equity, the excess is allocated against the majority interest except to the extent that the minority interest has a binding obligation, and is able, to make an additional investment to cover the losses. This has an impact of a decrease of £461,000 to profit before tax attributable to equity shareholders of the parent company for the year ended 31 December 2004.

A number of adjustments required under IFRS relate primarily to presentational or reclassification changes which have no impact on shareholders' equity.

Under IFRS, acquired computer software licences and costs that are directly associated with the production of identifiable and unique software products controlled by the Group are classified as intangible assets. Under UK GAAP these products were classified as tangible assets and reclassified under IFRS with no impact on shareholders' funds.

l) Consolidated cash flow statement

The Group has reflected the changes to the above items in preparing the restated consolidated cash flow statement. In addition, under IFRS, the consolidated cash flow statement reconciles cash and cash equivalents less any outstanding overdrafts compared to UK GAAP where the reconciliation made was of cash and investment portfolio movements.

Consolidated cash flow statements previously prepared under UK GAAP did not include syndicate cash flows and cash held within Lloyd's Premium Trust Funds. These amounts are included under IFRS and comparatives have been amended accordingly to reflect this.

Independent Auditor's Report to the Shareholders of Brit Insurance Holdings PLC

We have audited the group financial statements of Brit Insurance Holdings PLC for the year ended 31 December 2005 which comprise the Group Income Statement, the Group Statement of Recognised Income and Expense, the Group Balance Sheet, the Group Cash Flow Statement and the related Notes 1 to 39. These group financial statements have been prepared under the accounting policies set out therein.

We have reported separately on the parent company financial statements of Brit Insurance Holdings PLC for the year ended 31 December 2005 and on the information in the Directors' Remuneration Report that is described as having been audited.

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

Respective responsibilities of directors and auditors

The Directors are responsible for preparing the Annual Report and the group financial statements in accordance with applicable United Kingdom law and International Financial Reporting Standards ("IFRSs") as adopted by the European Union as set out in the Statement of Directors' Responsibilities.

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

We report to you our opinion as to whether the group financial statements give a true and fair view and whether the group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation. We also report to you if, in our opinion, the Directors' Report is not consistent with the group financial statements, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding director's remuneration and other transactions is not disclosed.

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

We read other information contained in the Annual Report and consider whether it is consistent with the audited group financial statements. The other information comprises only the Directors' Report, the Corporate Governance Statement, the Audit Committee Report and the Nomination Committee Report. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the group financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

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

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

Opinion

In our opinion the group financial statements:

- give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's affairs as at 31 December 2005 and of its profit for the year then ended; and
- have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation.

Ernst & Young LLP
Registered auditor
London
14 March 2006

Statement of Directors' Responsibilities in respect of the Company

Company Law requires Directors to prepare financial statements for each financial year, which give a true and fair view of the state of affairs of the Company at the end of the financial period and of the profit/loss of the Company for the year. The financial statements must be prepared in compliance with the required format and disclosures of the Companies Act 1985 and with applicable accounting standards (UK GAAP).

In addition, the Directors are required to:

- select suitable accounting policies and apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the accounts; and
- prepare financial statements on a going concern basis unless it is inappropriate to assume the Company will continue in business.

The Directors confirm that the financial statements comply with the above requirements.

The Directors are responsible for maintaining adequate accounting records which disclose with reasonable accuracy at any time the financial position of the Company to enable them to ensure that the financial statements comply with the requirements of the Companies Act 1985. They are also responsible for safeguarding the assets of the Company and for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are also responsible for ensuring the annual report includes information required by the Listing Rules of the Financial Services Authority.

Balance Sheet of the Company

as at 31 December 2005

	Note	As at 31 December 2005 £'000	As at 31 December 2004 £'000 (restated)
Fixed asset investments:			
Investments in subsidiary undertakings	2	507,754	506,854
Investments in Group undertakings		1,798	738
Investments in associated undertakings	3	703	1,055
Financial investments	4	17,335	28,141
		527,590	536,788
Current assets:			
Debtors	5	272,071	329,737
Prepayments and accrued income		100	26
Cash at bank and in hand		142,223	210
		414,394	329,973
Creditors: Amounts falling due within one year			
Bank overdrafts		–	18,221
Deferred taxation	6	655	20
Amounts owed to group undertakings		81,815	131,038
Accruals and deferred income		3,526	2,197
		85,996	151,476
Net current assets		328,398	178,497
Total assets less current liabilities		855,988	715,285
Creditors: Amounts falling due after more than one year			
Other creditors including convertible debt	7	194,213	50,228
Net assets		661,775	665,057
Capital and reserves:			
Called up share capital	8	245,236	243,518
Share premium account	9	314,758	311,145
Capital redemption reserve	9	586	586
Equity portion of convertible debt	9	–	1,681
Own shares	9 & 11	(7,247)	(7,190)
Employee share reserve	9	7,033	6,926
Profit and loss account	9	101,409	108,391
Equity Shareholders' funds	10	661,775	665,057

The financial statements were approved by the Board of Directors on 14 March 2006 and were signed on its behalf by

Clive Coates
Chairman

Matthew Scales
Finance Director

Notes to the Financial Statements

1 Accounting policies

Basis of preparation

The separate financial statements of the Company are presented as required by the Companies Act 1985. They have been prepared in accordance with applicable United Kingdom accounting standards and law.

The balance sheet of the Company has been prepared in accordance with Schedule 4 to the Companies Act 1985. No profit and loss account is presented for the Company as permitted by Section 230 of the Companies Act. The profit dealt with in the accounts of the parent company was £38,738,000 (2004 (restated): £2,512,000).

Changes in accounting policy

The continuing convergence of UK GAAP and International Financial Reporting Standards ("IFRS") has led to the introduction of Financial Reporting Standard 20 'Share based payments' ("FRS 20"), Financial Reporting Standard 21 'Events after the balance sheet date' ("FRS 21"), Financial Reporting Standard 22 'Earnings per share' ("FRS 22") and Financial Reporting Standard 23 'Foreign exchange rates' ("FRS 23"), Financial Reporting Standard 25 'Financial Instruments: Disclosure and Presentation' ("FRS 25"), and Financial Reporting Standard 26 'Financial Instruments: Measurement' ("FRS 26").

The requirements of FRS 20 are applicable to the Company for reporting periods beginning on or after 1 January 2005. As a result of this standard, the Company recognises the grant of equity instruments and the capital contribution to its Group undertaking where the Company grants equity settled payment transactions to employees of the Group undertaking. In addition, the Company recognises on its balance sheet own shares funded by a Group undertaking purchased for a Trust that is sponsored by the Company.

The balance sheet for 31 December 2004 has been restated and the financial effect has been to increase net assets and shareholders' funds by £738,000.

The requirements of FRS 21 are applicable to the Company for reporting periods beginning on or after 1 January 2005. As a result of this standard, dividends which are declared after the balance sheet date are to be disclosed, but not recognised as a liability.

The balance sheet for 31 December 2004 has been restated and the financial effect has been to increase net assets and shareholders' funds by £19,305,000.

The requirements of FRS 22 are applicable to the Company for reporting periods beginning on or after 1 January 2005. There are no financial impacts or disclosure on the adoption of this standard.

The requirements of FRS 23 are applicable to the Company for reporting periods beginning on or after 1 January 2005. There are no financial impacts or disclosure on the adoption of this standard.

The requirements of FRS 25 are applicable to the Company for reporting periods beginning on or after 1 January 2005. FRS 25 requires an entity to split a compound financial instrument into separate liability and equity components compared to UK GAAP where they are treated as a single instrument. The Company has applied this change in accounting policy to its convertible loan stock.

The balance sheet for 31 December 2004 has been restated and the financial effect has been to increase shareholders' funds by £1,051,000. Profit before tax decreases by £277,000 for the year ended 31 December 2004. At 31 December 2004 the debt liability recognised in the balance sheet has reduced by £1,426,000.

The requirements of FRS 26 are applicable to the Company for reporting periods beginning on or after 1 January 2005. On adoption of this standard, the Company has designated all of its financial assets held for investment purposes as fair value through the profit and loss ("FVTPL") at inception. The Company has taken advantage of the exemption in FRS 26 which allows previously recognised assets to be classified as FVTPL at the date of adoption of the standard.

There are no financial impacts on the adoption of this standard.

Other accounting policies

(i) Investments

(a) Classification and valuation

The Company has designated its financial assets held for investment purposes ("investments") as FVTPL which is in accordance with the Company's documented investment strategy. Information relating to investments is provided internally to the Company's Directors and key managers on this basis.

The fair values of quoted financial investments are based on current bid prices.

If the market for an investment is not active, the Company establishes fair value by using valuation techniques such as recent arm's length transactions, reference to similar listed investments, discounted cash flow models or option pricing models.

Unquoted equity investments are initially carried at cost as the best estimate of fair value and are adjusted thereafter whenever events or changes in circumstances indicate that the carrying amount may not approximate to fair value.

Gains and losses on investments designated as FVTPL are recognised through the income statement. Investments are held on the balance sheet at fair value.

Subsidiary undertakings and associated undertakings are valued at cost.

(b) Investment return

Interest income is recognised using the effective interest method. Dividend income is recognised when the shareholders' right to receive the payment is established.

(c) Realised gains and losses

Realised gains and losses on investments are calculated as the difference between net sales proceeds and original cost.

(ii) Income taxes

Income tax comprises current and deferred tax.

(a) Current income tax

Items of income/gain and expenditure/loss are recognised and assessable to corporation tax in the same period, after adjustment in accordance with tax legislation.

(b) Deferred tax

Deferred tax is provided in full on timing differences which result in an obligation at the balance sheet date to pay more tax, or a right to pay less tax, at a future date, at rates expected to apply when they crystallise based on current tax rates and law. Timing differences arise from the inclusion of items of income and expenditure in taxation computations in periods different from those in which they are included in the financial statements. Deferred tax is not provided on timing differences arising from the revaluation of fixed assets where there is no commitment to sell the asset, or on unremitted earnings of subsidiaries and associates where there is no commitment to remit those earnings. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes relate to the same fiscal authority.

Deferred tax assets and liabilities are not discounted.

(iii) Own shares

The consideration paid for the acquisition of own shares has been deducted from shareholders' funds.

(iv) Fees and other income

Fees and other income are recognised in the period to which they relate.

(v) Expenses

All expenses are accounted for on an accruals basis. Expenses which are incidental to the acquisition or disposal of an investment are treated as part of the cost or proceeds of the investment.

(vi) Foreign currency translation

The financial statements are presented in sterling which is the Company's presentation and functional currency.

Foreign currency transactions are recorded using the exchange rates prevailing at the dates of the transactions or at the average rate for the period when this is a reasonable approximation. Monetary assets and liabilities denominated in foreign currencies are translated at period end exchange rates. Non-monetary assets and liabilities that are measured at historical cost denominated in a foreign currency are not retranslated. The resulting exchange differences on translation are recorded in the profit and loss account.

(vii) Recognition and derecognition of financial assets and financial liabilities

Financial assets and financial liabilities are recognised when the Company becomes a party to the contractual provisions of the contract.

A financial asset is derecognised when either the contractual rights to the asset's cash flows expire, or the asset is transferred and the transfer qualifies for derecognition under a combination of risks and rewards and control tests.

A financial liability is derecognised when it is extinguished which is when the obligation in the contract is discharged, cancelled or expired.

All regular way purchases and sales of financial assets are recognised on the trade date, i.e. the date that the Company commits to purchase or sell the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the marketplace.

(viii) Borrowings

Borrowings are initially recognised at fair value, net of transaction costs incurred and subsequently stated at amortised cost. Fair value is normally determined by reference to the fair value of the proceeds received. Any difference between the initial carrying amount (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

The fair value of the liability portion of convertible loan stock is determined by discounting contractual cash outflows using an equivalent non-convertible bond. This amount is carried as a liability on an amortised cost basis until extinguished on conversion or redemption. The remainder of the proceeds is allocated to the conversion option and is recognised and included in shareholders' equity. Transaction costs are apportioned between the liability and equity components of the convertible loan stock based on the allocation of proceeds to the liability and equity components when the instruments are first recognised.

(ix) Pension scheme contributions

The Company receives recharges in respect of defined benefit and defined contribution Group schemes which are charged to the profit and loss in the period the recharge is made.

(x) Dividend distribution

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

2 Investments in subsidiary undertakings

	31 December 2005 £'000	31 December 2004 £'000 (restated)
Cost	508,855	507,955
Provision for permanent diminution in value	(1,101)	(1,101)
	507,754	506,854

Details of the Company's principal subsidiaries are as follows:

Name of company	Nature of business	Proportion of ordinary shares held by the Company %	Proportion of ordinary shares held by subsidiary %
Underwriting companies			
Brit Insurance Limited	Insurance company		100
Brit Insurance (UK) Limited	Insurance company		100
Brit Syndicates Limited	Lloyd's managing agent		100
Brit UW Limited	Lloyd's corporate member		100
Investment company			
Masthead Insurance Underwriting Limited	Intermediate holding company	100	
Distribution companies			
RI3K Limited	E-commerce solutions company	85.6	
Group services companies			
Brit Group Services Limited	Group services company		100
Open ended investment company			
CF Epic Investment Funds	Open ended investment company		78.2

All companies are registered and operate in England.

3 Investments in associated undertakings

Investments in associated undertakings consist entirely of the Company's interest in EPIC Investment Partners Limited ("EIP") (formerly the Equity Partnership Limited).

The carrying value of associated undertakings in the Company balance sheet is made up as follows:

	31 December 2005 £'000	31 December 2004 £'000 (restated)
Cost	403	403
Loans to associated undertaking	300	652
	703	1,055

EPIC Investment Partners Limited

The Company owns 40.9% of the ordinary share capital of EIP.

As at the balance sheet date, EIP had issued £440,000 of preference shares to a third party. Since 10 March 2004, these preference shares pay a dividend of 5% per annum. EIP is prevented from paying a dividend on the ordinary shares until the preference shares have been repaid in full.

The company's principal activity is that of an investment manager. The company's accounting reference date is 31 December. It is registered and operates in England.

4 Financial Investments

	31 December 2005		31 December 2004	
	Market value £'000	Cost £'000	Market value £'000 (restated)	Cost £'000 (restated)
Shares and other variable-yield securities :				
Listed	15,649	14,081	25,722	29,508
Unlisted	105	5,451	1,115	7,440
Debt securities and other fixed income securities :				
Listed	1,581	942	1,304	942
	17,335	20,474	28,141	37,890

If the investments held at 31 December 2005 had been sold at that date, there would have been no liability to tax.

The movement in the Company's financial investments during the year were as follows:

	31 December 2005 £'000	31 December 2004 £'000 (restated)
Market value at 1 January	28,141	63,005
Purchases	–	56,417
Sales	(17,511)	(93,057)
Sales – realised losses on sales	(1,361)	(421)
Reduction in unrealised losses	8,066	2,197
Market value at 31 December	17,335	28,141

5 Debtors

Amounts receivable within one year:

	31 December 2005 £'000	31 December 2004 £'000 (restated)
Amounts owed by Group undertakings	270,646	329,515
Taxation	1,250	–
Other debtors	175	222
	272,071	329,737

6 Deferred taxation

	31 December 2005 £'000	31 December 2004 £'000 (restated)
Unrealised gains/(losses) on investments	280	(355)
Unsecured loan stock	375	375
	655	20
Undiscounted deferred tax provision at the start of the year	20	80
Deferred tax charge/(credit) in profit and loss account for the year	635	(60)
Provision at the end of the year	655	20

In determining the deferred tax position, it has been assumed that group relief will be available between companies within the Group.

The Company did not recognise deferred tax assets on capital losses (realised and unrealised) and other timing differences as follows:

	31 December 2005 £'000	31 December 2004 £'000 (restated)
Capital losses	1,834	1,270

7 Other creditors

	Maturity	Effective interest rate %	31 December 2005 Amortised cost £'000	31 December 2005 Fair value £'000	31 December 2004 Amortised cost £'000 (restated)	31 December 2004 Fair value £'000 (restated)
Amounts payable between two and five years:						
8.5% unsecured subordinated loan stock	2008	9.50	38,644	43,131	42,689	47,822
US dollar floating rate unsecured subordinated loan notes	2034	US dollar 3 month LIBOR + 3.5	8,508	8,721	7,539	7,812
Amounts payable after five years:						
Lower Tier Two subordinated debt	2030	6.84	147,061	152,207	–	–
			194,213	204,059	50,228	55,634

Fair values represent the trading market values at the balance sheet date.

8.5% unsecured subordinated loan stock

The unsecured subordinated loan stock ("ULS") was formerly known as convertible unsecured subordinated loan stock ("CULS") until all conversion rights ceased to be exercisable from 21 November 2005. The loan stock was convertible at the rate of 123.46 ordinary shares for every £100 nominal of loan stock.

The ULS pays interest to holders at a rate of 8.5%. The amount charged to the income statement using the effective interest method and the fair value of the liability element shown above have been determined using an interest rate of 9.5%.

The movement in the ULS during the year is as follows:

	31 December 2005 £'000	31 December 2004 £'000 (restated)
Liability component brought forward	42,689	42,169
Interest expense	4,180	4,362
Interest paid	(3,549)	(3,836)
Conversions	(4,676)	(6)
Liability component at year end	38,644	42,689

On 12 January 2006, the Company announced a tender offer to purchase all of the outstanding ULS at 109p for every £1 nominal amount of ULS. 19,584,970 ULS units were validly tendered and following subsequent market purchases at 109p, 20,011,551 ULS units remain outstanding as at 14 March 2006.

US dollar floating rate unsecured subordinated loan notes

The US dollar floating rate unsecured subordinated loan notes amounted to US\$15,000,000 and were issued by the Company on 28 June 2004.

Lower Tier Two subordinated debt

The Lower Tier Two subordinated debt was issued by the Company on 9 December 2005.

It is callable in whole by the Company on 9 December 2020 or following this date the interest rate resets at 340 basis points above the 10-year gilt rate prevailing at the time. The effective interest rate method of accounting has been applied over the term up to this call date.

8 Share capital

	31 December 2005 £'000	31 December 2004 £'000	31 December 2005 Number '000	31 December 2004 Number '000
Authorised:				
Ordinary shares of 25p each	350,000	350,000	1,400,000	1,400,000
Allotted, issued and fully paid:				
Ordinary shares of 25p each	245,236	243,518	980,942	974,072
Number of ordinary shares of 25p each allotted, issued and fully paid:				
			2005 Number	2004 Number
At 1 January			974,071,862	974,053,647
Exercised share options			938,000	10,000
Converted unsecured loan stock			5,932,443	8,215
At 31 December			980,942,305	974,071,862

9 Reserves

	Share premium account £'000	Capital redemption reserve £'000	Equity portion of convertible debt £'000	Own shares £'000	Employee share reserve £'000	Profit and loss account £'000	Total £'000
Balance at 1 January 2005 as previously reported	311,145	586	–	(264)	–	88,978	400,445
Prior year adjustment	–	–	1,681	(6,926)	6,926	19,413	21,094
Balance at 1 January 2005 as restated	311,145	586	1,681	(7,190)	6,926	108,391	421,539
Issue of shares	3,613	–	–	–	–	–	3,613
Vesting of own shares	–	–	–	50	–	–	50
Employee shares purchased	–	–	–	(107)	107	–	–
Capital contribution on the granting of equity instruments	–	–	–	–	–	1,060	1,060
Expiry of loan stock conversion period	–	–	(1,681)	–	–	1,681	–
Profit for the year	–	–	–	–	–	38,738	38,738
Dividends	–	–	–	–	–	(48,461)	(48,461)
At 31 December 2005	314,758	586	–	(7,247)	7,033	101,409	416,539

The Company had distributable reserves of £59,765,000 at 31 December 2005 (2004: £68,405,000).

On 3 March 2006 the Company made an application to the High Court to transfer £180,000,000 from the share premium account to the retained earnings account.

10 Reconciliation of Equity Shareholders' funds

	31 December 2005 £'000	31 December 2004 £'000 (restated)
Issue of shares	5,331	15
Vesting of own shares	50	181
Capital contribution on the granting of equity instruments	1,060	738
Profit for the year	38,738	2,512
Dividends	(48,461)	(38,762)
Total movements during the year	(3,282)	(35,316)
Opening Equity Shareholders' funds as previously reported	643,963	699,045
Prior year adjustment	21,094	1,328
Opening Equity Shareholders' funds as restated	665,057	700,373
Closing Equity Shareholders' funds	661,775	665,057

11 Own shares

The Trustees of the Brit Performance Share Plan 2003, Executive Share Option Scheme 2003 and Long Term Incentive Plan 1999 acquire Brit Insurance Holdings PLC shares in accordance with the terms of the Trust. The number of shares held at 31 December 2005 was 8,809,106 (2004: 8,876,139) with a market value, based on mid-market value, of £7,840,104 (2004: £7,012,150)

The Trustees of the Brit All Employee Share Ownership Plan 2001 acquire Brit Insurance Holdings PLC shares in accordance with the terms of that trust. The number of unvested free and matching shares held at 31 December 2005 was 951,289 (2004: 784,622) with a market value, based on mid-market value, of £846,647 (2004: £619,851).

	31 December 2005 £'000	31 December 2004 £'000 (restated)
Performance Share Plan, Executive Share		
Option Scheme and Long Term Incentive Plan	6,522	6,572
All Employee Share Ownership Plan	725	618
	7,247	7,190

12 Staff costs

	31 December 2005 £'000	31 December 2004 £'000 (restated)
Wages and salaries	5,097	5,888
Social security costs	624	474
Other pension costs	1,197	643
	6,918	7,005

The above costs relate to staff costs recharged by Brit Group Services Limited, the Group services company.

The average monthly number of employees during the year, including Executive Directors, was as follows:

	31 December 2005 Number	31 December 2004 Number (restated)
Management	16	16
Administration	52	44
	68	60

13 Directors emoluments

	Year end 31 December 2005							2004 Total £'000 (restated) ¹
	Fees & salaries £'000	Benefits in kind £'000	Bonus £'000	Car Allowance £'000	Pension £'000	Salary supplement £'000	2005 Total £'000	
Current Directors								
Chairman								
Clive Coates	127	–	–	–	–	–	127	120
Executive Directors								
Dane Douetil	412	1	221	8	21	26	689	640
Matthew Scales	312	12	140	–	31	26	521	606
Non-Executive Directors								
Neil Eckert ²	346	10	95	–	41	–	492	851
Peter Hazell	65	–	–	–	–	–	65	30
Joe MacHale ³	6	–	–	–	–	–	6	–
Don McCrickard	91	–	–	–	–	–	91	88
Cees Schrauwers ⁴	25	–	–	–	–	–	25	–
Michael Smith	53	–	–	–	–	–	53	36
Anthony Townsend	101	–	–	–	–	–	101	84
Former Directors								
Glyn MacAulay ⁵	20	–	–	–	–	–	20	65
Total for the Year	1,558	23	456	8	93	52	2,190	2,520

¹ The comparatives have been restated to reflect remuneration of the directors who were in office on 1 January 2005 and not those who served for part of 2004.

² Neil Eckert resigned as an Executive Director on 31 December 2005 and took up a position as a Non-Executive Director on 1 January 2006.

³ With effect from appointment, 9 November 2005.

⁴ With effect from appointment, 1 June 2005.

⁵ Until cessation of directorship, 19 April 2005.

14 Pensions

(i) Defined Benefit Scheme

The Group operates a funded pension scheme providing benefits for some of its employees based on final pensionable emoluments. The assets of the Scheme are held in a separate Trustee administered fund. Each separate company within the Group is however unable to identify its share of the underlying assets and liabilities of the scheme.

This scheme closed to new entrants on 4th October 2001. The scheme is subject to a formal actuarial valuation every three years and the results of the valuation carried out as at 31 July 2003 were updated to the accounting date by an independent qualified actuary in accordance with FRS 17. As required by FRS 17, the value of the defined benefit liabilities have been measured using the projected unit method. The actuarial valuation updated for 31 December 2005 showed that the scheme had a deficit of £22,818,000 (2004: 18,470,000) before deferred tax.

The Company is recharged an appropriate amount of the Group cost of the scheme in proportion to the usage of Group staff resources during the year.

(ii) Defined Contributions Stakeholder Scheme

The Group operates a defined contribution stakeholder pension scheme. The assets of the scheme are held separately from those of the Company in an independently administered fund. The Company is recharged an appropriate amount of the Group cost of the scheme in proportion to the usage of Group staff resources during the year.

(iii) Funded Unapproved Retirement Benefits Scheme ("FURBS")

The Group operates a defined contribution FURBS, into which additional contributions are paid in respect of certain employees. The assets of the scheme are held separately from those of the Company in an independently administered fund. The Company is recharged an appropriate amount of the Group cost of the scheme in proportion to the usage of Group staff resources during the year.

15 Auditors' remuneration

	Ernst & Young LLP £'000	31 December 2005 Other auditors £'000	Mazars LLP £'000	31 December 2004 Other auditors £'000
Audit services:				
Statutory audit	122	61	106	–
Audit-related regulatory reporting:				
IFRS Reporting	106	–	–	–
Further assurance services:				
IFRS advisory	4	–	–	28
Capital raising	35	–	–	–
Tax services:				
Compliance services	13	95	52	–
Advisory services	–	56	–	1
	280	212	158	29

Ernst & Young LLP was appointed as auditor on 24 May 2005, following the resignation on that date of Mazars LLP.

16 Guarantees and contingent liabilities

(i) Lloyd's

As at 31 December 2005 the Company had given an indemnity to Lloyd's of up to £63,333,500, in the event that Masthead Insurance Underwriting Limited, a subsidiary, failed to meet its obligations.

As part of a reorganisation on 28 February 2006 the Company was released from this indemnity.

(ii) Bank borrowings

As at 31 December 2005 the Company had an overdraft facility with Barclays Bank PLC.

The lender had the following security under the terms of the facility which has priority over those provided to Lloyd's:

- A debenture which includes a fixed charge over assets including the shares held by Brit Insurance Holding PLC in Masthead Insurance Underwriting Limited and Brit Underwriting Group Limited and a floating charge over the remaining assets of the Company.
- A memorandum of deposit whereby Brit Underwriting Group Limited deposited its shares in Brit Insurance Limited.

The overdraft facility and related security were cancelled with effect from 4 January 2006.

17 Dividends

The Directors in their meeting dated 14 March 2006 approved a proposal to be put before the Annual General Meeting of shareholders, to be held on 25 April 2006, the payment of a final dividend of 3.0p per share for the year ended 31 December 2005 to all shareholders on the register on 24 March 2006. Based on the number of shares in issue as at 14 March 2006, but excluding those owned by the Company's Employee Benefit Trust which has waived its entitlement to dividends, this would amount to £29,186,000.

Independent Auditor's Report to the Shareholders of Brit Insurance Holdings PLC

We have audited the parent company financial statements of Brit Insurance Holdings PLC for the year ended 31 December 2005 which comprise the Balance Sheet and the related Notes 1 to 17. These parent company financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' Remuneration Report that is described as having been audited.

We have reported separately on the group financial statements of Brit Insurance Holdings PLC for the year ended 31 December 2005.

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

Respective responsibilities of directors and auditors

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

Our responsibility is to audit the parent company financial statements and the part of the Directors' Remuneration Report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

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

We read other information contained in the Annual Report and consider whether it is consistent with the audited parent company financial statements. The other information comprises only the Directors' Report and the unaudited part of the Directors' Remuneration Report. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the parent company financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

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

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

Opinion

In our opinion:

- the parent company financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the company's affairs as at 31 December 2005; and
- the parent company financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985.

Ernst & Young LLP
Registered auditor
London
14 March 2006

Company Information

Chairman

Clive Frederick Coates [□]

Executive Directors

Dane Jonathan Douetil
Chief Executive Officer

Matthew Scales
Finance Director

Non-Executive Directors

Neil David Eckert

Peter Frank Hazell ^{*□+}

Joseph Patrick MacHale ⁺

Donald Cecil McCrickard ^{*□+}
Senior Independent Director

Drs Cornelis Antonius Carolus Maria Schrauwers ("Ceas") ^{*}

Michael Gordon Smith ^{□+}

John Anthony Victor Townsend Anthony ^{*□+}

^{*} member of the Audit Committee
[□] member of the Nomination Committee
⁺ member of the Remuneration Committee

Secretary

Peter John Goddard
T: 020 7984 8741
peter.goddard@britinsurance.com

Investor Relations

Paul Gildersleeves
T: 020 7984 8763
paul.gildersleeves@britinsurance.com

Registered Office

55 Bishopsgate
London EC2N 3AS

Company Number

3121594

Stockbrokers

Citigroup Global Markets Limited
Citigroup Centre
Canada Square
Canary Wharf
London E14 5LB

Numis Securities Limited
Cheapside House
138 Cheapside
London EC2V 6LH

Registrars

Lloyds TSB Registrars
The Causeway
Worthing
West Sussex BN99 6DA

Auditor

Ernst & Young LLP
1 More London Place
London SE1 2AF

Investment Managers

EPIC Asset Management Limited
22 Billiter Street
London EC3M 2RY

EPIC Specialist Investments Limited
22 Billiter Street
London EC3M 2RY

Close Private Asset Management Limited
10 Crown Place
London EC2A 4FT

Artemis Investment Management Limited
28 Melville Street
Edinburgh EH3 7HA

Ruffer LLP
Nations House
103 Wigmore Street
London W1U 1QS

Bankers

Barclays Bank plc
1 Churchill Place
London
E14 5HP

Royal Bank of Scotland Group plc
City of London Office
1 Princes Street
London EC2R 8PA

This document does not constitute or form part of, and should not be construed as, an offer for sale or subscription of, or solicitation of any offer or invitation or advice or recommendation to subscribe for, underwrite or otherwise acquire or dispose of any securities (including options or 8.5% Unsecured Subordinated Loan Stock 2008) of the Company nor any other body corporate nor should it or any part of it form the basis of, or be relied on in connection with, any contract or commitment whatsoever which may at any time be entered into by the recipient or any other person, nor does it constitute an invitation or inducement to engage in investment activity under section 21 of the Financial Services and Markets Act 2000. This document does not constitute an invitation to effect any transaction with the Company or to make use of any services provided by the Company. Past performance cannot be relied on as a guide to future performance.

