

WATKINS SYNDICATE

**ANNUAL ACCOUNTS
FOR THE YEAR ENDED 31 DECEMBER 2006**

**M.C. WATKINS AND OTHERS
SYNDICATE 457**

Managed by Munich Re Underwriting Limited

CONTENTS

Directors and Administration	2
Report of the Directors of the Managing Agent	3
Statement of Managing Agent's Responsibilities	8
Report of the Independent Auditors	9
Profit and Loss Account	11
Balance Sheet	13
Statement of Cash Flows	15
Notes to the Accounts	16

DIRECTORS AND ADMINISTRATION

MANAGING AGENT:

Managing Agent
Munich Re Underwriting Limited

Directors

J H Rochman	Non-Executive Chairman
T E Artmann	Non-Executive Director
T Coskun, MSc, ACA	Compliance Officer and Company Secretary
O J Crabtree, ACII	Joint Active Underwriter
W F Goodier	Non-Executive Director
R W R Grande, BSc, ACA, MBA, ACII	Managing Director
N J T Gray, BSc, ACA	Finance Director
D J R Hoare, BA, ACII	Joint Active Underwriter
A C Maxwell	Director
M C Watkins, FCII	Group Chief Executive

Company Secretary

T Coskun, MSc, ACA

Managing Agent's Registered Office
St. Helens, 1 Undershaft, London EC3A 8EE
Telephone: 020 7886 3900 ♦ Facsimile: 020 7886 3901
E-mail: central@mrunderwriting.com
Website: www.watkins-syndicate.co.uk

Managing Agent's Registered Number
1328742

SYNDICATE:

Joint Active Underwriters

O J Crabtree
D J R Hoare

Bankers

Citibank N.A.

Investment Managers

EPIC Asset Management Limited and Mellon

Registered Auditors

Ernst & Young LLP, London

REPORT OF THE DIRECTORS OF THE MANAGING AGENT

The directors of the managing agent present their report for the year ended 31 December 2006.

This annual report is prepared using the annual basis of accounting as required by Statutory Instrument No 3219 of 2004, the Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2004 ("the 2004 Regulations").

RESULTS

The profit for calendar year 2006 is £33.4m (2005 – loss of £9.8m). Profits will continue to be distributed by reference to the results of individual underwriting years.

PRINCIPAL ACTIVITY AND REVIEW OF THE BUSINESS

The Syndicate's principal activity during the year remained the transaction of general insurance and reinsurance business.

The Syndicate's key financial indicators are as follows:

	2006	2005
Gross Written Premium	£322.7m	£248.2m
Profit/(Loss) for the financial year	£33.4m	(£9.8m)
Combined Ratio	88.4%	108.6%

The improvement in the Syndicate's combined ratio reflects the changes in the market trading environment following the windstorm season of 2005 and a low incidence of catastrophe losses in 2006. In order to take advantage of the improved underwriting conditions gross written premium increased by £74.5 million to £322.7 million, however the core underwriting philosophy of the Syndicate was broadly unchanged, with the focus of the portfolio being marine insurance and reinsurance. The Syndicate is involved in all classes of marine insurance business although the Syndicate's exposure to the Blue water hull market is very restricted.

It should be noted that despite significant reductions of aggregate exposures, particularly in the energy sector of the Syndicate account, premium volumes are broadly unchanged from the previous year.

The recruitment of a Yacht underwriter in late 2005 lead to the development of an international yacht portfolio within the Syndicate to compliment the existing book of business written by one of the Group Service Companies. During the latter part of 2006 the Syndicate employed a specialist transport and logistics liability underwriter, however the real impact of this new account will be seen in 2007 and subsequent years.

In addition rating conditions improved in most sectors of the market that the Syndicate is active in contributing to the overall improvement in performance.

REPORT OF THE DIRECTORS OF THE MANAGING AGENT (continued)

The following table provides a breakdown of gross written premiums:

Direct insurance:	2006	2005
	%	%
• Marine, Aviation and Transport	80.2	78.4
• Fire and Other Damage to Property	7.4	6.7
• Third Party Liability	8.3	5.2
Reinsurance	4.1	9.7
	-----	-----
	100.0	100.0
	=====	=====

The Syndicate continues to purchase an extensive reinsurance programme that is designed to protect the largest anticipated exposure from a single risk or a multiple loss event.

Subject to market capacity, reinsurance terms and conditions, the Syndicate reinsurance is placed with the highest quality security available. In order to achieve this the Syndicate utilises a mixture of Lloyd's syndicates, UK authorised reinsurance companies and international reinsurance companies. Some of the international companies are EU authorised insurers. The following table provides an analysis of paid reinsurance premiums for 2005 and 2006.

	2006	2005
	%	%
Lloyd's Syndicates	39.0	35.5
UK Authorised Companies	11.0	9.0
EU Companies (other than UK)	30.0	45.4
Other Insurance Companies	20.0	10.1
	-----	-----
	100.0	100.0
	=====	=====

2005 HURRICANE SEASON

A breakdown of the impact of the 2005 windstorm season on the Syndicate portfolio is detailed in Note 3. The Syndicate established loss reserves on a policy-by-policy basis, however there has been some deterioration in the figures during the course of 2006. This is predominantly as a result of escalating repair costs, increased costs attributable to removal of debris and the late reporting of some claims. It is clear that this trend has slowed considerably and further significant movement is not expected.

Throughout 2006 trading conditions improved in most sectors of the account. However there are clear indications that rates have peaked in most sectors of the marine market and in some areas rates are already under pressure. The Syndicate is closely monitoring market conditions and will continue its practice of cycle management.

REPORT OF THE DIRECTORS OF THE MANAGING AGENT (continued)

PRINCIPAL RISKS AND UNCERTAINTIES

The Board sets risk appetite annually as part of the syndicate's business planning and Individual Capital Assessment process. The managing agent has established a Risk Committee which meets monthly to review and update the risk register and to monitor performance against risk appetite. The agency is required to comply with the requirements of the Financial Services Authority, Lloyd's and overseas regulators, particularly in respect of US situs business. The principal risks and uncertainties facing the Syndicate are monitored in line with the 6 risk groups identified by the Financial Services Authority.

Credit Risk

Credit risk relates to the risk of loss if another party fails to perform its obligations or fails to perform them in a timely fashion. Key counterparties include reinsurers, brokers, insureds, reinsureds, coverholders and investment counterparties. The Board's policy is that the Syndicate will only reinsure with businesses that have been approved for that purpose. The Review Committee, a sub-committee of the Board, assesses and approves all new reinsurers before business is placed with them.

Market Risk

Market risk is the risk that arises from fluctuations in values of or income from assets, in interest rates or in exchange rates. The investment portfolio and returns are regularly reviewed and reports are submitted to the Board.

Operational Risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. Risks are managed through the use of detailed procedures manuals and a structured programme of testing of processes and systems by internal audit.

Insurance Risk

Insurance risk is the risk of loss arising from the inherent uncertainties about the occurrence, amount and timing of insurance liabilities and premiums. The Board manages insurance risk by agreeing its appetite for those risks annually through the business plan which sets out targets for volumes, pricing, line sizes and retention by class of business. The Board then monitors performance against the business plan monthly through the year. The agency uses catastrophe modelling software to model maximum probable losses from catastrophe exposed business. The syndicate actuary monitors reserve adequacy.

Liquidity Risk

Liquidity risk is the risk that sufficient financial resources are not maintained to meet liabilities as they fall due. To mitigate this risk a cash flow model is produced from the syndicate's systems and monitored by the finance director. The Board discusses cash flow on a quarterly basis, or more frequently as required.

Group Risk

Group risk is the potential of risk events, of any nature, arising in or from membership of a corporate group. Close dialogue exists with the casualty and marine division of Munich Reinsurance Company to discuss any necessary issues. There is a regular flow of information between the syndicate and Munich Reinsurance Company.

REPORT OF THE DIRECTORS OF THE MANAGING AGENT (continued)

DIRECTORS

The Directors of the managing agent who served during the year ended 31 December 2006 were as follows:

T E Artmann
T Coskun
O J Crabtree
W F Goodier
R W R Grande
N J T Gray
D J R Hoare
A C Maxwell (appointed 10 November 2006)
J H Rochman
M C Watkins

INVESTMENTS

Investment Policy And Managers

The investment policy of the Syndicate is to maximise the return without exposing the funds to a high degree of credit or liquidity risk. Investment in equities is not permitted at the present time.

Mellon manages the US and Canadian dollar funds. The benchmark for the US dollar funds during 2006 was the Merrill Lynch 1 to 3 years Government/Corporates index. The maximum permitted average life is 3 years and the minimum credit quality permitted is 'A' grade as classified by Moody's and/or Standard & Poor's rating services. Further restrictions apply to the maximum exposure to individual non-government issuers.

The benchmark for the Resident and Non-Resident Canadian dollar trust funds is the Merrill Lynch 1 to 3 years Government Bond index. The maximum permitted average life is 2 years, and the minimum credit quality permitted is 'A' grade as classified by Moody's and/or Standard & Poor's rating services. Further restrictions apply to the maximum exposure to individual non-government issuers.

EPIC Asset Management Limited manages the Sterling funds. The Sterling benchmark is a blend of the Merrill Lynch Constant Maturity 2 months Sterling LIBID index (55%) and the Merrill Lynch 1 to 3 Years Gilt Index (45%). The maximum permitted average life is 2 years, and the minimum credit quality permitted is 'A' grade as classified by Moody's and/or Standard & Poor's rating services.

Further restrictions apply to the maximum exposure to individual non-government issuers.

Investment Performance

The 2006 calendar year investment performance is as follows:

CURRENCY	FUND RETURN	BENCHMARK RETURN
	%	%
US dollars	4.3	4.2
Canadian dollars Non- Resident Fund	3.7	3.8
Sterling	4.2	3.9

REPORT OF THE DIRECTORS OF THE MANAGING AGENT (continued)

FUTURE DEVELOPMENTS

The Syndicate will continue to transact the current classes of general insurance and reinsurance business. If opportunities arise to write new classes of business, these will be investigated at the appropriate time.

DISCLOSURE OF INFORMATION TO THE AUDITORS

So far as each person who was a director of the managing agent at the date of approving this report is aware, there is no relevant audit information, being information needed by the auditor in connection with its report, of which the auditor is unaware. Having made enquiries of fellow directors of the agency and the syndicate's auditor, each director has taken all the steps that he/she is obliged to take as a director in order to make himself/herself aware of any relevant audit information and to establish that the auditor is aware of that information.

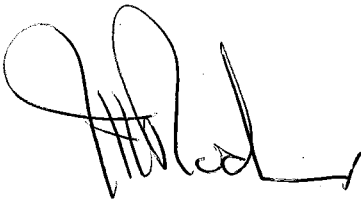
SYNDICATE ALLOCATED CAPACITY AND MEMBERSHIP OF THE SYNDICATE

The capacity of the Syndicate for the 2007 Account is £260m (2006: £260m). All of the capacity of the Syndicate is provided by Munich Re Capital Limited, an indirect subsidiary of Munich Re.

AUDITORS

Ernst & Young LLP has signified its willingness to continue in office as the independent auditor to the Syndicate and it is the managing agent's intention to reappoint Ernst & Young LLP for a further year.

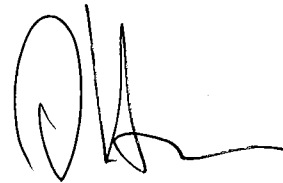
Approved by a resolution of the Board of Directors of Munich Re Underwriting Limited and signed on its behalf.



J. H. Rochman
Chairman
14 March 2007



O.J. Crabtree, ACII
Joint Active Underwriter
14 March 2007



D.J.R. Hoare, ACII
Joint Active Underwriter
14 March 2007

STATEMENT OF MANAGING AGENT'S RESPONSIBILITIES

The managing agent is responsible for preparing the syndicate annual accounts in accordance with applicable law and regulations.

The Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2004 require the managing agent to prepare syndicate annual accounts at 31 December each year in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). The annual accounts are required by law to give a true and fair view of the state of affairs of the syndicate as at that date and of its profit or loss for that year.

In preparing the syndicate annual accounts, the managing agent is required to:

1. select suitable accounting policies and then apply them consistently;
2. make judgements and estimates that are reasonable and prudent;
3. state whether applicable UK accounting standards have been followed, subject to any material departures disclosed and explained in the annual accounts; and
4. prepare the annual accounts on the basis that the syndicate will continue to write future business unless it is inappropriate to presume that the syndicate will do so.

The managing agent is responsible for keeping proper accounting records, which disclose with reasonable accuracy at any time the financial position of the syndicate and enable it to ensure that the syndicate annual accounts comply with the 2004 Regulations. It is also responsible for safeguarding the assets of the syndicate and hence for taking reasonable steps for prevention and detection of fraud and other irregularities.

The managing agent is responsible for the maintenance and integrity of the corporate and financial information included on the business' website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF SYNDICATE 457

We have audited the syndicate's annual accounts for the year ended 31 December 2006, which comprise the Profit and Loss Account, the Balance Sheet, the Cash Flow Statement, the Statement of Total Recognised Gains and Losses and the related notes 1 to 19. These accounts have been prepared under the accounting policies set out therein.

This report is made solely to the syndicate's members, as a body, in accordance with the Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2004. Our audit work has been undertaken so that we might state to the syndicate'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 syndicate's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of the managing agent and auditors

The managing agent's responsibilities for the preparation of the annual accounts in accordance with applicable United Kingdom law and Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Managing Agent's Responsibilities.

Our responsibility is to audit the annual accounts 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 annual accounts give a true and fair view and have been properly prepared in accordance with the Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2004. We also report to you whether in our opinion the information given in the Report of the Directors of the Managing Agent is consistent with the annual accounts.

In addition we report to you if, in our opinion, the managing agent in respect of the syndicate 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 remuneration of directors of the managing agent and other transactions is not disclosed.

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

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the annual accounts. It also includes an assessment of the significant estimates and judgements made by the directors of the managing agent in the preparation of the annual accounts, and of whether the accounting policies are appropriate to the syndicate'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 annual accounts 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 annual accounts.

■ The UK firm Ernst & Young LLP is a limited liability partnership registered in England and Wales with registered number OC300001 and is a member practice of Ernst & Young Global. A list of members' names is available for inspection at the above address which is the firm's principal place of business and its registered office.

Opinion

In our opinion:

- the annual accounts give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the syndicate's affairs as at 31 December 2006 and of its profit for the year then ended;
- the annual accounts have been properly prepared in accordance with the Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2004; and
- the information given in the Report of the Directors of the Managing Agent is consistent with the annual accounts.

Ernst & Young LLP

Ernst & Young LLP
Registered Auditor
London
14 March 2007

**PROFIT AND LOSS ACCOUNT: TECHNICAL ACCOUNT –
GENERAL BUSINESS
FOR THE YEAR ENDED 31 DECEMBER 2006**

	Notes	£000	2006 £000	£000	2005 £000
Earned premiums, net of reinsurance					
Gross premiums written	3		322,726		248,225
Outward reinsurance premiums			(83,058)		(50,591)
Net premiums written			<u>239,668</u>		<u>197,634</u>
Change in the provision for unearned premiums:					
Gross amount			(25,434)		(12,133)
Reinsurers' share			(6,179)		3,433
Change in the net provision for unearned premiums			<u>(31,613)</u>		<u>(8,700)</u>
Earned premiums, net of reinsurance			208,055		188,934
Allocated investment return transferred from the non-technical account			9,207		6,414
Claims incurred, net of reinsurance					
Claims paid					
Gross amount		(243,407)		(139,556)	
Reinsurers' share		158,485		57,758	
Net claims paid		<u>(84,922)</u>		<u>(81,798)</u>	
Change in the provision for claims					
Gross amount		101,397		(251,155)	
Reinsurers' share		(123,174)		182,866	
Change in the net provision for claims		<u>(21,777)</u>		<u>(68,289)</u>	
Claims incurred, net of reinsurance			(106,699)		(150,087)
Net operating costs	3,5		<u>(77,120)</u>		<u>(55,054)</u>
Balance on the technical account for general business			<u>33,443</u>		<u>(9,793)</u>

All operations are continuing.

**PROFIT AND LOSS ACCOUNT: NON-TECHNICAL ACCOUNT
FOR THE YEAR ENDED 31 DECEMBER 2006**

	Notes	2006 £000	2005 £000
Balance on the general business technical account		33,443	(9,793)
Investment income	8	10,555	8,905
Unrealised gains on investments		317	64
Investment expenses and charges	9	(934)	(1,349)
Unrealised losses on investments		(731)	(1,206)
Allocated investment return transferred to general business technical account		(9,207)	(6,414)
		<u>33,443</u>	<u>(9,793)</u>
Profit/(Loss) for the financial year		<u><u>33,443</u></u>	<u><u>(9,793)</u></u>

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

	Notes	2006 £000	2005 £000
Profit/(Loss) for the financial year		33,443	(9,793)
Exchange differences on foreign currency net investment		2,714	(1,300)
		<u>36,157</u>	<u>(11,093)</u>
Total recognised gains and losses since last annual report		<u><u>36,157</u></u>	<u><u>(11,093)</u></u>

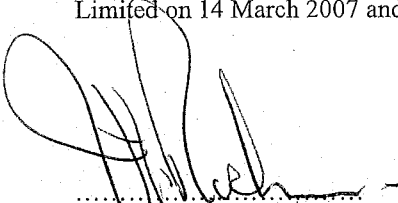
BALANCE SHEET – ASSETS AT 31 DECEMBER 2006

	Notes	2006 £000	2005 £000
Investments			
Financial investments	10	190,857	212,974
Deposits with ceding undertakings		221	171
Reinsurers' share of technical provisions			
Provision for unearned premiums		4,617	11,697
Claims outstanding	4	124,258	272,208
		<hr/>	<hr/>
		128,875	283,905
Debtors			
Debtors arising out of direct insurance operations	11	133,108	119,754
Debtors arising out of reinsurance operations		25,839	20,459
Other debtors		927	4,650
		<hr/>	<hr/>
		159,874	144,863
Other assets			
Cash at bank and in hand		11,904	19,773
Other	12	10,136	7,424
Prepayments and accrued income			
Accrued interest		242	183
Deferred acquisition costs		35,293	25,928
Other prepayments and accrued income		4,291	3,295
		<hr/>	<hr/>
		39,826	29,406
Total assets		<hr/> <hr/>	<hr/> <hr/>
		541,693	698,516

BALANCE SHEET – LIABILITIES AT 31 DECEMBER 2006

	Notes	£000	2006 £000	£000	2005 £000
Capital and reserves					
Members' balances	13,19		2,913		25,463
Technical provisions					
Provision for unearned premiums		136,508		122,624	
Claims outstanding	4	369,094		521,486	
			<u>505,602</u>		<u>644,110</u>
Creditors					
Creditors arising out of direct insurance operations	14	10,699		8,625	
Creditors arising out of reinsurance operations		21,992		14,484	
Other creditors		337		5,808	
			<u>33,028</u>		<u>28,917</u>
Accruals and deferred income			150		26
			<u>541,693</u>		<u>698,516</u>
Total liabilities			<u><u>541,693</u></u>		<u><u>698,516</u></u>

The financial statements on pages 11 to 28 was approved by the Board of Munich Re Underwriting Limited on 14 March 2007 and was signed on its behalf by



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J H Rochman

14 March 2007

**STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2006**

	Notes	2006 £000	2005 £000
Net cash inflow from operating activities	15	50,994	32,479
Transfer to members in respect of underwriting participations		(58,737)	(19,623)
Financing:			
Continuous solvency transfer		-	7,244
		<u>(7,743)</u>	<u>20,100</u>
		<u><u>(7,743)</u></u>	<u><u>20,100</u></u>
 Cash flows were invested as follows:			
(Decrease)/Increase in cash holdings	16	(6,090)	9,617
Increase in overseas deposits		3,249	2,039
(Decrease)/Increase in net portfolio investments	17	(4,902)	8,444
		<u>(7,743)</u>	<u>20,100</u>
		<u><u>(7,743)</u></u>	<u><u>20,100</u></u>

