Heritage

Heritage Underwriting Agency plc

Annual Report
For the year ended 31st December 2005

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Officers and Professional Advisers

Directors	J L Kavanaugh *(Non-Executive Chairman)* B J Cook *(Non-Executive)* N G A Denniston *(Finance Director)* J C Hays *(Non-Executive)* C G James *(Non-Executive)* R A Pexton *(Chief Executive)* S A Shaw *(Non-Executive)*
Secretary	B Rose
Company Number	3741768
Registered office	Knollys House 3rd Floor 47 Mark Lane London EC3R 7QQ
Auditors	CLB Littlejohn Frazer Chartered Accountants 1 Park Place Canary Wharf London E14 4HJ
Solicitors	Clyde & Co Beaufort House Chertsey Street Guildford Surrey GU1 4HA
Bankers	The Royal Bank of Scotland Plc 62/63 Threadneedle Street London EC2R 8LA
Registrars	Computershare Investor Services Plc P.O. Box 82 The Pavilions Bridgwater Road Bristol BS99 7NH

Key Financial Information

Financial Highlights

	2005 £'m	Restated 2004 £'m
● Consolidated (loss)/profit before tax	(5.3)	3.4
Impact of hurricane Katrina on the result was a loss of £(14.2m)		
● Total consolidated (loss)/profit after tax	(3.5)	1.8
● Return on equity	(18)%	14%
● Earnings per share	(13)p	11p
● Net Tangible Assets per share	60p	72p

Operational Highlights

	2005 £'m	2004 £'m
● Capacity of managed syndicates	208	204
● Heritage Group Share of capacity	51	16
● Combined ratio	119%	105%
● Combined ratio (excluding hurricane Katrina impact)	90%	–

Outlook for 2006

- 11% growth in capacity on 2005 to give a capacity of £230m for 2006 year of account.
- Further planned growth in 2006 to increase capacity for 2006 year of account to £265m representing a 27% increase over 2005.
- Heritage share of capacity increased from 2005 by 25% to give £64m capacity on 2006 year of account (27.8% of stamp). The planned growth taking this to approximately £99m (37% of stamp).

Chief Executive's Statement

The exceptional US hurricane activity has made 2005 a year of major development and challenge to the group. This has now created an environment of significant profit opportunity for Heritage moving forward. Consequently we wrote to you on 3rd May 2006 setting out our future plans to form, subject to Lloyd's and capital providers' approval, a new mid year syndicate, which will write business alongside existing Syndicate 1200. The Board intends to raise additional long term capital to fund the new Syndicate thereby increasing your Company's commitment to its managed syndicates at Lloyd's. To this end, the Company is considering raising capital through an AIM listing. An extraordinary general meeting of shareholders was held on 19th June 2006 at which the necessary resolutions for implementing the capital raising were approved.

Our financial performance for the 2005 financial year has been impacted by the unprecedented hurricane losses in our core underwriting markets. The human cost of these events has been devastating. The estimated cost to the industry of US$80bn is the largest in history. As a result of these events we are now seeing insurance rates in catastrophe zones increasing dramatically and we are planning to increase the capacity we manage for 2006 from £230 million to £265 million (2005: £208 million) to take advantage of these favourable conditions, a 27% increase on 2005 capacity.

HUA has borne its share of these Hurricane losses which is reflected in the results for 2005:

- Loss before tax attributable to ordinary shareholders £(5.3) million (2004: £3.4 million (profit restated)), after the impact of the three large 2005 hurricane's Katrina, Wilma and Rita of £(15.2) million.
- Earnings per ordinary share for the year ended 31st December 2005 was a loss of (13)p per ordinary share (2004: restated profit of 11p per ordinary share).
- Net tangible assets per ordinary share decreased by 12p to 60p (72p at 31st December 2004 (restated)).
- Return on ordinary equity was (18)% (2004: 14% profit restated).
- Combined ratio from operations for the year ended 31st December 2005 was 119% (2004: restated 105%).
- Combined ratio from operations excluding 2005 hurricane Katrina for the year ended 31st December 2005 was 90%.

The 2005 year is the first year we significantly increased our own underwriting with our participation on managed syndicates increasing from £16 million to £51 million and we have therefore not had the benefit in 2005 of a material level of profitable underwriting on 2003 and 2004 to offset the losses on 2005. Our current policy is to participate in the underwriting on each Syndicate broadly in proportion to the premium capacity underwritten by each Syndicate. Syndicate 1200 is the largest managed Syndicate accounting for 72% of our 2005 year of account managed premium capacity. As a result, the financial performance of the Group is driven significantly by Syndicate 1200's results for the 2005 underwriting year of account.

US Hurricane Activity

US hurricane activity is having a profound effect on 2006 insurance property prices in loss affected areas of the USA. Elsewhere it had a generally stabilising influence, arresting and reversing the downward trend in prices.

The cost of Hurricanes Katrina, Rita and Wilma (net of reinsurance) to our two Property Syndicates across 2004 and 2005 years of account is £66.7m for Syndicate 1200 and £2.2m for Syndicate 1245 (discontinued). The aggregate scale of these losses was unprecedented and fell outside our normal catastrophe loss allowances. This is evidenced by the table opposite detailing the largest industry losses since 1992.

Chief Executive's Statement

Most expensive insured losses (1992 – 2005) (insured cost adjusted for inflation)

Rank	Year	Event	Region	US$bn
1	2005	Hurricane Katrina; floods damage to levees and oil rigs	US, Gulf of Mexico, Bahamas, North Atlantic	45.0
2	1992	Hurricane Andrew	US, Bahamas	22.3
3	2001	Terror attack on WTC, Pentagon and other buildings	US	20.7
4	1994	Northridge earthquake	US	18.5
5	2004	Hurricane Ivan; damage to oil rigs	US, Caribbean, Barbados et al	11.7
6	2005	Hurricane Rita; floods, damage to oil rigs	US, Gulf of Mexico, Cuba	10.0
7	2005	Hurricane Wilma; torrential rain, floods	US, Mexico, Jamaica, Haiti et al	10.0
8	2004	Hurricane Charley	US, Cuba, Jamaica et al	8.3

Source: Swiss Re

Syndicate 1200 Review

The table below shows the results for Syndicate 1200, our worldwide property insurance business as adjusted for changes in hurricane loss estimates to reflect the most recently available information.

	2005 £m	2004 £m	2003 £m
2005 result earned (on an annual accounting basis) attributable to HUA	(7.9)	(0.2)	–
Stamp	£150	£118	£80
HUA stamp participation percentage	27%	9%	1%
Result/forecast to close			
31st December 2005	(10)% to 0%*	0% to 5%	28%

*Our best estimate is (7.5)% which is not the central point of this range.

- **2003 Underwriting year of account:** we are delighted to report that the 2003 year of account, the Syndicate's second year, has closed at a 28% return on stamp. The result is a significant improvement on the forecast of 23% as at the 31st December 2004 due to the benign development of the account in 2005.

- **2004 Underwriting year of account:** there has been a reduction in the ultimate return on stamp forecast for the 2004 year of account as a result of the 2005 US hurricanes impacting business incepting in the latter part of 2004 which was still in force during 2005.

- **2005 Underwriting year of account:** the forecast is made at a very early stage in the development of the 2005 underwriting year and is severely impacted by 2005 hurricanes. Clearly there is significant unexpired risk which will be exposed to the 2006 wind season and as a result we have assumed in our forecast of the ultimate outturn normalised hurricane losses.

Chief Executive's Statement

The strategy of the team in 2005 was to focus on classes of business and areas of the world where capacity was limited, and hence prices were higher. The Syndicate focused on writing excess layers where there was less pressure from US domestic insurers, as well as growing the non-catastrophe book which offered a number of opportunities.

- **2006 outlook:** the underwriting environment in 2005 was good and whilst the hurricanes have caused significant losses throughout the industry, they have also caused a reduction in capital which has helped stabilise rates in non-catastrophic areas, as well as generating substantial rate increases for 2006 in catastrophe exposed areas.

  This arises as a result of a number of factors. Supply is reduced; however, the demand for cover from customers has not. The cost of buying reinsurance has increased substantially which forces sensible insurers to increase prices.

  We have yet to see increased prices in the worldwide business. The jury is out as to whether this will happen or not as the more monoline catastrophe businesses, such as the reinsurers based in Bermuda, may chase this portfolio to diversify their portfolios.

- **Underwriting strategy:** our aim is to write the most attractive risks, while at the same time minimising both the operational risks and the capital required to support the business. We have a strong catastrophe modelling capability with four people employed full time managing and monitoring our aggregate exposures and modelling scenarios. We continue to develop this area of the business to gain greater knowledge and, therefore, security and competitive advantage. We have recently recruited a new team for Syndicate 1200 which will underwrite personal accident business. This is a long term strategy to add depth and diversity to our existing capability. It is also consistent with our strategy of employing high calibre underwriting teams with top quartile track records.

- **Capital:** The Company supplies underwriting capital of 28% of the stamp for 2006. The remainder is from industry trade reinsurers, Names and shareholders on an annual basis. We view the core reinsurance programme as secondary capital. Hence many of our reinsurers have been with us for some years. Obviously the programme was heavily impacted by Hurricane Katrina. Rates, terms and conditions of reinsurance have tightened significantly in 2006. We manage our exposures to keep the net Lloyd's modelled loss scenarios below 20% of stamp (net of reinsurance recoverable).

Syndicate 3245 Review

The table below shows the results for Syndicate 3245, our professional indemnity business.

	2005	2004	2003
2005 result earned (on an annual accounting basis) attributable to HUA	£0.2m	£0.1m	–
Stamp	£58m	£50m	£15m
HUA stamp participation percentage	17%	4%	0%
Result/forecast to close			
31st December 2005	7% to 13%	7% to 13%	17%

- **2003 Underwriting year of account:** Profit of 17% of stamp is an excellent result in the Syndicate's first year, and a significant improvement to the forecast as at 31st December 2004 of 10%.

- **2004 Underwriting year of account:** There has been a reduction in the ultimate return on stamp for the 2004 year due to a reduced estimate of written premium income; however, this forecast remains upper quartile for its class.

- **2005 Underwriting year of account:** The 2005 account, although at an early stage, is progressing according to plan. Less than 2% of the ultimate profit has been earned on this year of account and so contribution to HUA is small.

Chief Executive's Statement

- **2006 outlook:** The strategy of the Syndicate in 2005 has been to diversify the book by class and territory. We introduced a Financial Institutions team who are being well supported by brokers and clients. We continue to develop the business with more income being underwritten in Commonwealth jurisdictions - Australia, South Africa and Canada. This approach, which began in 2004, is being executed to a well researched plan and is paying dividends as the UK accounts come under pricing pressure.

  The non US liability market has not been affected by the hurricanes in 2004 and 2005. Therefore, some of our competitors are reducing rates to gain bigger shares of this market. We will not adopt this tactic. We do not believe that this will be sustainable for long, and stability in pricing should return in the second half of 2006.

- **Capital:** The Company supplies 27% of the stamp for 2006, up from 17% in 2005. The remainder of the support is annual capital, 43% supplied by Names and 30% by industry trade capital. Regarding the reinsurance programme, the pricing, structure and security of the programme are largely the same as in previous years.

Syndicate 1245 Discontinued Business Review

The table below shows the results for Syndicate 1245. This syndicate was set up for the 2000 year of account following the establishment of the Company in 1999. It underwrote predominantly property and North American casualty business as well as some accident & health, miscellaneous and transport business. The business was closed in 2004. The table below sets out the results for the syndicate:

	2004	2003	2002
2005 result earned (on an annual accounting basis) attributable to HUA	£(0.3)m	–	£(0.2)m
Stamp	£36m	£38m	£44m
HUA stamp participation percentage	11%	7%	3%
Result/forecast to close			
31st December 2005	(19)% to (13)%	(2)% to 3%	(50)% to (45)%

- **2002 Underwriting year of account:** 2002 remains open due to continued uncertainty on North American Casualty business and surety claims. There has been a substantial deterioration in our ultimate forecast due to these classes continuing to show greater adverse development (particularly arising from a major arbitration settlement) than we had previously forecast. We are currently engaged in arbitrations, commutations and negotiations to bring finality to the surety issues.

- **2003 Underwriting year of account:** The 2003 forecast is maintained at a small profit. We have decided to keep this year open with the intent of closing it directly into Syndicate 1200 at the end of 2006. We have taken this decision in consultation with our auditors on the basis of our concern to maintain equity between the capital providers on the 2003 and 2004 year of account. The issues which were uppermost in our minds were the volatility of the casualty classes and the fact that the 2004 year of account would be closing into Syndicate 1200, a separate Syndicate.

- **2004 Underwriting year of account:** In addition to the hurricane losses in 2004 the 2005 US hurricane losses have impacted the 2004 year of account. As Syndicate 1245's last year was 2004, the 2005 calendar year saw the final business attached to the Syndicate, which will run off by the end of 2006. The 2004 result has deteriorated by 4% of stamp capacity since the syndicate report and accounts were issued in March. This reflects an increase in forecasts for non-catastrophe non US property losses.

Chief Executive's Statement

- **Major events in 2005:** The closure plan for the Syndicate was produced early in 2005 and subsequently approved by Lloyd's. This plan continues to be implemented with a multi disciplined team of Heritage staff with the relevant experience and skills. Due to a lack of liquidity we will be making cash calls from capital providers on the 2002 and 2004 loss making years of account. We are working hard to close the open years of account. However, this goal is made difficult by continued deterioration in the early years.

Ownership of HUA

As you know 2005 was a busy year for us with your Company receiving a number of approaches for the Group from prospective offerors. The Board believed these proposals did not reflect a fair value for a controlling shareholding in your Company, and therefore resisted these approaches suffering additional cost and the diversion of key resources away from the business.

In March 2006 we were delighted to welcome HCC Insurance Holdings Inc, as a new major shareholder which acquired a 23% share in the business, being substantially all the ordinary shares owned by Perseverance and Associates. HCC Insurance Holdings Inc, a large Texan AA rated insurer, brings extensive knowledge, experience and support to the Group.

Lloyd's Platform

The Lloyd's Corporation has been examining a new strategy for some time. They wish to create the optimal platform to ensure Lloyd's continues to compete effectively.

Should this strategy be executed effectively, Lloyd's outlines five clear benefits that the Lloyd's platform will deliver:

1. A clear and transparent performance framework
2. Capital advantages
3. A secure, highly rated market
4. Outstanding market access
5. Efficient business processes

We support this initiative and are hopeful that real benefits will be achieved. However, we must bear in mind that costs need to be reduced and capital needs to be flexible.

Lloyd's has unique advantages over its competitors: efficient use of capital, access to a global network of business via its licenses and distribution system, a worldwide brand, and some of the best insurance practitioners in the world. These must be nurtured and capitalised upon, not damaged in the process.

Heritage Platform

We continue to grow the Agency in response to profitable opportunities in the insurance market. Capital management is a pillar of our culture. Should the market become more competitive, putting profit margins under pressure, you will see the Syndicates reduce in size to maintain their return on capital.

Capital utilisation is key to our strategy; we will grow and shrink the capital to match market conditions. This was evidenced by the Agency submitting business plans to Lloyd's for 2006 pre Katrina, showing a 12% reduction in gross premiums. However, knowing that prices would increase after the losses sustained in the hurricanes of 2005, we increased our plans by 10% and we have now taken the decision to increase the underwriting capacity by a further 15% through the formation of a "mid year pre-emption" syndicate.

Chief Executive's Statement

Subject to regulatory and existing capital providers' support, we will start a new £35m syndicate to write alongside Syndicate 1200. This will enable us to capture more of the opportunities that now exist post 2005 hurricanes, and introduce the new Personal Accident account.

Heritage continues to employ high calibre people as this is the key to our success. In addition to the Personal Accident team, we have recruited an Operations Director and more resource in our risk management and Business Information Systems functions. We believe risk management is a key area in the business, and we are already seeing benefits from the increased investment in this area.

Board Changes

As you will note in the Report of the Directors, Nic Poole resigned in February 2006 and was replaced by Barry Cook. Jeremy Evans, Nigel Hanbury and Les Rock resigned with effect from May 2006.

Nic Poole was replaced by Barry Cook in anticipation of the transfer of shares from Perseverance and Associates to HCC Insurance Holdings Inc. We thank Nic for his contribution to the board and look forward to benefiting from the extensive knowledge and experience that Barry will bring in the future.

Jeremy and Nigel have been with the company since its formation and have helped to mould it into the company it is now. Both are leaving to focus on their other business activities. We thank them for their valuable contribution to the company and look forward to their continued involvement in the group as supporting member's agents.

Les Rock has made an invaluable contribution to the running of the Syndicate 1200 and the Holding company for which we thank him whole heartedly. It is intended that he will continue to act as a consultant until 31 December 2006.

Strategy

Having developed a successful underwriting platform we are now focusing on maximising future opportunities.

We raised additional capital through an issue of £8.2m equivalent of Dekania floating rate notes. Heritage, on behalf of ordinary shareholders, now underwrites £64 million of capacity, £51 million on Syndicate 1200 and £13 million on Syndicate 3245.

Our strategy for 2006 is to:

- take advantage of the strong property catastrophe rating environment by growing the business. We increased 1200's capacity from £150m to £180m at January 2006. In July 2006 we will increase this to £215m, underwriting more of our own business, thereby also increasing the stability of the Heritage franchise.

- diversify the classes of business we write within the clearly defined strategy of remaining a specialist commercial lines insurer focusing on short to medium tail business.

Your Board has been examining alternative ways of taking advantage of the major opportunities in the insurance market to grow the scale and future profitability of the group. Accordingly we are examining a number of capital raising options including an AIM listing and we will keep you informed as these plans develop.

Chief Executive's Statement

Future Outlook

The Group has grown significantly over the last few years; however, we still have much to do. We face an exciting time; the insurance markets are favourable and we must exploit this opportunity to the full. We will never forget that our primary focus is underwriting for profit.

2005 was a particularly challenging year for the business in absorbing the largest ever hurricane in its core market. We have taken our share of financial exposure to this event but look forward to capitalising in 2006 on a really exciting rating environment for our property business, whilst we continue to build long term profitability through the targeted property and professional indemnity underwriting strategy of our skilled teams.

Heritage has excellent people and I would like to thank them all for their hard work and dedication in making this Agency both a successful and an enjoyable place to work.

R.A. Pexton
Chief Executive

29th June 2006

Financial Review

Overview

The result for the year ended 31st December 2005 is a loss after tax of £3.5m (2004: profit restated £1.8m). Along with most property insurers in the market with catastrophe exposures our results for the financial year 2005 have been significantly impacted by the unprecedented hurricane losses. The estimated cost of the 2005 hurricane activity has been reported to be approximately US$80 billion to the market as a whole. The effect on Heritage results is detailed below. Whilst our result for the year ended 31st December 2005 is disappointing, the improvement in rates in 2006 as a result of the losses, significantly increases the profit potential of the business for 2006.

Review of Financial Results

a) Underwriting result

The 2005 year is the first year we significantly increased our underwriting with our participation on managed syndicates increasing from £16 million to £51 million and we have therefore not had the benefit of a material level of profitable underwriting on 2003 and 2004 to dilute the impact of the losses on 2005. If we had participated on 2003 and 2004 years of account with the equivalent participation that we had on 2005 we would have made a much smaller underwriting loss in 2005. Without this dilution, the financial performance of the group is driven significantly by the US property underwriting of Syndicate 1200 for the 2005 underwriting year of account, the worst year on record for US hurricane insured losses and as such has yielded an underwriting loss of £(7.2)m before tax for the 2005 financial year (2004:loss £(0.5)m).

The 2005 year of account for Syndicate 1200 (representing 80% of our 2005 participation) generated a loss due largely to the impact of hurricane Katrina. The impact of 2005 hurricanes on HUA's result was £15 million. We carry the hurricane claims reserves in these accounts at the amount notified to us at the end April 2006 and expect these claims to settle at below this level over the next eighteen months.

The table below shows the sources of the company's profits and losses for the last two financial years. This demonstrates how the diversification between underwriting and service activities can dilute the effects of an unprecedented underwriting loss.

	2005 £m	**2004 £m**
Underwriting participation	51	16
Underwriting (loss): ordinary shareholders	(7.2)	(0.5)
Service profit	1.4	2.2
Investment income net of finance costs	0.5	1.7
(Loss)/profit before tax	(5.3)	3.4
Earnings per share	(13p)	11p
Net tangible assets per share	60p	72p
Return on equity	(18)%	14%
Combined ratio	119%	105%
Combined ratio (ex hurricane Katrina)	90%	N/A

Financial Review

b) *Service profits*

Service profits includes other income of £3.0m (£2.5m – 2004) consisting of managing agency fees and profit commissions that come from managing third party annual capital on our syndicates.

c) *Investment income*

During 2005 investment return remained stable. In 2005 our policy continues to be to invest insurance funds and HUA shareholder funds in cash and short duration bonds predominately consisting of treasury bonds but including a small proportion of corporate bonds of single A or better instruments. The table below sets out the average investment balances for the year and the returns generated across all currencies.

	HUA	1200	3245	1245
Year to 31st December 2005				
Cash and investments (average balance)	£32m	£100m	£32m	£48m
Return for 2005 average across currency	3.0%	2.9%	3.6%	2.5%

Syndicate 1200 funds are held 70% in US dollars which earned an average return during 2005 of 2.7%. Syndicate 3245 funds are held 60% in sterling which earned an average return over 2005 of 4.8%. HUA corporate funds are held 34% in sterling. Alliance Capital manage the majority of the syndicate funds.

d) *Finance costs*

Included within finance costs is interest of £0.4 m (2004: nil) charged on the Company's £12 million equivalent of US dollar ($6.5 million) loan stock and the Euro (€12 million) loan stock. The loans are repayable in 2034 and 2035 with breaks in 2010 and 2011 respectively. Included within restated finance costs for 2004 is the preference share dividend due to A shareholders now disclosed before profit before tax under IFRS along with any retained profits accrued to the A shareholders.

e) *Other operating expenses included within service profit*

The group expenses which include the costs of running the holding company and agency amount to £2.5 million. These costs include £418,000 incurred as a result of abortive takeover discussions with Perseverance, a major shareholder of HUA which in March 2006 sold substantially their entire shareholding to HCC Insurance Holdings Inc ("HCC").

Financial Review

US Hurricane Activity

The incurred cost of US National Catastrophes in 2005 was estimated to be US$60 – 80 billion. There were three events with an insured loss in excess of US$5 billion, each of which arose from North Atlantic Cyclones Hurricanes Katrina (US$45 billion), Rita (US$10 billion) and Wilma (US$10 billion).

We have reviewed the manner in which we account for hurricane related businesses in view of the significance of hurricane activity in 2005 and the fact that we wrote property business on higher layers in 2005. Accordingly we have introduced a method of seasonally adjusting the recognition of hurricane related premium to reflect more closely the time when hurricanes are active and the risk premium is being earned. This approach is followed by a number of insurance companies and syndicates writing hurricane related business. The following table shows how the ultimate losses forecast on the 2005 and 2004 hurricanes for Syndicate 1200 impact the HUA net reserves before tax.

	Market loss US$bn	Total gross US$m	Total net US$m	Total net £m	Net booked in Underwriting year 2005 £m	Net booked in Underwriting year 2004 £m	HUA share 2005 £m	HUA share 2004 £m
2005 Hurricanes	65	180	123	67	48	19	14	1
2004 Hurricanes	25	60	36	20	–	16	–	1

The 2005 hurricane losses at syndicate level generated approximately three times the level of gross and net loss as the 2004 hurricanes. Even adjusting for increased underwriting from 2004 to 2005 they had about twice the impact. This was primarily due to the severity of the flooding that also accompanied hurricane Katrina and significantly broadened the impact of this event. From a market perspective 2005 hurricanes cost the insurance industry just over two and a half times the 2004 hurricanes. Despite the severity of the financial impact of the 2005 hurricanes our reinsurance programme has responded well with no significant bad debt provisions and with only a small reduction in the gross to net ratio from 60% on 2004 hurricanes to 68% on 2005 hurricanes.

The impact of hurricane Stan ($5m gross) on 2005 and Jeanne ($6m gross) on 2004 have been excluded from the table above as they were small market losses and immaterial to HUA.

Reinsurance

The losses sustained from the 2005 hurricanes impacted the property classes of business. The gross losses for each hurricane have been separately estimated and the Syndicate's reinsurance programme has been applied to each estimate. Reinsurance protection for Katrina is now exhausted on an incurred basis, whilst further reinsurance protection on Rita and Wilma is still available.

The minimum security criteria for our reinsurer counterparties are AM Best A- and Standard & Poors A for property business and AM Best A and Standard & Poors AA for liability business. Reinsurance collectibles from counterparties below investment grade at December 2005 are immaterial to the Group.

Reserving Approach

Provision is made at the year-end for the estimated cost of claims including expenses incurred but not settled at the balance sheet date, including the cost of claims incurred but not yet reported to the company. However, given the uncertainty in establishing claims provisions, it is likely that the final outcome will prove to be different from the original liability established.

Financial Review

The estimation of claims incurred but not reported ("IBNR") is generally subject to a greater degree of uncertainty than the estimation of the cost of settling claims already notified to the company, where more information about the claim event is generally available. Claims IBNR may often not be apparent to the insured until many years after the event giving rise to the claims has happened. Classes of business where the IBNR proportion of the total reserve is high (Syndicate 3245) will typically display greater variations between initial estimates and final outcomes because of the greater degree of difficulty of estimating these reserves and the length of time taken which claims will finally settle. Once risks are fully earned, classes of business where claims are typically reported relatively quicker after the claim event (Syndicate 1200) tend to display lower levels of volatility.

Heritage People

Heritage continues to employ high calibre people as this is the key to our success. During 2005 we have continued to expand out our underwriting and support platform as shown below.

	2005	2004
Average number of employees		
Property	18	18
Non US liability	12	10
Management, infrastructure and discontinued business.	44	35
Total	74	63

- During 2005 Syndicate 3245 recruited a number of experienced underwriters including Martin Burrows (Professional indemnity) and Clive Couzens and Liz Hanlon (Financial Institutions). In May 2006 a Personal Accident team of underwriters led by Marc McLean, formerly at the Marlborough syndicate, joined Syndicate 1200.

- On the Agency side Paul Battagliola joined as Operations Director in January 2006. Paul, was previously Finance and Operations Director of Aon Re. We have also added resource to our Risk Management and Business Information Systems functions. We believe risk management is a key area in the business and this investment in people and systems is already benefiting the business.

- Continued development of our electronic business information systems with our in house team is meeting the increasing demands on the business as the Group and the London Insurance Industry moves towards electronic trading.

Financial Review

Group Balance Sheet Attributable to Ordinary Shareholders

The balance sheet included within the financial statements consolidates the Group's share of Syndicates 1200, 3245 and 1245 (discontinued) assets and liabilities with other directly held corporate assets. The balance sheet analysed below shows the Group's interest in Syndicate 1200, 3245 and 1245 (discontinued) as one-line items.

	2005 £000	2004 £000
Goodwill	53	74
Tangible fixed assets	136	232
Group financial investments used as FAL	31,787	22,505
Other financial investments and cash balances	8,134	(2,958)
Net other assets/(liabilities)	(19,386)	(13,970)
Interest in Syndicate 1200	(8,002)	7,897
Interest in Syndicate 3245	5,583	1,418
Interest in Syndicate 1245 (discontinued)	(1,032)	(481)
Total Group net assets	17,273	14,717

The Group's interest in Syndicates can be analysed as follows:

	2005 £000	2004 £000
Provisions for outstanding claims and unearned premiums	(230,113)	(158,445)
Reinsurers share	45,221	37,702
Net technical provisions	(184,892)	(120,743)
Cash and investments	123,536	92,217
Insurance and other debtors	163,439	151,035
Insurance and other creditors	(105,534)	(113,675)
Net interest in syndicate participations	(3,451)	8,834
Interest in Syndicate 1200	(8,002)	7,897
Interest in Syndicate 3245	5,583	1,418
Interest in Syndicate 1245 (discontinued)	(1,032)	(481)
Total	(3,451)	8,834

The Group financial investments used as Funds at Lloyd's includes £4.5 million held on behalf of A shareholders.

Financial Review

Capital Management, Financial Leverage and Catastrophe Risk Exposure

HUA's medium term underwriting participation: HUA's strategy is to grow its own underwriting participation so that it can fully benefit from the significant profit potential of its underwriting. The reason for this is that it believes that it will maximise the return on equity by participating in the underwriting of it two managed syndicates.

Role of annual capital: At the same time HUA plans to flex its underwriting capacity over the insurance cycle so that it maximises the premium, within a tightly controlled risk framework, it can write when insurance rates are hard, reducing capacity when rates soften. It is able to do this by flexing the amount of annual capacity that it accepts on to its syndicates. In addition it generates annual fees and profit commissions from the annual capacity, thereby enhancing HUA's return on equity.

Financial leverage: HUA has increased its long term unsecured debt to £12 million. HUA believes that in the hard market which Syndicate 1200 is now enjoying, it is appropriate to maximise HUA's underwriting participation.

Catastrophe exposure risk: The key risk that HUA runs is its exposure to US hurricanes. We currently limit Syndicate 1200's exposure to any one catastrophe loss (as prescribed by Lloyd's realistic disaster scenarios) to approximately 20% of stamp (net of reinsurance recoveries and reinstatement premiums). Lloyd's realistic disaster scenarios for 2006 have estimated return periods of between 1 in 50 and 1 in 250 years. The 2006 business plan includes catastrophe allowances equivalent to the gross cost we incurred in 2005 of having three hurricanes of Wilma scale (market loss US$10 billion).

Underwriting capital

HUA manages stamp capacity of some £230 million in 2006. Capital providers have the following participations:

	Stamp-premium limit				
	2006		2005		Change
	£'m	%	£'m	%	£'m
Capital providers					
Ordinary shareholders	64.0	28	50.8	25	11.5
A shareholders	8.5	4	15.2	7	(6.7)
Heritage	72.5	32	66.0	32	4.8
Annual capacity from Hays and Perseverance	40.1	17	37.5	18	2.6
Sub total	112.6	49	103.5	50	7.4
Names	58.9	26	49.8	24	10.8
Trade annual capacity	58.0	25	54.5	26	3.5
Total stamp capacity	229.5	100	207.8	100	21.7

- Capacity provided by HUA ordinary shareholder funds has increase by 25% for 2006 as a result of raising £8 million of long term debt. Its funds at Lloyd's available for underwriting are £27 million.

Financial Review

- The capital provided from other sources is diversified amongst HUA shareholders, direct Names and Trade providers and each group has increased their participations in line with the increase in the overall stamp managed by HUA, except for the A shareholders which has been constrained by the economic capital assessment of their corporate vehicle.
- HUA plans to increase its 2006 stamp through a mid year pre-emption of Syndicate 1200 taking total stamp managed from £230 million to £265 million.
- The Company is required to increase its capital held at Lloyd's by £5.8 million as a result of the 2005 underwriting losses; this will be funded by a new financing facility which is currently being finalised.

A Shareholders

The 2003 year of account for Syndicate 1200 closed at 28% return of stamp, generating a profit after tax of £38 per unit or a 38% return. However, we expect that we will only be able to pay out about half the profit due to the losses incurred on the 2005 year of account.

Insurance and Financial Risk Management

In note 2 and 19 to the financial statements we have set our analysis of the key insurance and financial risks to which we believe the group is exposed.

Accounting basis

These year-end consolidated financial statements are presented using International Financial Reporting Standards ("IFRS") for the first time. An explanation of how the transition to IFRS has affected the reported income statement and balance sheet is provided in note 31 to the Financial Statements.

N. G. A. Denniston
Finance Director

29th June 2006

Report of the Directors

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

Principal Activities

The Company's principal activity is to act as an ultimate parent company for the Heritage Group, a non-life insurance business operating through its management and participation on Lloyd's Syndicates 1200, 3245 and 1245 (discontinued).

Review of the Business and Future Developments

A more detailed review of the business for the year and a summary of future developments are included in the chief executive's statement on pages 4 to 10.

Results and Dividends

The group results for the year ended 31st December 2005 are shown in the income statement on page 25 of the financial statements. The group loss for the year after taxation was £(3,459,804) (2004: profit £1,791,005 (restated)). The directors' do not recommend the payment of a dividend to the ordinary shareholders (2004: £nil).

Report of the Directors

Directors and their Interests

The Directors who served during the year, together with their beneficial interests in the Company's issued share capital, were:

Name	Number Ordinary shares of 10p each 01.01.2005	31.12.2005	Number Share options 01.01.2005	Granted	Exercised	31.12.2005
J L Kavanaugh	250,000	260,000	50,000	50,000	–	100,000
J B Cook	–	–	–	–	–	–
N G A Denniston†	121,206	121,206	125,000	175,000	–	300,000
J R H Evans	–	–	–	–	–	–
N J Hanbury	131,250	131,250	–	–	–	–
J C Hays	2,782,452	6,584,259	–	–	–	–
C G James	–	–	–	–	–	–
R A Pexton†	468,467	485,213	410,000	400,000	–	810,000
N G Poole	–	–	–	–	–	–
L J Rock†	989,286	696,932	360,000	400,000	–	760,000
S A Shaw	80,000	80,000	–	–	–	–
B Swim	–	–	–	–	–	–

†included in table above are partly paid shares
Mr Cook was appointed on the 22nd February 2006.
Mr Poole resigned with effect from 10th February 2006.
Mr Swim was appointed on the 4th May 2005 and resigned with effect from 10th February 2006.
Mr Rock resigned with effect from 15th May 2006.
Mr Hanbury and Mr Evans resigned with effect from 16th May 2006.

As at 31st December 2004, 375,000 ordinary shares owned by L J Rock's former wife E K Rock were included as part of his beneficial holdings. Since their divorce L J Rock has no beneficial interest in these shares and his holdings disclosed above have been adjusted accordingly.

Messrs Poole, Hays and Shaw appointments are as representatives of Perseverance Limited, The Hays Group Inc and The Bank of New York (Nominees) Limited respectively who held at 31st December 2005 6,618,183, 6,584,259 and 2,912,000 ordinary shares respectively in the Company (2004 – nil, 2,782,452 and 1,566,883). Perseverance Limited participates through its corporate vehicle Flectat Limited with £24.3m and £5.7m on the 2005 year of account of Syndicates 1200 and 3245 respectively. The Hays Group Inc participates with £6.1m and £1.4m on the 2005 year of account of Syndicates 1200 and 3245 respectively. The Hays Group Inc also participates on Syndicate 1200 as follows: 2003 £4.4m, 2004 £1.9 and 2005 £6.2m, through loan stock and A shares issued to them by the Company used to support underwriting by Nameco (No. 616) Limited, a wholly owned subsidiary of Heritage Underwriting Agency plc.

Report of the Directors

Messrs Hanbury and Rock who were directors of the Company also participate on the Group's managed syndicates details of which are set out in note 26 of the financial statements.

Just under one quarter of the issued share capital of the Company is owned by individual investors who also participate in the underwriting of Syndicate 1245. The balance of the share capital is owned by recent investors including staff, Directors and third parties.

Included in the director's interest table are the issue of partly paid shares as follows:

	Issued at 70p Ordinary shares of 10p		Issued at 60p Ordinary shares of 10p	
Name	**01.01.2005**	**31.12.2005**	**01.01.2005**	**31.12.2005**
N G A Denniston	–	–	14,286	14,286
R A Pexton	125,000	125,000	114,285	114,285
L J Rock	125,000	125,000	114,286	114,286

The partly paid shares are paid up as to 25% of the issue price.

L.J. Rock participates on Syndicate 1200 through Nameco (No. 616) Limited, through A shares and loan stock issued by the Company. Nameco (No. 616) Limited is a wholly owned subsidiary of Heritage Underwriting Agency plc.

	2006 £	2005 £	2004 £	2003 £
1200	396,954	701,648	212,474	499,966

Under the articles of association certain directors are now required to retire from the board by rotation at the forthcoming Annual General Meeting and offer themselves for re-election as directors. Messrs Cook, Denniston and Kavanaugh therefore retire by rotation and offer themselves for re-election as directors.

Employees

We recognise that the success and future of the group is dependant on our ability to attract, develop, motivate and retain talented staff. We expect our staff to maintain a high level of integrity and effectiveness in dealing with internal and external stakeholders of the business.

The group is committed to providing equal opportunities to potential and actual employees in all aspects of employment.

Our employment policies in practice are free from discrimination on any grounds relating to selection, training and development, career progression and any other employment matters.

We are committed to training and developing all of our employees to maximise their potential. A comprehensive performance management programme ensures that each employee has a training plan to develop key aspects of their skills to allow them to develop their career more effectively. The training programmes are reviewed with each employee on an annual basis in conjunction with the performance of the individual and are both measured against clearly set objectives.

Employees are kept informed of the business and its activities through formal company-wide briefings that occur monthly, team meetings and the use of the intranet.

Heritage is committed to high standards of health and safety to create a safe environment for all employees and other persons that may be affected by the group's operations. All staff have access to this policy in the staff handbook and on the company's intranet.

Report of the Directors

Charitable and Political Donations

The Group made charitable donations during the year of £10,000 (2004: £nil). The Group's charity budget is managed by a Charities committee of staff representatives.

No political donations were made by the group in either of the current or preceding reporting period.

Share Transfer Market Report

The operator Credit Agricole Asset Management (UK) Limited reports on the share transfer market in accordance with the scheme rules that during the year there were 73,046 (2004: 37,806) ordinary shares traded in thirteen (2004: nine) auctions, the details of which are 12,252 at 48p, 10,000 at 50p, 15,000 at 52p and 35,794 at 75p (2004: 166 at 46p, 24,174 at 48p, 7,466 at 55p and 6,000 at 73p).

Further details of the share transfer market may be obtained from Credit Agricole Asset Management (UK) Limited at 41 Lothbury, London, EC2R 7HF, or from the company secretary.

Policy and Practice on the Payment of Creditors

It is the Group's policy to:

- agree the terms of payment at the commencement of business with a supplier;
- ensure that suppliers are aware of the terms of payment; and
- pay in accordance with contractual and other legal obligations.

The Directors do not believe it would be helpful to disclose the number of days purchases outstanding at 31st December 2005 as the activities of the Group are that of managing Syndicates at Lloyd's.

Financial Instruments and Risk Management

The board agrees and reviews policies and financial instruments for risk management.

Further information on reinsurance borrowings and financial instruments is contained in notes 2 and 13 to the financial statements.

Auditors and the Annual Report

During the year, our auditors changed their name to CLB Littlejohn Frazer. A resolution to reappoint CLB Littlejohn Frazer as auditors will be put to the members at the next General Meeting to be convened and at which the Annual Report will be laid before the members for consideration.

Approved by the Board of Directors and signed on behalf of the Board.

Belinda Rose
Secretary

29th June 2006

Statement of Directors' Responsibilities

Company Law requires the Directors to prepare financial statements which give a true and fair view of the state of the Group's affairs and of the profit or loss for that period. In preparing these financial statements, the Directors are required to:

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

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

The maintenance and integrity of the web site is the responsibility of the Directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the information contained in the financial statements since they were initially presented on their website. Legislation in the United Kingdom governing the preparation and dissemination of the financial statements and other information included in annual reports may differ from legislation in other jurisdictions.

Report of the Auditors

Independent Auditors' Report to the Shareholders of Heritage Underwriting Agency Plc

We have audited the Group and parent company financial statements (the "Financial Statements") of Heritage Underwriting Agency plc for the year ended 31st December 2005 which comprise the Group Income Statement, the Group and Parent Company Balance Sheets, the Group Cash Flow Statement, the Group and Parent Company Statements of Change in Shareholders' Equity, the accounting policies and the related notes 1 to 30. These parent company Financial Statements have been prepared under the accounting policies set out therein.

This report is made solely to the Group's shareholders, 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 Group's shareholders those matters we are required to state to them in an auditor's 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 Group and the Group's shareholders as a body, for our audit work, for this report, or for the opinions we have formed.

Respective Responsibilities of Directors and Auditors

As described in the Statement of Directors' Responsibilities the Directors are responsible for the preparation of the Annual Report and the Financial Statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted for use in the European Union.

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

We report to you our opinion as to whether the Financial Statements give a true and fair view and whether the 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 Report of the Directors is not consistent with the Financial Statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and other transactions is not disclosed.

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

Basis of Opinion

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

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

Report of the Auditors

Opinion

In our opinion the Group Financial Statements give a true and fair view, in accordance with IFRSs as adopted for use in the European Union, of the state of the Group's affairs as at 31st December 2005 and of the loss for the year then ended.

In our opinion the parent company Financial Statements give a true and fair view, in accordance with IFRSs as adopted for use in the European Union as applied in accordance with the provisions of the Companies Act 1985, of the state of the parent company affairs at 31st December 2005.

In our opinion the Financial Statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation.

CLB Littlejohn Frazer
Chartered Accountants
and Registered Auditors
1 Park Place
Canary Wharf
London E14 4HJ

29th June 2006

Consolidated Income Statement Year ended 31st December 2005

	Note	Year ended 31 December 2005 Continuing £'000	2005 Discontinued £'000	2005 Total £'000	Year ended 31 December (Restated) 2004 Continuing £'000	2004 Discontinued £'000	2004 Total £'000
Gross premium written	3	130,603	(1,355)	129,248	130,370	4,625	134,995
Written premium ceded to reinsurers		(58,066)	(98)	(58,164)	(114,950)	(411)	(115,361)
Net premiums written		72,537	(1,453)	71,084	15,420	4,214	19,634
Change in gross provision for unearned premium		10,892	2,835	13,727	(22,048)	(782)	(22,830)
Reinsurers share of change in the provision for unearned premiums		(34,465)	(273)	(34,738)	19,428	(118)	19,310
		(23,573)	2,562	(21,011)	(2,620)	(900)	(3,520)
Net earned premiums		48,964	1,109	50,073	12,800	3,314	16,114
Net Investment income	4	2,131	–	2,131	943	(2)	941
Other underwriting income		163	55	218	261	49	310
Other income	5	3,045	–	3,045	2,506	–	2,506
		5,339	55	5,394	3,710	47	3,757
Revenue		54,303	1,164	55,467	16,510	3,361	19,871
Gross claims paid		(59,020)	(1,912)	(60,932)	(24,196)	(1,829)	(26,025)
Reinsurance share of gross claims paid		47,979	1,005	48,984	20,676	554	21,230
Claims paid, net of reinsurance		(11,041)	(907)	(11,948)	(3,520)	(1,275)	(4,795)
Movement in gross technical provisions		(73,737)	71	(73,666)	(33,362)	(2,702)	(36,064)
Movement in reinsurers' share of technical provisions		41,080	(428)	40,652	31,922	1,453	33,375
Net change in provisions for claims		(32,657)	(357)	(33,014)	(1,440)	(1,249)	(2,689)
Net insurance claims		(43,698)	(1,264)	(44,962)	(4,960)	(2,524)	(7,484)
Expenses incurred in insurance activities	6	(13,776)	(470)	(14,246)	(3,151)	(1,400)	(4,551)
Other operating expenses		(2,487)	–	(2,487)	(2,751)	–	(2,751)
Operating expenses		(16,263)	(470)	(16,733)	(5,902)	(1,400)	(7,302)
Results of operating activities		(5,658)	(570)	(6,228)	5,648	(563)	5,085
Finance cost	7	927	–	927	(1,663)	–	(1,663)
(Loss)/profit before tax		(4,731)	(570)	(5,301)	3,985	(563)	3,422
Income tax	9	1,841	–	1,841	(1,631)	–	(1,631)
(Loss)/profit attributable to ordinary shareholders		(2,890)	(570)	(3,460)	2,354	(563)	1,791
Earnings per ordinary share:							
Basic	10	(11)p	(2)p	(13)p	14p	(3)p	11p

The discontinued components of the business are all the underwriting transactions generated by Syndicate 1245 which ceased underwriting after the 2004 Underwriting Year of account. Some of the business written in the 2003 Year of Account as an incidental professional indemnity account in Syndicate 1245 is now written by Syndicate 3245, and is included as part of continuing operations.

Heritage

Consolidated Balance Sheet At 31st December 2005

	Note	2005 £'000	Restated 2004 £'000
Assets			
Intangible assets	11	53	74
Plant and equipment	12	136	232
Financial investments			
– Investments	13	118,049	98,250
– Deposits with ceding undertakings		2	2
Reinsurance share of insurance liabilities			
– Reinsurers' share of outstanding claims	19	40,157	23,563
– Reinsurers' share of unearned premiums	19	5,064	14,139
Other receivables, including insurance receivables	14	172,423	157,575
Cash and cash equivalents	15	45,406	13,512
Deferred tax asset	20	1,043	170
Total assets		382,333	307,517
Liabilities			
Insurance liabilities			
– Claims outstanding	19	157,677	77,610
– Unearned premiums	19	72,436	80,835
Current tax liabilities	16	1,548	197
Trade and other payables, including insurance payables	17	121,395	128,192
Financial liabilities			
– Floating rate loan stock	18	11,998	3,399
– Preference shares	18	6	6
Deferred tax liabilities	20	–	2,561
Total liabilities		365,060	292,800
Shareholders' equity			
Share capital	21	2,945	2,093
Share premium		14,992	9,839
Share option reserve	22	364	127
Retained earnings		(1,028)	2,658
Total Shareholders' equity		17,273	14,717
Total liabilities and shareholders' funds		382,333	307,517

Approved by the board of directors on 29th June 2006

N.G.A. Denniston
Finance Director

R.A. Pexton
Chief Executive

Parent Company Balance Sheet At 31st December 2005

	Note	2005 £'000	Restated 2004 £'000
Assets			
Financial investments	13	27,644	15,446
Other receivables	14	3,655	9,615
Current tax	16	–	3
Cash at bank and in hand	15	4,217	71
Deferred tax	20	32	32
Total assets		35,548	25,167
Liabilities			
Trade and other payables	17	4,284	9,735
Current tax	16	168	–
Financial liabilities			
– Loan stock	18	11,998	3,399
– Preference shares	18	6	6
Total liabilities		16,456	13,140
Shareholders' equity			
Called up share capital	21	2,945	2,093
Share premium account		14,992	9,839
Share option reserve	22	364	127
Retained earnings		791	(32)
Total Shareholders' equity		19,092	12,027
Total liabilities and shareholders' equity		35,548	25,167

Approved by the board of directors on 29th June 2006

N.G.A. Denniston
Finance Director

R.A. Pexton
Chief Executive

Consolidated Cash Flow Statement Year ended 31st December 2005

	Note	Group 2005 £'000	Group Restated 2004 £'000	Company 2005 £'000	Company Restated 2004 £'000
Cash flow from operating activities					
Net (loss)/profit		(6,228)	5,085	1,058	238
Depreciation		96	116	–	–
Amortisation of intangibles		21	21	–	–
Changes in working capital:					
(Increase)/decrease in loans and other receivables		(14,848)	(36,800)	5,725	(9,221)
(Decrease)/increase in trade payables		112	39,328	898	9,236
Net increase in technical provisions		64,149	38,599	–	–
Interest expense		(459)	–	(476)	–
Taxation		(290)	1,205	(1)	(2)
Net cash inflow from operating activities		42,553	47,554	7,204	251
Cash flows from investing activities					
Purchase of property, plant and equipment	12	–	(159)	–	–
Purchase of intangible assets	11	–	(15)	–	–
Purchase of investments		(19,799)	(64,429)	(12,198)	(6,699)
Net cash used in investing activities		(19,799)	(64,603)	(12,198)	(6,699)
Cash flows from financing activities					
Net proceeds from issue of ordinary share capital		65	3,067	65	3,067
Net proceeds from issue of loan stock		9,075	3,399	9,075	3,399
Net cash used in financing activities		9,140	6,466	9,140	6,466
Net increase/(decrease) in cash and cash equivalents		31,894	(10,583)	4,146	18
Cash and cash equivalents at 1st January		13,512	24,095	71	53
Cash and cash equivalents at 31st December	15	45,406	13,512	4,217	71

Statement of Changes in Shareholders' Equity

Year ended 31st December 2005

Group	Share Capital £'000	Share Premium £'000	Share Option Reserve £'000	Retained Earnings £'000	Total £'000
At 1st January 2004 (restated)	1,569	7,297	27	429	9,322
Net profit	–	–	–	1,791	1,791
Share options – value of employee services	–	–	100	–	100
Foreign exchange movement on retained reserves	–	–	–	438	438
New ordinary shares issued	524	2,542	–	–	3,066
At 31st December 2004	2,093	9,839	127	2,658	14,717
Net loss	–	–	–	(3,460)	(3,460)
Share options – value of employee services	–	–	237	–	237
Foreign exchange movement on retained reserves	–	–	–	(226)	(226)
New ordinary shares issued	852	5,153	–	–	6,005
At 31st December 2005	**2,945**	**14,992**	**364**	**(1,028)**	**17,273**

Company	Share Capital £'000	Share Premium £'000	Share Option Reserve £'000	Retained Earnings £'000	Total £'000
At 1st January 2004 (restated)	1,569	7,297	27	(270)	8,623
Net profit	–	–	–	238	238
Share options – value of employee services	–	–	100	–	100
New ordinary shares issued	524	2,542	–	–	3,066
At 31st December 2004	2,093	9,839	127	(32)	12,027
Net profit	–	–	–	823	823
Share options – value of employee services	–	–	237	–	237
New ordinary shares issued	852	5,153	–	–	6,005
At 31st December 2005	**2,945**	**14,992**	**364**	**791**	**19,092**

Notes to the Financial Statements Year ended 31st December 2005

1. Accounting Policies

The principal accounting policies adopted in the preparation of these Financial Statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

a. Basis of Preparation

The Financial Statements have been prepared in accordance with International Financial Reporting Standards (IFRS), incorporating IFRIC interpretations endorsed by the European Union (EU) and with those parts of the Companies Act 1985, applicable to companies reporting under IFRS.

The Financial Statements have been prepared under the historical cost convention except that financial investments are stated at their fair value. A summary of the more important Group accounting policies is set out below, together with an explanation of where changes have been made to previous policies on the adoption of new accounting standards in the year.

The preparation of financial statements in conformity with generally accepted accounting principles requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on management's best knowledge of the amount, event or actions, actual results ultimately may differ form these estimates.

The Group participates in insurance business through its Lloyd's corporate members. Assets and liabilities arising as a result of the underwriting activities are subject to trust deeds for the benefit of the relevant syndicate's insurance creditors.

b. First Time Adoption of IFRS

The Group has made use of one of the exemptions set out in IFRS 1 – "First Time Adoption of IFRS". The Group has accounted for the business combination between Heritage Underwriting Agency plc and Heritage Group Investments Limited as a merger. This has not been reclassified.

The changes in accounting policy from historical UK GAAP to IFRS have accordingly been applied consistently and retrospectively.

Reconciliations and descriptions of the effect of the transition from UK GAAP to IFRS on the Group's profit and shareholders' equity, are provided in Note 30.

c. Consolidation

The Consolidated Financial Statements incorporate the Financial Statements of the Company, and entities controlled by the Company, for the year ended 31st December 2005. Certain subsidiary undertakings underwrite as corporate members of Lloyd's on syndicates managed by the Group. The Group's share of the transactions, assets and liabilities relating to syndicate participation is included in the consolidated financial statements.

1. Accounting Policies (continued)

Inter-company transactions, balances and unrealised gains on transactions between Group companies are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of impairment of the asset transferred.

No profit and loss account is presented for Heritage Underwriting Agency plc as permitted by Section 230 of the Companies Act 1985.

d. Underwriting

The results are determined on an annual basis whereby the incurred cost of claims, commission and related expenses are charged against the earned proportion of premiums, net of reinsurance as follows:

Premiums Written

Gross premiums written and outwards reinsurance premiums relate to policies incepting during the financial year and include estimates of 'pipeline' premiums together with any difference between booked premiums for prior years and those previously accrued. Written premiums are stated inclusive of acquisition costs but exclusive of insurance premium taxes.

(ii) Unearned Premiums

The provision for unearned premium comprises the proportion of gross premiums written in the year which is estimated to be earned after the balance sheet date. The earning of premiums is based primarily on time apportionment, with an adjustment or the risk profile of certain classes of business particularly those exposed to seasonal weather related events.

(iii) Acquisition Costs

Commissions and other acquisition costs that vary with and are related to securing new contracts and renewing existing contracts are capitalised as deferred acquisition costs (DAC). All other costs are recognised as expenses when incurred. The DAC is subsequently amortised over the life of the contracts in the same way as premium is earned.

(iv) Claims Incurred

Claims incurred comprise claims and related expenses paid in the year and changes in the provisions for outstanding claims, including provisions for claims incurred but not reported and related expenses, together with any other adjustments to claims from previous years. Where applicable, deductions are made for salvage and other recoveries.

(v) Claims Provisions and Related Reinsurance Recoveries

Provision is made at the year-end for the estimated cost of claims incurred but not settled at the balance sheet date, including the cost of claims incurred but not yet reported to the Company. The estimated cost of claims includes expenses to be incurred in settling claims and a deduction for the expected value of salvage and other recoveries. The Group takes all reasonable steps to ensure that it has appropriate information regarding its claims exposures. However, given the uncertainty in establishing claims provisions, it is likely that the final outcome will prove to be different from the original liability established.

1. Accounting Policies (continued)

The estimation of claims incurred but not reported ("IBNR") is generally subject to a greater degree of uncertainty than the estimation of the cost of settling claims already notified to the Company, where more information about the claim event is generally available. Claims IBNR may often not be apparent to the insured until many years after the event giving rise to the claims has happened. Classes of business where the IBNR proportion of the total reserve is high will typically display greater variations between initial estimates and final outcomes because of the greater degree of difficulty of estimating these reserves. Classes of business where claims are typically reported relatively quickly after the claim event tend to display lower levels of volatility.

A component of these estimation techniques is usually the estimation of the cost of notified but not paid claims. In estimating the cost of these the Group has regard to the claim circumstance as reported, any information available from loss adjusters and information on the cost of settling claims with similar characteristics in previous period.

Large claims impacting each relevant business class are generally assessed separately, being measured on a case by case basis or projected separately in order to allow for the possible distortive effect of the development and incidence of these large claims.

Where possible the Company adopts multiple techniques to estimate the required level of provisions. This assists in giving greater understanding of the trends inherent in the data being projected. The projections given by the various methodologies also assists in setting the range of possible outcomes. The most appropriate estimation technique is selected taking into account the characteristics of the business class and the extent of the development of each accident year.

Provisions are calculated gross of any reinsurance recoveries. A separate estimate is made of the amounts that will be recoverable from reinsurers based upon the gross provisions and having due regard to collectability.

Provisions for unexpired risks are made where the costs of outstanding claims and related deferred acquisition costs are expected to exceed the assumed premium provisions carried forward at the balance sheet date. The provision for unexpired risks is calculated separately by reference to classes of business which are managed together, after taking into account relevant investment returns.

e. Syndicate Closed Years of Account and Reinsurance to Close

At the end of the third year an underwriting year of account is normally closed by reinsurance into the following year of account. The amount of the reinsurance to close premium payable is determined by the managing agent.

The payment of a reinsurance to close premium does not eliminate the liability of the closed year for outstanding claims. If the reinsuring syndicate was unable to meet its obligations, and the other elements of Lloyd's chain of security were to fail, then the closed underwriting account would have to settle outstanding claims.

The Directors consider the likelihood of such a failure of the reinsurance to close is extremely remote, and consequently, the reinsurance to close has been deemed to settle liabilities outstanding at the closure of an underwriting account. The Group adjusts its provision for outstanding claims at 36 months for a year of closure to equal its share of the syndicate reinsurance to close, and no further provision is made for any potential variation in the ultimate liability of that year of account.

The portfolio premiums payable and receivable by the Group arising from the syndicate reinsurance to close are offset and the difference, representing the increase or decrease in the Group's capacity on the syndicate, is shown in

1. Accounting Policies (continued)

the technical account as gross premiums written or reinsurance premiums payable.

Lloyd's operates a detailed set of regulations regarding solvency and the distribution of profits and payment of losses between syndicates and their members. Lloyd's continues to require membership of syndicates to be on an underwriting year of account basis and profits and losses belong to members according to their membership of a year of account. Normally profits and losses are transferred between the syndicate and members after results for a year of account are finalised after 36 months. This period may be extended if a year of account goes into run-off. The syndicate may make earlier on account distributions or cash calls according to the cash flow of a particular year of account and subject to Lloyd's requirements.

The 2003 year of account of Syndicates 1200 and 3245 closed at 31st December 2005. The 2002 and 2003 year of account of the discontinued Syndicate 1245 are running off.

(i) Run-off Years and Estimated Liabilities

Where an underwriting year of account is not closed at the end of the third year (a "run-off" year of account), a provision is made for the estimated cost of all known and unknown outstanding liabilities for that year. The provision is determined initially by the managing agency on a similar basis to the reinsurance to close. However, any subsequent variation in the ultimate liabilities for that year remains with the corporate member participating thereon. As a result any run-off year will continue to report movements in its results after the third year until such time as it secures a reinsurance to close.

f. Segmental Reporting

Business written is analysed between direct and reinsurance acceptances. Direct insurance acceptances by class are disclosed separately where the gross written premium is more than £7 million or more than ten per cent of the total gross written premium, or where the class result is greater than ten per cent of the total result. In any event the three largest categories will be disclosed. A business class is identified where the operations engaged in providing the products and services are subject to risks and returns that are different from those of other business classes. The allocation of costs between business classes is done under a combination of direct allocation where identifiable and proportional allocation based on premium income where direct attribution is not possible.

The geographical split by origin for the business written is only disclosed when more than five per cent of the total gross written premiums are concluded outside the UK. The geographical split by destination for the business written is only disclosed when it is materially different from the analysis by origin.

g. Foreign Currency Translation

(i) Functional and Presentational Currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). The consolidated financial statements are presented in thousands of pounds sterling, which is the Group's functional and presentational currency.

(ii) Transactions and Balances

Foreign currency transactions are translated into the functional currency using average rates of exchange as a

1. Accounting Policies (continued)

proxy for the transactional rates. Through its participations on various syndicates the Group has various assets and liabilities denominated in currencies other than sterling. The profit and loss arising from converting these assets to closing rates is taken directly to reserves. Similarly, the profit or loss arising on converting the reported results expressed in these currencies from an average rate to a closing rate is also taken directly to reserves.

h. Financial Instruments

(i) Investments

Investments in marketable securities are stated at their bid-market value at the balance sheet date. The Group values its financial assets at fair value through profit and loss. Gains or losses on the revaluation of financial assets held at fair value are recognised through profit and loss. Investments in unlisted securities are valued at fair value.

(ii) Preference Shares

Preference shares issued as A shares are classified as liabilities in the balance sheet and the dividends payable on these preference shares are recognised in the income statement as part of finance costs.

(iii) Loan Stock

Loan stock is held on the balance sheet as a non-current liability and the interest payable on this debt is recognised in the income statement as part of finance costs.

(iv) Share Options

Share-based compensation

The Group operates an equity-settled share-based compensation plan. The fair value of the employee services received in exchange for the grant of the options is recognised as an expense. The total amount to be expensed over the vesting period is determined by reference to the fair value of the options granted. At each balance sheet date, the entity revises its estimates of the number of options 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 to equity over the remaining vesting period. The proceeds received net of any directly attributable transaction costs are credited to share capital (nominal value) and share premium when the options are exercised.

i. Leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease.

j. Plant and Equipment

All assets included within plant and equipment are carried at historical cost. Depreciation is calculated to write down the cost less estimated residual value of office equipment and computer equipment by the straight line method over their expected useful lives.

Office equipment	10 years
Computer equipment	3 years

1. Accounting Policies (continued)

k. Intangibles

Intangible fixed assets, which represent establishment expenses of subsidiaries which are corporate capital members, are stated at cost, less any provision for impairment, and amortised on a straight line basis over the useful economic life which is estimated to be five years. No amortisation is charged until transactions are reflected from the activities on the first year of account following formation. The amortisation charge is included within operating expenses on the income statement.

l. Pensions

The Group operates a defined contribution plan, which is a pension plan under which the Group pays fixed contributions into a separate entity. The Group has no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay all employees the benefits relating to employee service in the current and prior periods.

m. Performance Related Remuneration

Performance related remuneration (PRR) is recognised in the accounts as and when employees become entitled, over the relevant period of employment in each case, to the remuneration concerned. The deferred element of any PRR, being the part to which employees have not yet become entitled, falls within the definition of long-term employee benefits set out in IAS 19, and is accordingly not charged in the income statement.

n. Investments in Subsidiaries

Subsidiaries are all entities over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group.

The Group uses the acquisition method of accounting to account for the acquisition of subsidiaries. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition.

The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the income statement. Intra-group transactions, balances and unrealised gains on intra-group transactions are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

o. Cash and Cash Equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise cash at bank and other short-term highly liquid investments with a maturity of three months or less from the date of acquisition and bank overdrafts.

p. Discontinued Operations

To the extent that certain business classes of one of the managed syndicates are no longer being actively written, the

Notes to the Financial Statements Year ended 31st December 2005

1. Accounting Policies (continued)

results pertaining to these classes are disclosed as discontinued operations, as long as they remain material to the group results. The discontinued business classes are separately identifiable within the syndicate that has ceased underwriting and were excluded from the rest of the syndicate's business that was transferred to a new syndicate.

q. Investment Income

Interest receivable from cash and short-term deposits and interest payable are accrued to the end of the year. Syndicate investments and cash are held on a pooled basis, the return from which is allocated to underwriting years of account proportionately to the funds contributed by the year of account. Investment income and investment gains and losses relating to syndicate investments and cash are taken to the technical account.

r. Expenses

All expenses are accounted for on an accruals basis.

Syndicate operating expenses are allocated to the year of account for which they are incurred.

s. Other Income

Other income represents agent fees and profit commission derived from the management of underwriting syndicates at Lloyd's, together with a charge made to the syndicate for the use of the Group's assets.

t. Lloyd's Managing Agent

Agency fees payable to the Company under agency agreements with members of Lloyd's are recognised when the contractual right to such fees is established, and to the extent that the Company's obligations under those agency agreements have been performed.

Profit commission arising from agency agreements with members of Lloyd's is recognised when the underwriting profit giving rise to that profit commission is also recognised.

Agency fees that have been received by the Group, but not yet recognised as income in accordance with the policy described above, is credited to the deferred income account under creditors in the Group's balance sheet.

u. Fair Value Estimation

The fair values of short-term deposits are assumed to approximate to their book values. The fair values of the Group's debt securities have been based on quoted market prices for these instruments.

v. Deferred Taxation

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 accounted for.

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.

2. Risk Management

The Group's activities expose it to a variety of financial and non-financial risks. The Board is responsible for managing the Group's exposure to these risks and, where possible, to introduce controls and procedures that mitigate the effects of the exposure to risk.

The following describes the Group's exposure to these risks and the steps management have taken to mitigate their impact from a quantitative and qualitative perspective.

a. Investment Risks

The investment of surplus syndicate funds is managed by external investment managers. The Board monitors the performance of the external investment managers on a regular basis and periodically agrees with them the investment strategy to be adopted to mitigate risks of interest rate fluctuation and credit risks and to provide appropriate liquidity.

The investment policy is to achieve a before tax return better than a twelve month Government Security for US dollars and eighteen month Government Security for Sterling (except for Syndicate 1245, which is benchmarked to a twelve month Government security), Euros and Canadian dollars. The maximum weighted portfolio duration is two years and no more than thirty percent of the combined portfolio can be invested in Corporate bonds with a minimum rating of single A (Standard & Poors).

The investment allocation (including surplus cash) at the year-end is shown below:

	31st December 2005			31st December 2004		
	Syndicate £m	Corporate £m	Total £m	Syndicate £m	Corporate £m	Total £m
Bonds	90.3	–	90.3	79.3	–	79.3
Cash and equivalents	33.3	12.1	45.4	13.4	0.1	13.5
Funds at Lloyd's	–	31.8	31.8	–	22.5	22.5
Others	–	0.1	0.1	–	0.1	0.1
	123.6	44.0	167.6	92.7	22.7	115.4

	31st December 2005			31st December 2004		
	Syndicate %	Corporate %	Total %	Syndicate %	Corporate %	Total %
Bonds	73	–	54	86	–	69
Cash and equivalents	27	28	27	14	–	12
Funds at Lloyd's	–	72	19	–	100	19
Others	–	–	–	–	–	–
	100	100	100	100	100	100

The corporate assets are currently all held as cash or short-term instruments to support the underwriting activities of the Group's corporate vehicles. Currently £27.3m is used to support Nameco (No. 604) Limited and £4.5m to support Nameco (No. 616) Limited. The funds used to support Nameco (No. 616) Limited are linked to fully paid loan notes or letters of credit (see note 13).

Notes to the Financial Statements Year ended 31st December 2005

2. Risk Management (continued)

The syndicate bonds are invested as follows:

	2005 £m	2004 £m	2005 %	2004 %
Government bonds	61.1	45.8	68	58
Corporate bonds including financial institutions – Tier 1	28.0	32.1	31	40
– Tier 2	1.2	1.4	1	2
	90.3	79.3	100	100

For an explanation of the different tiers see note below.

b. Reinsurance Risk

Reinsurance risks arise from two different sources. The first relates to concentration risk whereby recoveries from claims paid are due from a limited number of reinsurers. To mitigate this risk, the Group places its reinsurance in line with policy guidelines managed by reference to counterparties limits that are set each year and are subject to regular reviews.

The second source of reinsurance risks relates to credit risk. Credit risk arises where reinsurers fail to meet their financial obligations in full as they fall due.

To understand the Group's exposure to credit risks both now and in the future, the table below shows the credit rating, categorised by the rating agencies and used by Lloyd's in its reporting.

	A M Best	Moody's	S & P
Tier 1	A++ to A-	Aaa to A3	AAA to A-
Tier 2	B++ to B-	Baa1 to Ba3	BBB+ to BB-
Tier 3	C++ to C-	B1 to Caa	B+ to CCC
Tier 4	D, E, F, S	Ca to C	R, (U, S) 3

More than 95% of reinsurance ceded by the group is Tier 1 with the remaining balance being Tier 2.

c. Liquidity Risk

The Group is exposed to daily calls on its available cash resources, principally from claims arising from its insurance business. Liquidity risk arises where cash may not be available to pay obligations when due.

The Group's approach is to manage its liquidity position so that it can fund claims arising from significant catastrophic events, as modelled in its Lloyd's realistic disaster scenario. The funds held by the Group at syndicate level are reviewed on a regular basis to ensure sufficient liquidity is maintained to cater for these events.

2. Risk Management (continued)

d. Currency Risk

The Group's main exposure to foreign currency risk arises from insurance business originating overseas, primarily denominated in US dollars. Transactions dominated in US dollars form a significant part of the Group's operations. This risk is, in part, mitigated by the Group maintaining financial assets denominated in US dollars against its major insurance exposures.

The sterling equivalent of monetary assets and liabilities held by the Group designated in US dollars at the year-end are as follows:

	December 2005 £m	December 2004 £m
Reinsurance assets	9.3	3.2
Financial investments	19.6	4.1
Insurance receivable	11.4	8.3
Cash and cash equivalents	4.9	0.7
Insurance liabilities including provisions	(52.0)	(17.8)
Trade and other payable	(3.4)	(2.0)
	(10.2)	(3.5)
Surplus	10.2	3.5

e. Interest Rate Risk

The Group's main exposure to fluctuation in interest rates arises in its effect on the value of funds invested in bonds and equities. In order to mitigate this risk, the Board, together with its external investment managers, to try to anticipate any future interest rate movement and to take appropriate action to mitigate its affect on the value of investments held.

f. Insurance Risk

The very nature of the Company's business exposes it to the possibility that claims will arise on business written. The risk attaching to insurance contracts is based on the fortuity that events will occur which will lead to a claim under that contract. The underwriting risks which predominantly affect the Group are:

Catastrophic events – the risk that catastrophic events occur which will lead to claims not anticipated by the Group.

Rating levels – the risk that the premiums charged by underwriters are inadequate and do not cover the cost of claims arising from attritional losses or catastrophic events.

Reserving levels – the risk that the reserves established by the Group at the previous year-end prove to be inadequate.

Notes to the Financial Statements Year ended 31st December 2005

2. Risk Management (continued)

Catastrophic Events

The Group has developed underwriting guidelines which limit the authority of the underwriting teams and limit exposure geographically and by assured. The Group has also developed Realistic Disaster Scenarios (RDS) which provide an estimate of the effect on the syndicate results of an aggregation of the claims arising from a number of disasters specified by Lloyd's. The Group uses a number of modelling tools to monitor aggregation and to simulate catastrophe losses, in order to measure the effectiveness of the underwriting guidelines to limit exposure to these scenarios and on its reinsurance programmes.

The illustrative effect of RDS on the syndicate's and Group's results are as follows:

Description of RDS	Gross loss to syndicate £m	Net loss to syndicate £m	Proportion of capacity %	Net pre-tax loss to Group £m
As at 31st March 2006				
Syndicate 1200				
1. Specific event scenarious – Los Angeles earthquake Elysian Park line	62.6	37.5	21	10.3
2. Specific event – San Francisco earthquake	61.4	35.8	20	9.8
3. Specific event – Miami Dade windstorm	72.1	33.9	19	9.3
4. Specific event – Pinellas windstorm	67.3	32.1	18	8.8
5. Specific event – Gulf of Mexico windstorm	57.7	30.9	17	8.5
Syndicate 3245				
1. Alternative RDS A – Collapse in UK housing market	13.1	2.5	5	0.5
2. Defined Professional Lines – UK Pensions mis-selling	6.9	6.9	14	1.3
3. Liability Professional Lines – Systemic loss due to problem with new technology in respect of building cladding	18.8	2.5	5	0.5
As at 31st March 2005				
Syndicate 1200				
1. Specific event – Los Angeles Elysian Park line earthquake	48.0	29.4	20	2.6
2. $60 billion Florida/Gulf of Mexico windstorm	53.5	28.8	20	2.5
3. Specific event – New Madrid earthquake	51.9	27.9	19	2.4
4. Second event – Hurricane Andrew and Northridge earthquake	37.3	19.5	13	1.7
5. Specific event – European windstorm	25.0	12.5	8	1.1
Syndicate 3245				
1. Liability – failure of construction project	7.5	1.1	2	–
2. Major risk loss – largest line written	5.0	0.5	1	–

Where exposures are not calculated in sterling they are converted to sterling using the premium income monitoring (PIM) rates specified by Lloyd's. Proportion of capacity uses the stamp of the year, as at 31st March 2006 we would use 2006 stamp on each syndicate. The PIM rates for 2005 and 2006 for US dollars were 1.74 and 1.86.

Syndicate 1245 ceased underwriting at 31st December 2004 and the likelihood that it still could be affected by a major future catastrophic event is remote.

2. Risk Management (continued)

Rating Levels

The Group produces an annual business plan for each syndicate under its management. The plan is produced by anticipating rating levels and terms and conditions attaching to risks expected to be underwritten by each syndicate. Performance against the plan is monitored on a regular basis through a system of underwriting committees, as well as regular review by the Board of the Managing Agent. If market conditions change after the plan is produced, a revised plan is prepared and authorised by the Managing Agent Board. In this way, rating levels of both businesses written and reinsurance purchased are subject to constant review. Should risks be assessed as uneconomical, they will be declined.

Reserving Risk

In order to mitigate reserving risk, the Group uses a number of approaches, including actuarial techniques, to project gross and net premiums written and insurance liabilities. The results of these techniques are then subject to formal peer review to independently check the integrity of the estimates produced by the underwriting teams. In addition, the Group commissions an external independent actuary to perform his own assessment of the Group's ultimate gross and net premiums and insurance liabilities. The results of the actuary's projections are then compared to the underwriting team's assessment before deciding on the levels of reserve to be held.

g. Annual Venture Risk

Under the Lloyd's annual venture regime, the Group has to show annually that it has enough support to carry on underwriting through its managed syndicates. To mitigate the risk that the Group will not have sufficient backing to continue to trade, the Group has adopted a policy of diversifying its capital base, as well as using its own funds to support the syndicates' underwriting.

In order to understand the Group's exposure to this risk, the table below shows the capital backing of the Group's managed syndicates.

	31st December 2005			31st December 2004		
	1200	3245	Total	1200	3245	Total
	£m	£m	£m	£m	£m	£m
Individuals	60.1	27.3	87.4	26.9	28.3	55.2
Trade insurers	33.5	21.0	54.5	76.4	20.0	96.4
A shareholders	15.2	–	15.2	4.6	–	4.6
Group ordinary shareholders	41.1	9.6	50.7	10.4	2.0	12.4
	149.9	57.9	207.8	118.3	50.3	168.6

	31st December 2005			31st December 2004		
	1200	3245	Total	1200	3245	Total
	%	%	%	%	%	%
Individuals	40.09	47.15	42.06	22.74	56.31	32.75
Trade insurers	22.35	36.27	26.23	64.58	39.83	57.20
A shareholders	10.14	–	7.31	3.89	–	2.73
Group ordinary shareholders	27.42	16.58	24.40	8.79	3.86	7.32
	100	100	100	100	100	100

Notes to the Financial Statements Year ended 31st December 2005

3. Segmental Information

a. The Group's underwriting activities split by class of business are as follows:

Year ended 31st December 2005	Gross premium earned £'000	Gross claims incurred £'000	Net operating expenses £'000	Reinsurance balance £'000	Underwriting result £'000
Direct business					
Fire and other damage to property	75,225	(85,710)	(7,985)	(2,555)	(21,025)
Third party liability	25,906	(13,013)	(1,985)	(9,442)	1,466
Other	2,645	(2,190)	(361)	152	246
Total direct	103,776	(100,913)	(10,331)	(11,845)	(19,313)
Reinsurance business					
Other reinsurance acceptances	39,199	(33,685)	(3,915)	8,579	10,178
	142,975	(134,598)	(14,246)	(3,266)	(9,135)

	Gross premiums written £'000
Direct business	
Fire and other damage to property	66,939
Third party liability	26,801
Other	2,343
Total direct	96,083
Reinsurance business	
Other reinsurance acceptances	33,165
	129,248

The total gross premiums written of £129,248,000 were all in respect of direct business written in the United Kingdom.

Changes to segmental analysis rules require all business which is placed as a facultative reinsurance of another company to be treated as reinsurance accepted. The only reinsurance accepted is facultative reinsurance and the business written during 2005 has not changed materially since last year

3. Segmental Information (continued)

Year ended 31st December 2004 Restated	Gross premium earned £'000	Gross claims incurred £'000	Net operating expenses £'000	Reinsurance balance £'000	Underwriting result £'000
Direct business					
Fire and other damage to property	81,784	(40,845)	(3,398)	(39,674)	(2,133)
Third party liability	27,302	(18,565)	(894)	(1,957)	5,886
Other	2,360	(1,632)	(219)	(482)	27
Total direct	111,446	(61,042)	(4,511)	(42,113)	3,780
Reinsurance business					
Other reinsurance acceptances	719	(1,047)	(40)	667	299
	112,165	(62,089)	(4,551)	(41,446)	4,079

	Gross premiums written £'000
Direct business	
Fire and other damage to property	104,833
Third party liability	27,109
Other	2,763
Total direct	134,705
Reinsurance business	
Other reinsurance acceptances	290
	134,995

The total gross premiums written of £134,995,000 were all in respect of direct business written in the United Kingdom.

Approximately 60% of the written premium income of the Group in 2004 and 2005 derives from policies that cover risk situated in the US. The balance relates to risk situated predominatly in the UK and Western Europe.

Notes to the Financial Statements Year ended 31st December 2005

3. Segmental Information (continued)

b. The Group's pre-tax profit split by management activities is as follows:

Year ended 31st December 2005	**Group service activities £'000**	**Ordinary shareholders share of underwriting activities £'000**	**A shareholders share of underwriting activities £'000**	**Quota share insurers £'000**	**Total £'000**
Gross premiums written	–	60,997	17,371	50,880	129,248
Written premium ceded to reinsurers	–	(5,861)	(1,423)	(50,880)	(58,164)
Net premiums	–	55,136	15,948	–	71,084
Change in gross provision for unearned premiums	–	(17,149)	(3,860)	34,736	13,727
Reinsurers' share of change in the provision for unearned premiums	–	341	(343)	(34,736)	(34,738)
	–	(16,808)	(4,203)	–	(21,011)
Net earned premiums	–	38,328	11,745	–	50,073
Net investment income	1,301	450	380	–	2,131
Other underwriting income	–	–	–	218	218
Other income	3,045	–	–	–	3,045
	4,346	450	380	218	5,394
Revenue	4,346	38,778	12,125	218	55,467
Gross claims paid	–	(13,417)	(5,521)	(41,994)	(60,932)
Reinsurers' share of gross claims paid	–	4,932	2,058	41,994	48,984
Claims paid, net of reinsurance	–	(8,485)	(3,463)	–	(11,948)
Movement in gross technical provisions	–	(33,034)	(8,412)	(32,220)	(73,666)
Movement in reinsurers' share of technical provisions	–	6,876	1,556	32,220	40,652
Net change in provisions for claims	–	(26,158)	(6,856)	–	(33,014)
Net insurance claims	–	(34,643)	(10,319)	–	(44,962)
Expenses incurred in insurance activities	1,000	(10,907)	(3,881)	(458)	(14,246)
Other operating expenses	(2,410)	(33)	(44)	–	(2,487)
Operating expenses	(1,410)	(10,940)	(3,925)	(458)	(16,733)
Result of operating activities	2,936	(6,805)	(2,119)	(240)	(6,228)
Finance costs	(458)	–	1,385	–	927
Result before tax – continuing	2,478	(6,235)	(734)	(240)	(4,731)
– discontinuing	–	(570)	–	–	(570)
	2,478	(6,805)	(734)	(240)	(5,301)

3. Segmental Information (continued)

Year ended 31st December 2004	Group service activities £'000	Ordinary shareholders share of underwriting activities £'000	A shareholders share of underwriting activities £'000	Quota share insurers £'000	Total £'000
Gross premiums written	–	18,112	5,823	111,060	134,995
Written premium ceded to reinsurers	–	(2,966)	(1,335)	(111,060)	(115,361)
Net premiums	–	15,146	4,488	–	19,634
Change in gross provision for unearned premiums	–	(6,933)	2,859	(18,756)	(22,830)
Reinsurers' share of change in the provision for unearned premiums	–	1,187	(633)	18,756	19,310
	–	(5,746)	2,226	–	(3,520)
Net earned premiums	–	9,400	6,714	–	16,114
Net investment income	646	95	200	–	941
Other underwriting income	–	–	–	310	310
Other income	2,506	–	–	–	2,506
	3,152	95	200	310	3,757
Revenue	3,152	9,495	6,914	310	19,871
Gross claims paid	–	(2,696)	(3,517)	(19,812)	(26,025)
Reinsurers' share of gross claims paid	–	629	789	19,812	21,230
Claims paid, net of reinsurance	–	(2,067)	(2,728)	–	(4,795)
Movement in gross technical provisions	–	(6,708)	1,149	(30,505)	(36,064)
Movement in reinsurers' share of technical provisions	–	2,515	355	30,505	33,375
Net change in provisions for claims	–	(4,193)	1,504	–	(2,689)
Net insurance claims	–	(6,260)	(1,224)	–	(7,484)
Expenses incurred in insurance activities	2,100	(3,645)	(3,006)	–	(4,551)
Other operating expenses	(2,666)	–	(85)	–	(2,751)
Operating expenses	(566)	(3,645)	(3,091)	–	(7,302)
Result of operating activities	2,586	(410)	2,599	310	5,085
Finance costs	–	–	(1,663)	–	(1,663)
Result before tax – continuing	2,586	153	936	310	3,985
– discontinuing	–	(563)	–	–	(563)
	2,586	(410)	936	310	3,422

Notes to the Financial Statements Year ended 31st December 2005

3. Segmental Information (continued)

The profit from services activities arises from the Group's management of Syndicates 1200, 3245 and 1245.

The Group operates a number of corporate members who have arranged quota share reinsurance in respect of 100% of their underwriting activities. The quota share reinsurance is arranged by certain leading reinsurers who have deposited letters of credit with Lloyd's to support the underwriting activities of the above corporate members. The underwriting activities relating to these corporate vehicles are shown above under the column headed "Quota share insurers".

In the event of underwriting losses being suffered in excess of the letter of credit facility made available to Lloyd's, together with the failure of the quota share reinsurer, the liability for the excess losses would fall onto the corporate member and, therefore, the Group. The Directors are of the opinion that given the quality of the reinsurers, any residual liability to the Group is remote.

4. Net investment Income

	2005 £'000	Restated 2004 £'000
Investment income at fair value through income statement	1,300	646
Realised gains/(losses) on financial investments at fair value through income statement	857	312
Investment management expenses	(26)	(17)
	2,131	941

5. Other Income

	2005 £'000	Restated 2004 £'000
Lloyd's underwriting agent fees	1,127	959
Lloyd's underwriting profit commission	516	520
Charge to Syndicates for the use of assets	86	104
Other	1,316	923
	3,045	2,506

Fees and profit commission arise principally in the United Kingdom, from business underwritten at Lloyd's on behalf of Members resident in the United Kingdom and overseas.

6. Expenses Incurred in Insurance Activities

	2005 £'000	Restated 2004 £'000
Syndicate operating expenses	2,558	392
Members' personal expenses on Lloyd's Syndicates	539	(1,379)
Commissions and brokerage	12,098	4,926
Loss on exchange	52	612
Recovery of underwriting losses	(1,001)	–
	14,246	4,551

7. Finance Costs

	2005 £'000	Restated 2004 £'000
Loan stock		
Floating rate US$ loan stock due 2034	294	–
Floating rate Euro loan stock due 2035	164	–
Dividend payable to A shareholders:		
Within 12 months	12	1,620
After 12 months	(1,397)	43
	(927)	1,663

8. Profit on Ordinary Activities before Taxation

	2005 £'000	Restated 2004 £'000
(Loss)/profit on ordinary activities before taxation is stated after charging:		
Employee benefits expense (note 24)	1,075	1,029
Auditors' remuneration:		
For audit work	44	12
For other services	54	29
Depreciation of fixed assets	96	116
Amortisation of intangible assets	21	21
Operating lease rentals	58	68
Equity settled share based payment transactions	236	100

Notes to the Financial Statements Year ended 31st December 2005

9. Taxation on (loss)/profit on Ordinary Activities

a. *Analysis of (credit)/charge in period*

	2005 £'000	2004 £'000
Current tax – continuing operations		
Current year	1,537	198
US federal tax	56	–
	1,593	198
Deferred tax – continuing operations (note 20)	(3,434)	1,433
Taxation on (loss)/profit on ordinary activities	(1,841)	1,631

b. *Factors affecting tax charge for the year*

The tax for the year is lower (2004: lower) than the standard rate of corporation tax in the UK (30%).

The differences are explained below.

	2005 £'000	2004 £'000
(Loss)/profit on ordinary activities before tax	(5,301)	3,422
(Loss)/profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 30%	(1,590)	1,027
Expenses not deductible for tax purposes	83	24
Preference shares' dividend not subject to tax	(416)	499
Timing differences on underwriting result	3,480	(1,367)
Capital allowances for period in excess of depreciation	18	11
Utilisation of tax losses	(38)	(30)
Losses carried forward	–	49
Other timing differences	56	(13)
Small company tax rate	–	(2)
Current tax (credit)/charge for the period	1,593	198

10. Earnings per Share

Basic earnings per share is calculated by dividing the earnings attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the year. For 2005, the loss attributable to ordinary shareholders and weighted average number of ordinary shares, for the purpose of calculating the diluted earnings per ordinary share, were identical to those used for basic earnings per ordinary share because the exercise of share options would have the effect of reducing the loss per ordinary share and is therefore not dilutive under the terms of IAS 33.

For diluted earnings per share, the weighted average number of ordinary shares in issue is adjusted to assume conversion of all dilutive potential ordinary shares. The Group has two classes of dilutive potential ordinary shares: those share options granted to Directors and senior management and the convertible loan stock linked with the Funds at Lloyd's.

Reconciliations of the earnings and weighted average number of shares used in the calculations are set out below.

	2005			2004 (Restated)		
	Earnings £'000	Weighted Average Number of Shares	Per share amt (p)	Earnings £'000	Weighted Average Number of Shares	Per share amt (p)
Basic EPS						
Earnings attributable to ordinary shareholders	(3,460)	27,330,393	(0.13)	1,791	16,423,651	0.11
Effect of dilutive securities						
Options	n/a	n/a	n/a		196,143	0.00
Diluted EPS						
Adjusted earnings	n/a	n/a	n/a	1,791	16,619,794	0.11
Earnings per share from continuing operations						
Basic EPS						
Pre-tax losses from continuing operations	(4,731)	27,330,393	(0.17)	3,985	16,423,651	0.24
Tax relating to continuing operations	1,841	27,330,393	0.06	(1,631)	16,423,651	(0.10)
Basic EPS from continuing operations	(2,890)	27,330,393	(0.11)	2,354	16,423,651	0.14
Diluted EPS						
Pre-tax losses from continuing operations	n/a	n/a	n/a	3,985	16,619,794	0.24
Tax relating to continuing operations	n/a	n/a	n/a	(1,631)	16,619,794	(0.10)
Diluted EPS from continuing operations	n/a	n/a	n/a	2,354	16,619,794	0.14
Earnings per share from discontinued operations						
Basic EPS						
Pre-tax losses from discontinued operations	(570)	27,330,393	(0.02)	(563)	16,423,651	(0.03)
Tax relating to discontinued operations	–	–	–			
Basic EPS from discontinued operations	(570)	27,330,393	(0.02)	(563)	16,423,651	(0.03)
Diluted EPS						
Pre-tax losses from discontinued operations	n/a	n/a	n/a	(563)	16,619,794	(0.03)
Tax relating to discontinued operations	n/a	n/a	n/a			
Diluted EPS from discontinued operations	n/a	n/a	n/a	(563)	16,619,794	(0.03)

Notes to the Financial Statements Year ended 31st December 2005

11. Intangible Assets

	2005 £'000	2004 £'000
Group		
As at 1st January	74	80
Acquired in year	–	15
Amortised in year	(21)	(21)
As at 31st December	53	74

The amount included in intangible assets above represents Syndicate application fees payable to Lloyd's on Syndicate 1200 and Syndicate 3245.

12. Plant and Equipment

	Computer Equipment £'000	Office Equipment £'000	Total £'000
Group			
Cost			
At 1st January 2005	361	146	507
Additions	–	–	–
Disposals	(76)	–	(76)
At 31st December 2005	285	146	431
Depreciation			
At 1st January 2005	264	11	275
Charge for the period	81	15	96
Disposals	(76)	–	(76)
At 31st December 2005	269	26	295
Net book value			
At 31st December 2005	16	120	136
At 31st December 2004	97	135	232

All of the tangible fixed assets of the Group are held by a subsidiary undertaking. As at 31st December 2005, the Group had no capital commitments (2004 – £Nil).

13. Financial Investments

	Group 2005 £'000	Group 2004 £'000	Company 2005 £'000	Company 2004 £'000
Shares in subsidiary undertakings (see Note 13a)	–	–	400	508
Other investments (see Note 13a)	71	71	71	71
Funds at Lloyd's (see Note 13b)	31,787	22,505	31,233	18,451
Less convertible loan stock (see Note 13b)	(4,060)	(3,585)	(4,060)	(3,584)
Total – held directly	27,798	18,991	27,644	15,446
Held by Syndicates (see Note 13c)	90,251	79,259	–	–
	118,049	98,250	27,644	15,446

a. Shares in Subsidiary Undertakings and Other Investments

	Group 2005 Total £'000	Group 2004 Total £'000	Company 2005 Total £'000	Company 2004 Total £'000
Cost				
Heritage Group Investments Limited	–	–	400	400
Heritage Managing Agency Limited	–	–	–	–
Heritage Group Services Limited	–	–	–	–
Heritage Direct Limited	–	–	–	–
Prime Holdings Inc.	71	71	71	71
Nameco (No. 604) Limited	–	–	–	20
Nameco (No. 606) Limited	–	–	–	26
Nameco (No. 616) Limited	–	–	–	12
Nameco (No. 617) Limited	–	–	–	11
Nameco (No. 703) Limited	–	–	–	19
Nameco (No. 704) Limited	–	–	–	20
At 31st December	71	71	471	579

The Company was interested in the following principal subsidiaries at 31st December 2005 which, except where indicated, are registered in England and Wales.

Notes to the Financial Statements Year ended 31st December 2005

13. Financial Investments (continued)

	Principal Activity	Class of Shares	Held by the Company	Held through Subsidiaries
Heritage Group Investments Limited	Intermediary Holding Company	B Ordinary*	100%	-
Heritage Managing Agency Limited	Lloyd's Managing Agents	Ordinary	–	100%
Heritage Group Services Limited	Service Company	Ordinary*	100%	–
Heritage Direct Limited	Lloyd's Service Company	Ordinary	–	100%
Nameco (No. 604) Limited	Corporate Capital Vehicle	Ordinary*	100%	–
Nameco (No. 607) Limited	Corporate Capital Vehicle	Ordinary*	100%	–
Nameco (No. 616) Limited	Corporate Capital Vehicle	Ordinary*	100%	–
Nameco (No. 617) Limited	Corporate Capital Vehicle	Ordinary*	100%	–
Nameco (No. 703) Limited	Corporate Capital Vehicle	Ordinary*	100%	–
Nameco (No. 704) Limited	Corporate Capital Vehicle	Ordinary*	100%	–

*These are all held directly, all other holdings are holdings held via Heritage Group Investments Limited.

In order to comply with the 1982 Lloyd's Act, the Company transferred its interest in Heritage Managing Agency Limited to Heritage Group Investments Limited. Heritage Group Investments Limited has two classes of shares.

The A shares control the voting rights and are currently held by J Gill, the Compliance Officer of the Group. The B shares are entitled to all the economic interest in Heritage Group Investment Limited. In accordance with IAS8 Accounting Policies changes in accounting estimates and errors, the investment in Heritage Group Investment Ltd has been accounted for in accordance with its substance and economic reality rather than its legal form. Accordingly, in these financial statements this investment is accounted for as a subsidiary undertaking. Further details are shown in Note 23.

b. Funds at Lloyd's

The Group has transferred funds to be held by Lloyd's to support the underwriting activities of the Group's dedicated corporate members.

Group

	Source of funds	Cash 2005 £'000	Third party deposits and LOC 2005 £'000	Cash 2004 £'000	Third party deposits and LOC 2004 £'000
Nameco (No. 604) Limited	Heritage Underwriting Agency plc	27,292	–	15,040	8,353
Nameco (No. 607) Limited	Third Party/early release	–	16,000	1,792	17,580
Nameco (No. 616) Limited	Heritage Underwriting Agency plc	4,495	1,599	4,457	2,074
Nameco (No. 617) Limited	Third Party/early release	–	23,265	1,031	24,295
Nameco (No. 703) Limited	Third Party/early release	–	7,964	185	8,172
Nameco (No. 704) Limited	Third Party	–	27,546	–	27,546
		31,787	76,374	22,505	88,020

13. Financial Investments (continued)

Company

	Source of funds	Cash 2005 £'000	Third party deposits and LOC 2005 £'000	Cash 2004 £'000	Third party deposits and LOC 2004 £'000
Nameco (No. 604) Limited	Heritage Underwriting Agency plc	27,177	–	14,870	–
Nameco (No. 607) Limited	Third Party/early release	–	–	–	–
Nameco (No. 616) Limited	Heritage Underwriting Agency plc	4,056	–	3,581	–
Nameco (No. 617) Limited	Third Party/early release	–	–	–	–
Nameco (No. 703) Limited	Third Party/early release	–	–	–	–
Nameco (No. 704) Limited	Third Party	–	–	–	–
		31,233	–	18,451	–

The above cash supports the underwriting of Nameco (No. 604) Limited and Nameco (No. 616) Limited and will be held by Lloyd's until the underwriting liabilities of these companies are extinguished.

The Letters of Credit (LOC's) above are lodged by third parties with Lloyd's under a third party property deed on behalf of each Nameco. In the case of Nameco (No. 616) Limited, LOC's have been lodged by convertible redeemable preferences A share holders who have issued LOC's instead of paying up loan stock to the Company. In the cases of Nameco (No. 607) Limited. Nameco (No. 617) Limited, Nameco (No. 703) Limited and Nameco (No. 704) Limited, the LOC's have been lodged as part of the terms of whole account quota share reinsurance contracts entered into by those companies.

The Group's LOC total £76,374,000 (2004 – £60,673,000) and third party deposits total £nil (2004 – £27,347,000). Since these funds are held as third party deposits by Lloyd's, they have not been included in the assets of the Group or parent company.

The Group cash for 2005 includes the continuous solvency releases. On the "Third Party" funds it is all of the cash, on Nameco (No. 604) Limited and Nameco (No. 616) Limited and it is £115,000 (2004 – £146,769) and £439,000 (2004 – £876,130) respectively.

In accordance with IAS 32, the book value of the convertible loan stock has been set off against the book value of the linked Funds at Lloyd's. This is because the Group intends to realise the asset and settle the liability simultaneously.

Notes to the Financial Statements Year ended 31st December 2005

13. Financial Investments (continued)

c. *Held by Syndicates*

Group	Historic Cost 2005 £'000	Market Value 2005 £'000	Historic Cost 2004 £'000	Market Value 2004 £'000
Debt securities and other fixed income securities	88,957	90,251	79,457	79,259

Analysis of market value	2005 £'000	2004 £'000
Listed on a recognised stock exchange	87,393	79,163
Unlisted	2,858	96
	90,251	79,259

14. Other Receivables, including Insurance Receivables

	Group 2005 £'000	Group 2004 £'000	Company 2005 £'000	Company 2004 £'000
Debtors arising from direct insurance operations	40,074	46,973	–	–
Debtors arising from reinsurance operations	84,057	75,199	–	–
Insurance receivables	124,131	122,172	–	–
Amounts owed by group undertakings	–	–	318	832
Subordinated loan to subsidiary undertaking	–	–	300	300
Amounts owed by managed Syndicates	3,212	401	–	30
– Other debtors	760	3,287	3,037	8,453
– Syndicate's other debtors	10,647	7,612	–	–
– Prepayments	32,060	22,791	–	–
– Trade debtors	1,613	1,312	–	–
	48,292	35,403	3,655	9,615
	172,423	157,575	3,655	9,615

The subordinated loan is due from Heritage Managing Agency Limited, a wholly owned subsidiary of Heritage Underwriting Agency plc. The purpose of the loan was to enable Heritage Managing Agency Limited to meet its Lloyd's solvency requirements.

15. Cash and Cash Equivalents

	Group		Company	
		Restated		Restated
	2005	2004	2005	2004
	£'000	£'000	£'000	£'000
Cash in bank and at hand	45,406	13,512	4,217	71

16. Current Income Tax

	Group		Company	
	2005	2004	2005	2004
	£'000	£'000	£'000	£'000
Current tax assets	–	–	–	3
Current tax liabilities	1,548	197	168	–

17. Trade and Other Payables

	Group		Company	
		Restated		Restated
	2005	2004	2005	2004
	£'000	£'000	£'000	£'000
Creditors arising from direct insurance operations	1,804	200	–	–
Creditors arising from reinsurance operations	92,796	109,117	–	–
Insurance payables	94,600	109,317	–	–
Amounts owed to group undertakings	–	–	3,821	805
Other insurance creditors	9,628	3,230	–	–
Trade creditors	4,546	1,588	–	–
Other creditors	9,059	7,816	36	6,959
Dividend due to preference shareholders	268	3,259	–	1,620
Accruals and deferred income	3,294	2,982	427	351
	26,795	18,875	4,284	9,735
	121,395	128,192	4,284	9,735

Notes to the Financial Statements Year ended 31st December 2005

18. Financial Liabilities

a. Loan stock

	Group		Company	
	2005 £'000	2004 £'000	2005 £'000	2004 £'000
Non current				
Floating rate US$ loan stock due 2034	3,779	3,399	3,779	3,399
Floating rate Euro loan stock due 2035	8,219	–	8,219	–
	11,998	3,399	11,998	3,399

In the year ended 31st December 2004, the Company issued US dollar denominated loan stock of $6.5 million which carries an interest rate of 4.2% over the 6 month US dollar LIBOR rate. The loan is repayable in 2034 with an option to repay from 2010. The notes have been listed on the Irish Stock Exchange. In the event of winding up, the loan stock will rank in priority to distributions on all classes of share capital and will rank pari passu with each of the claims of all unsubordinated creditors.

In the year ended 31st December 2005, the Company issued Euro denominated loan stock of €12 million which carries an interest rate of 4.0%, over the 3 month Euro LIBOR rate. The loan is repayable in 2035 with an option to repay from 2011. In the event of winding up, the loan stock will rank in priority to distributions on all classes of share capital and will rank pari passu with each of the claims of all unsubordinated creditors.

b. Preference Shares

	2005 £'000	2004 £'000
Group and Company		
Authorised		
500,000 A preference shares of 10p each	50	50
Allotted, called up and fully paid		
59,511 A preference shares of 10p each	6	6

The preference shares which are classified as debt under IAS 32, and which carry restricted voting rights, were issued in 2002 at 10p nominal value per share. The Company undertook two share issues in July and November 2002 in order to support Syndicate 1200's underwriting. Under these two issues potential investors were invited to subscribe for A shares which are linked to A1 and A2 loan stock, which was also issued by the Company at the same time. The loan stock and the corresponding linked preference shares (the A shares) are known as A units. A1 loan stock was fully paid and the Company has used these funds to support Syndicate 1200. The loan stock attached to the A2 units were nil paid, but the investor has an obligation to maintain funds at Lloyd's supporting Syndicate 1200, equivalent to the nominal value of the loan stock. The holders of the A1 and A2 units have a right to receive as a dividend their share of the profit generated by Syndicate 1200 less appropriate expenses. A1 units are also entitled to the appropriate interest earned on the funds at Lloyd's to support Syndicate 1200.

18. Financial Liabilities (continued)

These dividends are on a cumulative basis and are payable within 90 days of the date Nameco (No. 616) Limited paid a dividend to the Company. On winding up or in the event that dividends on these shares are in arrears for 90 days or more, holders of the preference shares become entitled, subject to approval from 75% of the holders, to exercise a right compelling Heritage Underwriting Agency plc to transfer the entire issued share capital of Nameco (No. 616) Limited to the preference shareholders (or a third party nominated by them). They also become entitled to procure that Heritage Managing Agency Limited transfers the right to manage Syndicate 1200 to a Lloyd's managing agent appointed by the preference share holders, subject to Lloyd's approval.

A preference share holder can convert the preference shares into ordinary shares in the Company annually, subject to the minimum investment period.

In the event of an Initial Public Offering or a directive issued by Lloyd's to alter the capital structure, the preference share holders may be required to convert their A units into ordinary shares in Heritage Underwriting Agency plc at a fair value to be determined by the auditors.

The funds raised from the issue of the fully paid convertible loan notes have been deposited with Lloyd's to support Nameco (No. 616) Limited underwriting. The convertible loan notes will only be repaid once these funds have been released by Lloyd's. Accordingly the liability arising from the fully paid loan note has been off set against its equivalent funds at Lloyd's. This is illustrated note 13.

Any interest received from the above Funds at Lloyd's are payable to the fully paid convertible loan stock holders.

c. Currencies

The carrying amount of the Group's borrowings are denominated in the following currencies:

	Group		Company	
	2005	**2004**	**2005**	**2004**
	£'000	**£'000**	**£'000**	**£'000**
Pound Sterling	6	6	6	6
Dollar	3,779	3,399	3,779	3,399
Euro	8,219	–	8,219	–
	12,004	3,405	12,004	3,405

Notes to the Financial Statements Year ended 31st December 2005

18. Financial Liabilities (continued)

Fair value of non-current borrowings

	Group		Group	
	2005 Book value £'000	2005 Fair Value £'000	2004 Book value £'000	2004 Fair Value £'000
Long term borrowings	11,998	11,998	3,399	3,399
Preference shares	6	6	6	6
	12,004	12,004	3,405	3,405

Fair values of other financial assets and financial liabilities

	£'000	£'000	£'000	£'000
Preference share dividend	268	268	3,259	3,259
Liabilities arising out of direct insurance operations	1,804	1,804	200	200
Liabilities arising out of reinsurance operations	92,796	92,796	109,117	109,117
Other liabilities	28,075	28,075	15,811	15,811
Debtors arising out of direct insurance operations	40,074	40,074	46,973	46,973
Debtors arising out of reinsurance operations	84,057	84,057	75,199	75,199
Other receivables	49,335	49,335	35,573	35,573
Reinsurers' share of Technical provisions	45,221	45,221	37,702	37,702
Short term deposits	–	–	–	–
Cash at bank and in hand	45,406	45,406	13,512	13,512

d. Maturity of Financial Liabilities

All of the Group's non current liabilities mature in more than five years.

e. Banking Facilities

The Company entered into an agreed 12 month overdraft facility with The Royal Bank of Scotland to a limit of £500,000 on 17th November 2004. Interest of 1.75% over the bank's base rate was payable on any borrowing up to the overdraft facility limit, and at 29.5% per annum for any borrowings in excess of the overdraft facility. The facility was due to expire on 19th November 2005 but was extended for an additional 2 months. On 23rd January 2006 a new facility with the Royal Bank of Scotland was entered into up to a limit of £500,000 and at the same interest rate for borrowings up to the facility limit but at 6.75% over the bank's base rate for borrowings in excess of the overdraft facility.

The overdraft facility was utilised during 2005 to its full extent with a draw down of £350,000 on 26th January 2005 and £150,000 on 1st February 2005 which was repaid in full by 25th April 2005. At 31st December 2005 £10,833 was included within creditors and represents funds borrowed under the bank overdraft facility. The amount outstanding at any time under this facility is secured by the bank with a floating charge over the assets of Heritage Underwriting Agency Plc.

19. Insurance Liabilities and Reinsurance Balance

a. *Movement in Claims Outstanding*

	2005 Gross £'000	2005 Reinsurance £'000	2005 Net £'000	2004 Gross £'000	2004 Reinsurance £'000	2004 Net £'000
Claims reported and loss adjustment expenses	44,912	17,201	27,711	16,535	4,855	11,680
Claims incurred but not reported	32,698	6,362	26,336	25,888	4,119	21,769
At 1st January	77,610	23,563	54,047	42,423	8,974	33,449
Claims paid	(60,932)	(48,984)	(11,948)	(26,025)	(21,230)	(4,795)
Increase in ultimate claims:						
2005 year of account - current	86,453	19,751	66,702	47,170	11,772	35,398
2004 and prior years of account	57,222	46,472	10,750	12,541	22,938	(10,397)
Change in group participation	(432)	(104)	(328)	–	–	–
Net exchange difference	(2,244)	(541)	(1,703)	1,501	1,109	392
At 31st December	157,677	40,157	117,520	77,610	23,563	54,047

b. *Movement in Unearned Premium*

	2005 Gross £'000	2005 Reinsurance £'000	2005 Net £'000	2004 Gross £'000	2004 Reinsurance £'000	2004 Net £'000
At 1st January	80,835	14,139	66,696	58,814	10,118	48,696
Premiums written in year	129,248	10,653	118,595	134,992	25,915	109,077
Premiums earned in year	(142,975)	(20,320)	(122,655)	(111,977)	(21,398)	(90,579)
Net exchange difference	5,328	592	4,736	(994)	(496)	(498)
At 31st December	72,436	5,064	67,372	80,835	14,139	66,696

c. *Assumptions, Changes in Assumptions and Sensitivity*

The reserves carried by the Group are calculated by the underwriting and reserving team using a number of methods to project ultimate gross and net premiums written and insurance liabilities. The principal methods applied are as follows:

- A case by case review of certain lines of business.
- The use of hurricane modelling techniques for major hurricane events during the year.
- Benchmarking certain lines of business based on previous underwriting experience, in particular the longer tail classes of business.
- Actuarial techniques such as the chain ladder method and the Bornhuetter-Ferguson method. These are mainly applied to the classes of business that have a relatively stable development pattern.

19. Insurance Liabilities and Reinsurance Balance (continued)

The Group also commissioned an independent external actuarial assessment of its reserves to ensure that the reserves established are reasonable. The eventual reserves selected are then subject to an independent peer review and any comments or adjustments recommended are incorporated into the final figures.

The major assumptions underlying the reserves established by the Group are:

- The Group's past claims development experience (with appropriate adjustment for known changes) can be used to project future claims development factors.
- The hurricanes experienced during calendar year 2005 will have similar claims development factors to previous years' hurricanes.
- In 2006, the incidence and size of hurricanes will return to normal levels.
- The Group will experience normal incidence of bad debts against future recoveries.

The Group has not revised any reserving assumptions that materially affect the profit or loss.

The loss reserves established by the Company are sensitive to various factors as follows:

- The reserves established to cover claims from the 2005 hurricanes. A 10% net adverse movement in the ultimate loss established for the 2005 hurricanes would reduce the Group's pre-tax profit by £1.5m
- The ULR established to cover attritional losses on the 2005 year of account of Syndicates 1200 and 3245. A 10% gross adverse movement in the gross ULR in respect of these syndicates will reduce the Group's pre-tax profits as follows:

Syndicate 1200	£4.3m
Syndicate 3245	£0.9m

- The run-off reserve established for Syndicate 1245 2002 year of account. A 10% gross adverse movement in the run-off reserves would reduce the Group's pre-tax profit by £0.2m.
- The percentage of premiums earned during the calendar year. A 10% increase in the unearned premium for Syndicates 1200 and 3245 would reduce the pre-tax profit of the Group as follows:

Syndicate 1200	£2.2m
Syndicate 3245	£0.6m

d. Surplus/Deficit on Reserves established in Previous Years

The loss development tables that follow are disclosed to provide information about historical claims development. In effect, the tables highlight the Group's ability to provide a robust estimate of the claims costs.

The top part of the table illustrates how the Group's estimate of ultimate loss ratios for each underwriting year for each syndicate under its management has changed at successive year-ends. The bottom half of the table reconciles the gross and net claims to the amount appearing in the Balance Sheet. An underwriting year basis is considered to be the most appropriate basis for business written by the Group.

19. Insurance Liabilities and Reinsurance Balance (continued)

While the information in the table provides a historical perspective on the adequacy of the claims liabilities established in previous years, users of these financial statements are cautioned against extrapolating redundancies or deficiencies of the past on current claims liabilities. The Group believes that the estimate of total claims liabilities as at 31st December 2005 are adequate. However, due to the inherent uncertainties in the reserving process, it cannot be assured that such balances will ultimately prove to be adequate.

Syndicate 1200	**2002**	**2003**	**2004**	**2005**	**Total**
Underwriting Year – Gross					
12 months		70%	92%	112%	
24 months		58%	104%		
36 months		56%			
	£'000	**£'000**	**£'000**	**£'000**	**£'000**
Total gross claims	–	40,651	92,642	75,639	208,932
Less paid claims	–	25,790	44,748	15,057	85,595
Gross RITC provision	33	–	–	–	33
Gross claims liabilities	33	14,861	47,894	60,582	123,370

	2002	**2003**	**2004**	**2005**	**Total**
Underwriting Year – Net					
12 months		71%	86%	106%	
24 months		56%	93%		
36 months		53%			
	£'000	**£'000**	**£'000**	**£'000**	**£'000**
Total gross claims	–	28,970	64,564	57,890	151,424
Less paid claims	–	18,804	30,885	9,915	59,604
Net RITC provision	25	–	–	–	25
Net claims liabilities	25	10,166	33,679	47,975	91,845

Notes to the Financial Statements Year ended 31st December 2005

19. Insurance Liabilities and Reinsurance Balance (continued)

Syndicate 3245	**2003**	**2004**	**2005**	**Total**
Underwriting Year – Gross				
12 months	81%	83%	83%	
24 months	81%	76%		
36 months	70%			
	£'000	**£'000**	**£'000**	**£'000**
Total gross claims	10,617	11,479	8,995	31,091
Less paid claims	1,011	487	138	1,636
Gross claims liabilities	9,606	10,992	8,857	29,455

	2003	**2004**	**2005**	**Total**
Underwriting Year – Net				
12 months	79%	80%	77%	
24 months	77%	71%		
36 months	68%			
	£'000	**£'000**	**£'000**	**£'000**
Total gross claims	8,378	8,813	6,715	23,906
Less paid claims	877	487	138	1,502
Net claims liabilities	7,501	8,326	6,577	22,404

19. Insurance Liabilities and Reinsurance Balance (continued)

Syndicate 1245	**2002 and earlier**	**2003**	**2004**	**Total**
Underwriting Year – Gross				
12 months		76%	97%	
24 months		87%	119%	
36 months		95%		
	£'000	**£'000**	**£'000**	**£'000**
Total gross claims	–	2,802	3,055	5,857
Less paid claims	–	1,076	1,707	2,783
Gross EFL claims provision	1,777	–	–	1,777
Gross claims liabilities	1,777	1,726	1,348	4,851

	2002 and earlier	**2003**	**2004**	**Total**
Underwriting Year – Net				
12 months		79%	85%	
24 months		82%	104%	
36 months		85%		
	£'000	**£'000**	**£'000**	**£'000**
Total gross claims	–	1,747	2,046	3,793
Less paid claims	–	700	922	1,622
Net EFL claims provision	1,100	–	–	1,100
Net claims liabilities	1,100	1,047	1,124	3,271

Balance sheet reconciliation	**2002 and earlier £'000**	**2003 £'000**	**2004 £'000**	**2005 £'000**	**Total £'000**
Net Claims Liability					
Syndicate 1200	25	10,166	33,679	47,975	91,845
Syndicate 3245	–	7,501	8,326	6,577	22,404
Syndicate 1245	1,100	1,047	1,124	–	3,271
Per Balance Sheet	1,125	18,714	43,129	54,552	117,520
Gross claims liability per Balance Sheet	1,810	26,193	60,235	69,439	157,677
Reinsurer's share	685	7,479	17,106	14,887	40,157
Per Balance Sheet	1,125	18,714	43,129	54,552	117,520

Notes to the Financial Statements Year ended 31st December 2005

20. Deferred Income Tax

Deferred income tax is calculated in full on temporary differences under the liability method using a tax rate of 30% (2004 – 30%). The movement on the deferred tax account is shown below:

	Group		Company	
	2005 £'000	Restated 2004 £'000	2005 £'000	Restated 2004 £'000
At 1st January	2,391	958	32	32
(Credit)/charge for the year	(3,434)	1,433	–	–
At 31st December	(1,043)	2,391	32	32

Deferred tax (asset)/liability

Deferred income tax assets have been recognised in respect of all tax losses and other temporary differences giving rise to deferred income tax assets because it is probable that these assets will be recovered.

The movements in deferred income tax assets and liabilities (prior to the offsetting of balances within the same jurisdiction as permitted by IAS 12) during the year are shown below.

Deferred tax income assets and liabilities are only offset where there is a legally enforceable right of offset and there is an intention to settle the balances net.

Deferred tax assets	***Other timing differences £'000***	***Total £'000***
At 1st January 2005	(170)	(170)
Charge for year	(873)	(873)
At 31st December 2005	(1,043)	(1,043)

Deferred tax liabilities	***Other timing differences £'000***	***Total £'000***
At 1st January 2005	2,561	2,561
Charge for year	(2,561)	(2,561)
At 31st December 2005	–	–

Other timing differences relates to a timing difference arising from the underwriting profits and associated costs which are subject to corporation tax in the year they are distributed.

All of the deferred tax assets were available for offset against deferred tax liabilities and hence the net deferred tax provision at 31st December 2005 was £(1,043,000).

21. Share Capital

Group and Company

	2005 £	Restated 2004 £
Authorised		
Ordinary shares of 10p each	4,950,000	4,950,000
Allotted called up and fully paid		
28,752,148 Ordinary shares of 10p each	2,875,215	2,012,982
Allotted, partly called up and partly paid		
700,000 Ordinary shares of 10p each	70,000	80,000
	2,945,215	2,092,982

During 2004 only 50% of the November 2004 share placing had been issued as approval was required from the Financial Services Authority for Perserverance Limited and Hays Group Inc; to be controllers (i.e. own more than 9.9% of the issued ordinary share capital); this approval was received in March 2005 and the remaining ordinary shares which had been conditionally placed were issued. At December 2004 proceeds received by the Company from the conditional shares were included as creditors rather than as shareholders funds. On issuance of the shares in March 2005 £5,940,888 was moved to shareholders funds.

Potential Issues of Ordinary Shares

Certain senior executives hold options to subscribe for shares in the Company at prices ranging from 50p to 70p under the share option schemes approved by shareholders in January 2002. During the year 38,000 options were exercised with an exercise price of 0.50p. The number of shares subject to options, the periods in which they were granted and the periods in which they may be exercised are given below:

Year and date of grant	Exercise price p	Exercise period	2005 Numbers	2004 Numbers
2002 – 11th November 2002	0.50p	2003-2011	526,000	563,500
2003 – 23rd March 2003	0.60p	2003-2012	154,000	154,000
2004 – 23rd March 2004	0.70p	2004-2013	1,607,500	1,607,500
2004 – 30th June 2004	0.70p	2004-2013	125,000	125,000
2005 – 1st April 2005	0.70p	2005-2014	1,950,000	1,950,000

Notes to the Financial Statements Year ended 31st December 2005

22. Share Based Payments

The Executive Share Option Plan (ESOP) was introduced in November 2002. Under the ESOP the remuneration committee can grant options over shares in the Company to employees of the Company. Options are granted with a fixed exercise price equal to the market price of the shares under option at the date of grant. The contractual life of an option is ten years. Awards under the ESOP are generally reserved for employees at senior management. The Company has made annual grants each year since November 2002. Options granted under the ESOP will become exercisable on the third anniversary of the date of grant. Exercise of an option is subject to continued employment. No performance conditions were included in the fair value calculations. The fair value per option granted and the assumptions used in the calculation are as follows:

	November 2002	March 2003	March 2004	June 2004	April 2005
Grant date	11/11/02	23/03/03	23/03/04	30/06/04	01/04/05
Share price at grant date and exercise price	0.50p	0.60p	0.70p	0.70p	0.70p
Shares under option	526,000	154,000	1,607,500	125,000	1,950,000
Option life (years)	10	10	10	10	10
Vesting period (years)	3	3	3	3	3
Expected life (years)	3	3	3	3	3
Expected compound growth rate in share price over option period	12.5%	12.5%	12.5%	12.5%	12.5%
Required total rate of return for a shareholder	20%	20%	20%	20%	20%
Fair value per option	£0.16	£0.15	£0.16	£0.18	£0.21

On 15th December 2004 the remuneration committee authorised the issue of 1,950,000 further options for ordinary shares at 70p to members of the board and staff. These options were authorised subject to the approval by the FSA to two new shareholders who breached the 10% holding level.

22. Share Based Payments (continued)

A reconciliation of option movements over the year to 31st December 2005 is shown below:

	Number ('000)	2005 Weighted average exercise price (p)	Number ('000)	2004 Weighted average exercise price (p)
Outstanding at 1st January	4,400	67	740	52
Granted	–	–	3,682	70
Exercised	(38)	50	–	–
Lapsed	–	–	(22)	50
Outstanding at 31st December	4,362	67	4,400	67
Exercisable at 31st December	526	50	564	50

A charge has been made to the income statements for options granted, details of which are shown in the table below:

	Nov 2002	March 2003	March 2004	June 2004	April 2005	Total
Option exercise price	0.50p	0.60p	0.70p	0.70p	0.70p	
Opening reserve at 1st January (£)	41,416	13,227	69,040	3,579	–	127,262
Charge for year (£)	18,223	7,558	92,054	7,158	111,666	236,659
Closing reserve at 31st December (£)	59,639	20,785	161,094	10,737	111,666	363,921

Notes to the Financial Statements Year ended 31st December 2005

23. Investment in Heritage Group Investments Limited

As explained in note 13(a) Heritage Group Investments Limited has been accounted for as a subsidiary undertaking in accordance with IAS 8 "Accounting policies, changes in accounting estimates and errors" the investment has been accounted for in accordance with its substance and economic reality rather than its legal form. Consolidated in the group accounts are the following amounts (net of consolidation adjustments) in respect of Heritage Group Investments Limited and its subsidiary undertakings.

	2005 £'000	2004 £'000
Income statement		
Investment income	56	19
Other income	2,221	2,068
Operating expenses	(1,579)	(1,575)
Profit before tax	698	512
Income tax	(363)	(177)
Profit for the year	335	335

	2005 £'000	2004 £'000
Balance sheet		
Plant and equipment	136	232
Financial investments	38	59
Other receivables	3,046	3,413
Cash and cash equivalents	8,441	670
Trade and other payables	(4,298)	(2,983)
Reserves	71	(323)

24. Employees and Directors

	2005 £'000	2004 £'000
Employee Benefit Expense for the Group during the Year		
Wages and salaries	5,045	3,893
Social security costs	585	404
Pension costs	80	434
Other costs	465	391
	6,175	5,122
Less costs recharged to syndicates	(5,100)	(4,093)
Costs borne by Group	1,075	1,029

	Number	Number
Average Number of Employees		
Executive Directors	6	7
Non-executive Directors	7	3
Underwriting staff	40	37
Office and management staff	21	16
	74	63

	£'000	£'000
Directors' Remuneration		
Directors' emoluments	1,608	1,302
Less costs recharged to syndicates	(1,244)	(657)
Costs borne by Group	364	645
Highest paid Director		
Salary	350	275
Profit related pay	313	437
	663	712

The Group has accrued on behalf of certain Directors, contributions to money purchase pension schemes totalling £102,000 (2004 – £109,000). Of this, £75,843 (2004 – £90,000) was borne by Syndicates 1200, 1245 and 3245.

Three (2004 – three) Directors have retirement benefits accruing under money purchase pension schemes.

No share options were exercisable by the Directors during the year.

Notes to the Financial Statements Year ended 31st December 2005

25. Pension Commitments

Charges have been made totalling £79,993 (2004 – £66,001) for the provision of pension contributions for Directors and staff. These sums will be paid into individual personal pension plans held in separately administered funds on behalf of the employees.

26. Related Party Transactions

During the year, the Group paid the following expenses on behalf of Syndicates 1200, 1245 and 3245:

	2005 £'000	2004 £'000
Salaries and related costs	5,100	4,093
Other administrative expenses	1,160	2,785
	6,260	6,878

The tables set out below illustrate the group and parent company intercompany balances at each relevant year end the amounts owed are repayable on demand.

Group	2005 £'000	2004 £'000
Balances owed from/to group companies at the year end:		
Amount owed to managed syndicate:		
Syndicate 1200	239	–
	239	–
Amount due from managed syndicates:		
Syndicate 1200	–	149
Syndicate 1245	53	101
Syndicate 3245	1,292	151
	1,345	401

Company	2005 £'000	2004 £'000
Balances due to company at the year end:		
Amount due from group companies		
Heritage Group Investments Limited	7	30
Heritage Direct Limited	311	–
Heritage Managing Agency Limited	–	684
Nameco's	–	148
Subordinated loan to Heritage Managing Agency Limited	300	300
	618	1,162

26. Related Party Transactions (continued)

	2005 £'000	2004 £'000
Balances owed to group companies at the year end:		
Amount owed to group companies		
Heritage Managing Agency Ltd.	2,688	–
Heritage Direct Limited	–	484
Heritage Trustees Limited	738	321
Nameco's	395	–
	3,821	805

Messrs Hanbury and Rock participate on the Group's managed syndicate's please see table below for their participations through personal and corporate vehicles.

Name	Syndicate	2006 £	2005 £	2004 £	2003 £	2002 £
N J Hanbury	1200	505,341	100,000	115,000	100,000	–
N J Hanbury Limited	1200	1,013,195	325,000	395,626	208,516	–
N J Hanbury	3245	100,773	50,000	100,000	–	–
N J Hanbury Limited	3245	504,061	225,000	415,214	–	–
N J Hanbury	1245	–	–	50,000	38,751	–
N J Hanbury Limited	1245	–	–	418,640	401,193	446,840
L J Rock	1200	750,000	500,000	375,000	250,000	–

Other related party interests relate to investors in our group and managed syndicates. Please see below a table of their share holdings and participations on managed syndicates:

	Shareholding Number of Shares £'000			Participation† £m		
	2006*	2005	2004	2006	2005	2004
Perseverance Limited	–	6,618	–	30	30	–
The Hays Group Inc	4,486	4,486	1,385	10	8	–
The Bank of New York (Nominees) Limited (EEA)	2,912	2,912	1,567	–	–	–
Waters Investments II LLC (Hays)	2,098	2,098	1,397	–	–	–
HCC Insurance Holdings Inc	6,945	–	–	–	–	–

*Shareholding for 2006 is as at 26th June 2006.

†Participation is participation on managed syndicate by underwriting year of account.

The Hays Group participated on Syndicate 1200 and 3245 on the 2005 year of account through a £3 million pound contribution to the funds at Lloyd's requirement for Nameco (No. 604) Limited by their company Waters Investment III LLC. In Nov 2005 the Company purchased the participation on Nameco (No. 604) Limited for £3 million from the Hays Group and therefore they did not participate on the 2006 year of account through Nameco (No. 604) Limited. The Hays Group remains liable for their share of any profits or losses incurred on the 2005 year of account. The Hays groups also particpate on Syndicate 1200 by ownership 22,250 A units giving implied participations of £1.9m, £6.3m and £3.5m on the 2004, 2005 and 2006 underwriting years of account.

Notes to the Financial Statements Year ended 31st December 2005

26. Related Party Transactions (continued)

Mr Hays who is a non executive director of the Company is also a connected party via Water Investments II LLC a major shareholder in the Company.

Mr Cook who is a non executive director of the Company is also a connected part via HCC Insurance Holdings Inc a major shareholder in the Company.

HUA has provided consultancy services to Equity Partnership Limited, for which £13,000 is receivable in respect of the 2005 calendar year.

Mr Denniston was appointed a Non-Executive Director of Dual International, a subsidiary of Hyperion on 16th May 2006. Part of the Group's own insurance policy is placed by Dual International.

27. Syndicate Participations

The Group's corporate vehicles have the following lines on the 2004 and 2005 underwriting years of account of syndicates 1200, 1245 and 3245:

	2005 yoa Syndicate 1200 £m	2005 yoa Syndicate 3245 £m	2004 yoa Syndicate 1245 £m	2004 yoa Syndicate 1200 £m	2004 yoa Syndicate 3245 £m
Nameco (No. 604) Limited	47.07	11.40	3.89	10.36	1.94
Nameco (No. 607) Limited	–	–	–	–	–
Nameco (No. 616) Limited	15.24	–	–	4.61	–
Nameco (No. 617) Limited	–	–	–	44.00	–
Nameco (No. 703) Limited	12.50	–	–	12.50	–
Nameco (No. 704) Limited	21.00	21.00	–	20.00	20.00
	95.81	32.40	3.89	91.47	21.94

	2005 yoa Syndicate 1200 %	2005 yoa Syndicate 3245 %	2004 yoa Syndicate 1245 %	2004 yoa Syndicate 1200 %	2004 yoa Syndicate 3245 %
Nameco (No. 604) Limited	31	20	11	9	4
Nameco (No. 607) Limited	–	–	–	–	–
Nameco (No. 616) Limited	10	–	–	4	–
Nameco (No. 617) Limited	–	–	–	37	–
Nameco (No. 703) Limited	8	–	–	11	–
Nameco (No. 704) Limited	14	36	–	17	40
	63	56	11	78	44

28. Group Owned Net Assets

The consolidated balance sheet includes the following assets and liabilities held by Syndicates on which the Group participates. These assets are subject to trust deeds for the benefit of the relevant syndicates' insurance creditors. The table below illustrated the split of the group consolidated balance sheet between syndicate and group owned assets and liabilities.

		2005			Restated 2004		
		Group	Synd	Total	Group	Synd	Total
	Note	£'000	£'000	£'000	£'000	£'000	£'000
Assets							
Intangible assets	11	53	–	53	74	–	74
Plant and equipment	12	136	–	136	232	–	232
Financial investments							
– Investments	13	27,798	90,251	118,049	18,991	79,259	98,250
– Deposits with ceding undertakings		–	2	2	–	2	2
Reinsurance assets							
– Reinsurers' share of outstanding claims	19	–	40,157	40,157	–	23,563	23,563
– Reinsurers' share of unearned premiums	19	–	5,064	5,064	–	14,139	14,139
Other receivables, including insurance receivables	14						
– Direct insurance operations		–	40,074	40,074	–	46,973	46,973
– Reinsurance operations		–	84,057	84,057	–	75,199	75,199
– Other loans and receivables		8,787	39,505	48,292	6,710	28,693	35,403
Cash and cash equivalents	15	12,123	33,283	45,406	556	12,956	13,512
Deferred tax asset		1,241	(198)	1,043	–	170	170
Total Assets		50,138	332,195	382,333	26,563	280,954	307,517

Notes to the Financial Statements Year ended 31st December 2005

28. Group Owned Net Assets (continued)

	Note	2005 Group £'000	2005 Synd £'000	2005 Total £'000	Restated 2004 Group £'000	Restated 2004 Synd £'000	Restated 2004 Total £'000
Liabilities							
Insurance liabilities	19						
– Claims outstanding		–	157,677	157,677	–	77,610	77,610
– Unearned premiums		–	72,436	72,436	–	80,835	80,835
Current tax liabilities	16	1,548	–	1,548	197	–	197
Trade and other payables, including insurance payables	17						
– Direct insurance operations		–	1,804	1,804	–	200	200
– Reinsurance operations		–	92,796	92,796	–	109,117	109,117
– Other trade and payables		15,862	10,933	26,795	14,516	4,359	18,875
Financial liabilities							
– Floating rate loan stock	18	11,998	–	11,998	3,399	–	3,399
– Preference shares	18	6	–	6	6	–	6
Deferred tax liabilities	20	–	–	–	2,561	–	2,561
Total liabilities		29,414	335,646	365,060	20,679	272,121	292,800
Consolidated shareholders fund at 31st December		20,724	(3,451)	17,273	5,884	8,834	14,717

29. Operating Lease Commitments

In March 2004 Heritage Trustees Limited, a 100% subsidiary of Heritage Underwriting Agency plc, agreed a lease which commits the Company to rental payments until 23rd June 2010. This is guaranteed by Heritage Underwriting Agency plc. This commitment, together with the lease commitment for Heritage Managing Agency Limited is disclosed below:

	2005 £'000	2004 £'000
Land and Buildings		
Expiring within one year	448	448
Expiring within two and five years	1,568	1,792
Expiring after five years	–	224

30. Reconciliation of Net Assets and Profit under UK GAAP to IFRS

Heritage Underwriting Agency plc reported under UK GAAP in its previously published financial statements for the year ended 31st December 2004. The analysis below shows a reconciliation of net assets and profit as reported under UK GAAP as at 31st December 2004 to the revised net assets and profit under IFRS as reported in these financial statements. In addition, there is a reconciliation of net assets under UK GAAP to IFRS at the transition date for this Company being 1st January 2004.

Reconciliation of Equity at 1st January 2004 (Date of Transition to IFRS)

Group	Note	UK GAAP £'000	Effect of transition to IFRS £'000	IFRS £'000
Assets				
Plant and equipment		189	–	189
Intangible assets		80	–	80
Financial investments – investments		33,823	–	33,823
Deposits with ceding undertakings		2	–	2
Reinsurance assets				
– Reinsurers' share of outstanding claims		8,975	–	8,975
– Reinsurers' share of unearned premiums	a.	10,013	105	10,118
Other receivables, including insurance receivables				
– Direct insurance operations		40,734	–	40,734
– Reinsurance operations		61,090	–	61,090
– Other loans and receivables	a.	18,822	127	18,949
Cash and cash equivalents		24,095	–	24,095
Deferred tax asset	b.	–	248	248
Total Assets		197,823	480	198,303

Notes to the Financial Statements Year ended 31st December 2005

30. Reconciliation of Net Assets and Profit under UK GAAP to IFRS (continued)

Group

	Note	UK GAAP £'000	Effect of transition to IFRS £'000	IFRS £'000
Liabilities				
Insurance liabilities				
– Claims outstanding		42,423	–	42,423
– Unearned premiums	a.	58,353	461	58,814
Trade and other payables, including insurance payables		–	–	–
– Direct insurance operations		1,606	–	1,606
– Reinsurance operations		75,548	–	75,548
Other trade and payables	c., e.	8,565	2,019	10,584
Financial liabilities – preference shares	e.	–	6	6
Total Liabilities		186,495	2,486	188,981
Shareholders' Equity				
Share capital		1,575	(6)	1,569
Share options reserve	d.	–	27	27
Share premium		7,297	–	7,297
Retained earnings		2,456	(2,027)	429
Total Shareholders' Equity		11,328	(2,006)	9,322
Total Liabilities and Shareholder's Equity		197,823	480	198,303

30. Reconciliation of Net Assets and Profit under UK GAAP to IFRS (continued)

Reconciliation of equity at 31st December 2004

Group

	Note	UK GAAP £'000	Effect of transition to IFRS £'000	IFRS £'000
Assets				
Intangible assets		74	–	74
Plant and equipment		232	–	232
Financial investments – investments		98,274	(24)	98,250
Deposits with ceding undertakings		2	–	2
Reinsurance assets				
– Reinsurers' share of outstanding claims		24,105	(542)	23,563
– Reinsurers' share of unearned premiums	a.	14,057	82	14,139
Other receivables, including insurance receivables				
– Direct insurance operations		46,973	-	46,973
– Reinsurance operations		75,200	-	75,200
– Other loans and receivables		35,478	(76)	35,402
Cash and cash equivalents		13,510	2	13,512
Deferred tax asset	b.	–	170	170
Total Assets		307,905	(388)	307,517

Notes to the Financial Statements Year ended 31st December 2005

30. Reconciliation of Net Assets and Profit under UK GAAP to IFRS (continued)

Reconciliation of equity at 31st December 2004

Group

	Note	UK GAAP £'000	Effect of transition to IFRS £'000	IFRS £'000
Liabilities				
Insurance liabilities				
– Claims outstanding		79,853	(2,243)	77,610
– Unearned premiums	a.	80,559	276	80,835
Current tax liabilities		197	–	197
Trade and other payables, including insurance payables		–	–	–
– Direct insurance operations		200	–	200
– Reinsurance operations		109,116	–	109,116
Other trade and payables	c., e.	15,448	3,428	18,876
Financial liabilities:				
– Floating rate loan stock		3,399	–	3,399
– A shares	e.	–	6	6
Deferred income tax	b.	2,561	–	2,561
Total Liabilities		291,333	1,467	292,800
Shareholders' Equity				
Share capital	e.	2,099	(6)	2,093
Share options reserve	d.	–	127	127
Share premium		9,839	–	9,839
Retained earnings		4,634	(1,976)	2,658
Total Shareholders' Equity		16,572	(1,855)	14,717
Total Liabilities and Shareholder's Equity		307,905	(388)	307,517

30. Reconciliation of Net Assets and Profit under UK GAAP to IFRS (continued)

Reconciliation of Equity at 1st January 2004 (Date of Transition to IFRS)

Parent Company

	Note	UK GAAP £'000	Effect of transition to IFRS £'000	IFRS £'000
Assets				
Financial investments – investments		8,747	–	8,747
Other assets		426	–	426
Cash and cash equivalents		53	–	53
Total Assets		9,226	–	9,226
Liabilities				
Other liabilities	c.	597	–	597
Financial liabilities – preference shares	e.	–	6	6
Total Liabilities		597	6	603
Shareholders' Equity				
Share capital	e.	1,575	(6)	1,569
Share premium		7,297	–	7,297
Share option reserve	d.	–	27	27
Retained earnings		(243)	(27)	(270)
Total Shareholders' Equity		8,629	(6)	8,623
Total Liabilities and Shareholder's Equity		9,226	–	9,226

Notes to the Financial Statements Year ended 31st December 2005

30. Reconciliation of Net Assets and Profit under UK GAAP to IFRS (continued)

Reconciliation of Equity at 31st December 2004

Parent Company

	Note	UK GAAP £'000	Effect of transition to IFRS £'000	IFRS £'000
Assets				
Financial investments – investments		15,446	–	15,446
Other assets		9,615	–	9,615
Current tax asset		3	–	3
Deferred tax asset		32	–	32
Cash and cash equivalents		71	–	71
Total Assets		25,167	–	25,167
Liabilities				
Other liabilities	c.	9,735	–	9,735
Financial liabilities:				
– Loan stock		3,399	-	3,399
– Preference shares	e.	–	6	6
Total Liabilities		13,134	6	13,140
Shareholders' Equity				
Share capital	e.	2,099	(6)	2,093
Share premium		9,839	–	9,839
Share option reserve	d.	–	127	127
Retained earnings		95	(127)	(32)
Total Shareholders' Equity		12,033	(6)	12,027
Total Liabilities and Shareholder's Equity		25,167	–	25,167

30. Reconciliation of Net Assets and Profit under UK GAAP to IFRS (continued)

Reconciliation of Profit for the year ended 31st December 2004

Group

	Note	UK GAAP £'000	Effect of transition to IFRS £'000	IFRS £'000
Gross premiums written		137,100	(2,105)	134,995
Written premium ceded to reinsurers		(117,159)	1,798	(115,361)
Net premiums written		19,941	(307)	19,634
Change in the gross provision for unearned premiums	a.	(25,123)	2,293	(22,830)
Reinsurers' share of change in the provision for unearned premiums	a.	21,131	(1,822)	19,310
		(3,992)	472	(3,520)
Net earned premium		15,949	165	16,114
Net Investment income		941	–	941
Other underwriting income		310	–	310
Other income		2,532	(26)	2,506
		3,783	(26)	3,757
Revenue		19,732	139	19,871
Gross claims paid		(26,025)	–	(26,025)
Reinsurers' share of gross claims paid		21,230	–	21,230
Claims paid, net of reinsurance		(4,795)	–	(4,795)
Movement in gross technical provisions		(36,065)	1	(36,064)
Movement in reinsurers' share of technical provisions		33,376	(1)	33,375
Net change in provisions for claims		(2,689)	–	(2,689)
Net insurance claims		(7,484)	–	(7,484)

Notes to the Financial Statements Year ended 31st December 2005

30. Reconciliation of Net Assets and Profit under UK GAAP to IFRS (continued)

Reconciliation of Profit for the year ended 31st December 2004

Group

	Note	UK GAAP £'000	Effect of transition to IFRS £'000	IFRS £'000
Expenses incurred in insurance activities	a.	(4,249)	(302)	(4,551)
Other operating expenses	c.	(2,649)	(102)	(2,751)
Operating expenses		(6,898)	(404)	(7,302)
Result of operating activities		5,350	(265)	5,085
Finance costs	e.	–	(1,663)	(1,663)
Profit before tax		5,350	(1,928)	3,422
Income tax expense	b.	(1,552)	(79)	(1,631)
Profit attributable to equity shareholders		3,798	(2,007)	1,791

Explanation of reconciling items between UK GAAP and IFRS

a. In accordance with IAS 21, non-monetary assets and liabilities (i.e. those without a corresponding future cash flow) such as unearned premium reserves and deferred acquisition costs are translated at historic exchange rates. Prior to the adoption of IFRS the Group converted non-monetary assets and liabilities at the exchange rate at the balance sheet date. This resulted in an increase of £82,479 in both the reinsurers' share of the provision for unearned premiums, an increased in of £275,517 in the technical provision and increased in the provision for deferred acquisition costs of £50,654 for the year ended 31st December 2004. The debit to the cumulative profit and loss account was £291,867.

b. A deferred tax asset of £170,215 has been created in respect of the IFRS adjustments which have been processed as a direct consequence of adopting IFRS accounting standards.

c. In accordance with IAS 19, the elements of profit related remuneration that do not constitute a present obligation on the Group and fall within the definition of long-term employee benefits are not recognised in the financial statements but rather are disclosed as a liability contingent on future employment. This has resulted in a debit to the cumulative profit and loss account and an increase in liabilities of £425,000 in the year ended 31st December 2004.

d. In accordance with IFRS 2 a charge to the income statement is required in respect of all share-based payments including share options. The charge is based on the fair value of the share options at grant date. Under UK GAAP, the profit and loss charge, if any, is based on the difference between the exercise price and the market price at the date of issue. On transition at 1st January 2004 a charge of £27,205, at 31st December 2004 a further charge of £100,058 was required under IFRS 2. In the year ended 31st December 2005, the charge was £236,251. There is no impact on net assets.

e. In accordance with IAS 32, preference shares are shown within debt as their substance is of a debt instrument. Under UK GAAP, preference shares are shown within equity. Dividends on preference shares are shown within interest and similar finance charges under IAS, whereas under UK GAAP such dividends were shown as divided appropriations within the profit and loss account. At 31st December 2004, interest bearing loans were increased by £6,000 and share capital was reduced by £6,000. On transition at 1 January 2004 a charge of £1,421,000 was transferred from retained earnings to creditors. In the year to 31st December 2004, the preference share dividend after tax of £1,582,000 was reclassified and the cumulative profit and loss account reduced accordingly. In the year to 31st December 2005, the preference share dividend of £1,385,000 was classified as credit interest within finance costs.

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Heritage Underwriting Agency plc