

Important Information about Syndicate Reports and Accounts

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REPORT OF THE DIRECTORS OF THE MANAGING AGENT

At 31 December 2006

The directors of XL London Market Ltd (XLLM), the managing agent for Syndicate 861, present their report for the year ended 31 December 2006.

The financial statements have been prepared in accordance with the Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2004 ("the Regulations") which came into force on 31 December 2005 and essentially require the managing agent to prepare accounts for the syndicate in accordance with Schedule 9A of the Companies Act 1985 and applicable accounting standards.

Principal activity

Syndicate 861 underwrote general insurance business within the Lloyd's of London market. The business conducted was direct insurance and facultative reinsurance. The last year of account of Syndicate 861 was the 2001 year of account, which remains open and in run-off.

Key uncertainties preventing the closure of the 2001 account

The combination of a number of uncertainties prevents the calculation of a Reinsurance to Close Premium (RITC) including a risk premium, that is equitable to both the members of Syndicate 861 and the members of any potential receiving syndicate, there being no natural successor syndicate.

These key uncertainties preventing the closure of the 2001 year of account are as follows:

Political Risks

The residual Political Risks exposures remain significant and therefore continue to represent material uncertainty. There continues to be effort to reduce these exposures and attempts to purchase cost-effective reinsurance, but the level of exposure remains significant.

World Trade Center (WTC)

The syndicate sustained heavy losses related to this event, particularly in relation to the Accident and Health business reinsured by the syndicate. Despite having settled many claims to date, the level of outstanding loss notifications is still high and the ultimate outcome remains uncertain. Specific reinsurances have been exhausted; any gross movement is a net movement, implying potential volatility in the final result. A review of the syndicate's exposure to the WTC Accident and Health losses is carried out annually by external consultants.

Professional Indemnity

There has previously been market-wide deterioration in this book of business. The account has experienced some late development and a number of uncertainties remain. Whilst the issues of IPO Laddering and the events surrounding the collapse of Enron and WorldCom have stabilised, there is significant exposure in the US Lawyers portfolio with regard to the well publicised litigation of US "Tax Shelters". In addition, there remain live exposures in this book.

Disputes and other outstanding claims

A key legal dispute in respect of Political Risks, and other outstanding claims, remain at the balance sheet date.

Business Review

Results and performance

The syndicate's results and balance sheet, as set out on pages 8 to 10, show a cumulative loss after 72 months of £82.6m. During the year the cumulative loss has decreased by the profit in the year of £6.2m.

The principal reason for the profit in the period is an unrealised exchange gain, mainly arising on the retranslation of cash calls which are denominated in US dollars. The syndicate has broadly matched all major currency exposures and accordingly the exchange profit booked through the profit and loss account under UK GAAP is offset by the fall in the converted GBP value of the USD denominated cash calls. In other words the amount due from or to members is not materially affected by exchange rate movements.

Ignoring the exchange gains above, there has been a small loss in the 2006 calendar year, principally due to:

- Deterioration on live exposures within the Political Risks account
- Attritional claims deterioration on Accident & Health business

Forecast ultimate loss

The cumulative retained loss as at 31 December 2006 amounts to 68% of capacity after personal expenses (2005: 73%). This loss is inclusive of unrealised foreign exchange gains and losses. The forecast ultimate loss is currently anticipated to be in the range of 70-90% of capacity. This forecast does not include unrealised foreign exchange gains and losses, which are required to be included within the account. In the directors' opinion the realisation of these unrealised gains or losses cannot be accurately predicted until such time as the syndicate closes by way of a RITC premium, and have therefore been excluded from the forecast ultimate loss. These unrealised foreign exchange gains and losses are offset by the change in value of cash calls to date, which are denominated in US dollars.

REPORT OF THE DIRECTORS OF THE MANAGING AGENT

At 31 December 2006

Future developments and strategy

XLLM remains committed to the closure of the 2001 year of account as soon as possible at a figure which is fair and equitable to all parties. The syndicate will continue to monitor and assess the Market's appetite for accepting a potential RITC premium including a risk premium that is both equitable to the members of Syndicate 861 and any potential receiving syndicate.

XLLM continues to dedicate resources to the management of legacy issues and pro-actively to resolving the uncertainties where this is possible. A dedicated claims run-off manager has been recruited to oversee all legacy claims issues for managed syndicates. XLLM has entered into a service agreement to validate lead claims reserves where there has been no movement on the reserve for at least 12 months.

Principal risks and uncertainties

The process of risk acceptance and risk management is addressed through a framework of policies, procedures and internal controls. This is reviewed annually as part of the Individual Capital Assessment (ICA) process. The Board of XLLM approved the overall framework and has charged day to day monitoring to the Risk Monitoring Committee (RMC) which reports to the Board. The RMC meets at least quarterly to review and update the risk register as appropriate and to monitor performance against risk appetite using a series of key risk indicators. The Board is responsible for satisfying itself that a proper internal control framework exists to manage financial risks and that controls operate effectively.

The principal risks from our general insurance business arise from inaccurate pricing, fluctuations in timing, frequency and severity of claims compared to our expectations; inadequate reinsurance protection; and inadequate reserving. Our underwriting and reinsurance strategies are set within the context of the overall XL Capital strategies, approved by the Board and communicated clearly throughout the business through policy statements and guidelines.

The principal risks and uncertainties facing the syndicate are as follows:

Insurance risk

Insurance risk is the risk of loss arising from the inherent uncertainties about the occurrence, amount and timing of insurance liabilities and premiums arising from the risks accepted through insurance and reinsurance activities. The two main components are underwriting risk (i.e. the risks form live exposures) and reserving risk (i.e. risks from past exposures).

The syndicate continues to try to reduce its remaining live exposures where possible.

The syndicate aims to commute policies where possible and actively pursues subrogated claims recoveries. Consultants have been employed to investigate static claims which are also actively examined in-house. This has led to reductions in some gross reserves.

XLLM continues actively to pursue subrogated claims recoveries.

Legacy reinsurance, jointly protecting Syndicates 588, 861 and 1209, was renewed at the start of 2006 for a 24 month period, in so far as this could be placed in the market.

Financial Risks and Uncertainties**Credit risk**

Credit risk is the impact arising from failure of a counterparty to make full and timely payments on their financial obligations or from the change in the market value of assets due to a deterioration of a counterparty's creditworthiness.

The syndicate has stringent security requirements for all outwards reinsurance focusing on both level of security and aggregate exposure to any one reinsurer. The syndicate continues to pursue non-paying reinsurers.

Investments are almost entirely held in government or government backed securities or equivalent instruments.

Market risk

Market Risk is the impact arising from the uncertainty of asset prices, interest rates, foreign exchange rates, and other factors related to financial markets and investment asset management.

At the start of the year the primary investment objective was capital preservation by investing in fixed income securities. A secondary objective was to achieve a risk adjusted total return by active investment management.

During the first quarter of the year the investment strategy was changed to move funds from fixed income securities to cash deposits as the investments matured, to more closely replicate the run-off nature of the liabilities and provide liquidity as the syndicate settles claims. Returns on deposits remain comparatively high.

The calendar year yield of 4.00% is higher than in the previous year, when a yield of 3.24% was achieved. The main reason for this increased yield is an increase in short dated US dollar denominated bond yields.

REPORT OF THE DIRECTORS OF THE MANAGING AGENT

At 31 December 2006

Liquidity risk

Liquidity risk is the risk that insufficient financial resources are available to meet obligations as they fall due or can only be secured at excessive cost.

The syndicate manages liquidity risk through regular cash flow forecasts, both on a short term and ultimate long term basis.

During the year the syndicate made a cash call of \$20m (£10.2m) due on 30 June 2006 of which 97% has been collected as at 31 December 2006. The purpose of this cash call was to fund forecast claims payments and to cover liquidity issues arising from funds tied up within regulatory trust funds.

Assuming normal claims settlement patterns, it is considered unlikely that the syndicate will need to make a cash call in 2007.

Managed syndicates and underwriting arrangements

XLLM is the managing agent of Syndicates 861, 588 and 1209. XLLM is, through other group companies, a wholly owned subsidiary of XL Capital Ltd (XL), the Bermuda based holding company of an international insurance and reinsurance group. The immediate parent company of XLLM is XL London Market Services Ltd.

Syndicate 861, backed by third party members, underwrote in parallel alongside Syndicate 1209 until 31 December 2001. The underwriting splits between Syndicates 861 and 1209 for the 2001 year of account were determined on the basis of each of the syndicates' respective allocated capacities. The split across the relevant year of account was as follows:

	861	1209
	%	%
2001	36	64

The stamp capacity for the 2001 year of account is £122,396,136.

Members' Agents

For the 2001 year of account Hampden Agencies Ltd provided 59.3% of the syndicate's capacity and Argenta Private Capital Ltd 32%.

No other members' agent or direct participant has provided in excess of 20% of syndicate allocated capacity for the 2001 year of account.

Directors of the managing agent

The directors who held office at any time during the year are shown below. None of the directors nor the run-off manager participated as members during this time.

S.C. Barrett	
M.J. Beane	
Sir Brian Corby	(non-executive)
P.J. Drake	(resigned 26/02/2006)
J. Loudon	(Chairman, non-executive)
E. E. McCusker	(appointed 16/02/2006)
D.J. O'Donohoe	
A. Ramage	
P. O. Sheridan	(non-executive, appointed 28/11/2006)
W.P. Thompson	(non-executive, resigned 31/12/2006)
C.R. Tobin	
M.D. Turner	

Run-off manager

Ian Bollons was appointed as Run-off manager in July 2004 following the retirement of his predecessor Mr. Clifford.

Company secretary

The company secretary of XLLM is Graham Brady.

Annual general meeting

XLLM will be applying to Lloyd's for consent not to hold an annual general meeting during 2007 and have issued notice to members' agents to this effect.

Charitable donations

Neither XLLM nor the syndicate made any charitable or political donations in the period (2005: Nil).

Registered office

The registered office of XLLM is XL House, 70 Gracechurch Street, London, EC3V 0XL. The accounting records are held at this site.

**REPORT OF THE DIRECTORS OF THE MANAGING
AGENT**

At 31 December 2006

Auditors

XLLM intend re-appointing PricewaterhouseCoopers LLP as auditors to the syndicate and PricewaterhouseCoopers LLP have expressed their willingness to continue in office.

Dispensation has been granted by Lloyd's under the Audit Arrangements Byelaw in order for PricewaterhouseCoopers LLP to perform the audit of the syndicate as well as certain related companies within the XL Capital Group.

**Approved by the Board of XL London Market Ltd
on 14 March 2007**

D.J. O'Donohoe
Chief Executive Officer

STATEMENT OF MANAGING AGENT'S RESPONSIBILITIES

The managing agent is responsible for preparing the syndicate underwriting year accounts in accordance with Lloyd's Syndicate Accounting Byelaw.

The Syndicate Accounting Byelaw requires the managing agent to prepare underwriting year accounts for each syndicate in respect of any underwriting year which is in run-off at 31 December.

In preparing the underwriting year accounts, the managing agent is required to:

- select suitable accounting policies which are applied consistently and where there are items which affect more than one year of account, ensure a treatment which is equitable as between the members of the syndicate affected;
- take into account all income and charges relating to the underwriting year without regard to the date of receipt or payment;
- make judgements and estimates that are reasonable and prudent; and
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;

Each of the persons who is a director of the managing agent at the date of this report confirms that:

- so far as each director is aware, there is no information relevant to the audit of the syndicate's financial statements for the year ended 31 December 2006 of which the auditors are unaware;
- each director has taken all the steps that they ought to have taken as a director in order to make him/herself aware of any relevant audit information and to establish that the syndicate's auditors are aware of that information.

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

The directors of the managing agent confirm that they have complied with the above requirements in preparing the financial statements.

Approved by the Board of XL London Market Ltd on 14 March 2007

D.J. O'Donohoe
Chief Executive Officer

REPORT OF THE INDEPENDENT AUDITORS TO THE MEMBERS ON THE 2001 RUN-OFF ACCOUNT OF SYNDICATE 861

We have audited the syndicate underwriting year accounts for the 2001 run-off underwriting year of account as at 31 December 2006 which comprise the profit and loss account, the balance sheet and the related notes. These financial statements have been prepared under the accounting policies set out therein.

Respective responsibilities of the managing agent and auditors

The managing agent's responsibilities for preparing the syndicate underwriting year accounts in accordance with the Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2004, Lloyd's Syndicate Accounting Byelaw (No.8 of 2005) and applicable United Kingdom Generally Accepted Accounting Practice are set out in the statement of managing agent's responsibilities.

Our responsibility is to audit the syndicate underwriting year accounts in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the syndicate's members and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or in to whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the syndicate underwriting year accounts have been properly prepared in accordance with the Lloyd's Syndicate Accounting Byelaw. In addition, we report to you if, in our opinion, the managing agent has not kept proper accounting records in respect of the syndicate, if the syndicate underwriting year accounts are not in agreement with the accounting records or if we have not received all the information and explanation we require for our audit.

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

Basis of audit opinion

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

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

Opinion

In our opinion the syndicate underwriting year accounts for the 2001 run-off underwriting year of account have been properly prepared in accordance with the Lloyd's Syndicate Accounting Byelaw.

Emphasis of matter – Reserves Uncertainty

In forming our opinion, we have considered the disclosures made by the Managing Agent, in particular in Note 15 of the Run-Off Account relating to the uncertainties that prevent the 2001 year of account from closing. Future experience may show that, material adjustments, either favourable or adverse, are required in respect of the assumptions made in estimating the claims provisions and related reinsurance recoveries. In view of the significance of these uncertainties we consider that it should be drawn to your attention but our opinion is not qualified in this respect.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
London, United Kingdom
14 March 2007

PROFIT AND LOSS ACCOUNT

As at 31 December 2006

Technical account – general business

	Notes	At 60 months £000	Transactions in year £000	At 72 months £000
Earned premiums, net of reinsurance				
Gross premiums written		180,589	(13,109)	167,480
Reinsurers' share of premiums		(55,008)	4,914	(50,094)
		<u>125,581</u>	<u>(8,195)</u>	<u>117,386</u>
Reinsurance to close premiums received, net of reinsurance		80,848	(10,756)	70,092
Earned premiums, net of reinsurance		<u>206,429</u>	<u>(18,951)</u>	<u>187,478</u>
Allocated investment return transferred from the non-technical account		18,582	2,611	21,193
Claims incurred, net of reinsurance				
Claims paid				
Gross amount		(283,920)	1,081	(282,839)
Reinsurers' share		151,653	(7,432)	144,221
		<u>(132,267)</u>	<u>(6,351)</u>	<u>(138,618)</u>
Amount retained to meet all known and unknown outstanding liabilities, net of reinsurance		(131,957)	29,270	(102,687)
Claims incurred, net of reinsurance		<u>(264,224)</u>	<u>22,919</u>	<u>(241,305)</u>
Net operating expenses	5	(49,636)	(379)	(50,015)
Balance on the technical account for general business		<u>£(88,849)</u>	<u>£6,200</u>	<u>£(82,649)</u>

All items relate to discontinued operations.

PROFIT AND LOSS ACCOUNT

As at 31 December 2006

Non-technical account

	At 60 months £000	Transactions in year £000	At 72 months £000
Balance on the general business technical account	(88,849)	6,200	(82,649)
Investment income	19,085	2,501	21,586
Realised gains on investments	2,988	397	3,385
Unrealised gains on investments	1,922	(778)	1,144
Realised losses on investments	(3,899)	350	(3,549)
Unrealised losses on investments	(999)	107	(892)
Investments expenses and charges	(515)	34	(481)
Allocated investment return transferred to the general business technical account	(18,582)	(2,611)	(21,193)
Result for the five years ended 31 December 2005 for the 2001 run-off account	£(88,849)		
		£6,200	
Result for the six years ended 31 December 2006 for the 2001 run-off account			£(82,649)

There are no recognised gains or losses in the accounting period other than those dealt with in the technical and non-technical accounts.

All items relate to discontinued operations.

BALANCE SHEET

As at 31 December 2006

		2006	
ASSETS	Notes	£000	£000
Investments	8		68,418
Debtors			
Debtors arising out of direct insurance operations - intermediaries	6	1,933	
Debtors arising out of reinsurance operations	7	4,747	
Other debtors		3,865	
			10,545
Reinsurance recoveries anticipated on gross amounts retained to meet all known and unknown outstanding liabilities			38,914
Other assets			
Cash at bank and in hand		26,799	
Overseas Deposits	10	7,857	
			34,656
TOTAL ASSETS			£152,533
LIABILITIES			
Amounts due to members	11		7,799
Amounts retained to meet all known and unknown outstanding liabilities – gross amount			141,602
Creditors			
Creditors arising out of reinsurance operations	12	3,122	
Other creditors including taxation and social security		10	
			3,132
TOTAL LIABILITIES			£152,533

The Run-Off accounts were approved by the Board of XL London Market Ltd on 14 March 2007 and were signed on its behalf by

D.J. O'Donohoe
Chief Executive Officer

14 March 2007

NOTES TO THE ACCOUNTS

At 31 December 2006

1. Basis of Preparation

The underwriting year accounts have been prepared in accordance with the Syndicate Accounting Byelaw and applicable accounting standards in the United Kingdom. They comply with the Statement of Recommended Practice issued by the Association of British Insurers in December 2005 ("the ABI SORP"), as applicable.

Members participate on a syndicate by reference to a year of account and each syndicate year of account is a separate annual venture. These accounts relate to the 2001 year of account which remains in run-off at 31 December 2006; consequently the balance sheet at that date represents the assets and liabilities of the 2001 year of account and the profit and loss account reflects the transactions for that year of account during the 72 months then ended. As required by the Syndicate Accounting Byelaw, the profit and loss account also shows transactions for the 12 months ended 31 December 2006.

2. Accounting Policies***Underwriting transactions***

- (a) The underwriting accounts for each year of account are normally kept open for three years before the result on that year is determined. At the end of the three year period, outstanding liabilities can normally be determined with sufficient accuracy to permit the year of account to be closed by payment of a reinsurance to close premium to the successor year of account. Where this is not possible, an amount to meet all known and unknown outstanding liabilities is retained at each year end until an equitable reinsurance to close can be effected. The 2001 year of account remains open for the reasons detailed in note 15.

The directors consider that the net amount retained to meet all known and unknown outstanding liabilities is fairly stated on the basis of the information currently available to them. However, ultimate liability will vary as a result of subsequent information and events and this may result in significant adjustments to the amounts retained. Adjustments to the amounts of claims provisions established in prior years are reflected in the financial statements for the period in which the adjustments are made.

The methods used, and the estimates made, are reviewed regularly.

The amount retained to meet all known and unknown outstanding liabilities comprises the outstanding technical provisions at 31 December and includes those for outstanding claims.

- (b) Gross premiums are allocated to years of account on the basis of the inception date of the policy. Commission and brokerage are charged to the year of account to which the relevant policy is allocated. Policies written under binding authorities, lineslips or consortium arrangements are allocated to the year of account into which the arrangement incepts. Additional and return premiums follow the year of account of the original premium. Premiums are shown gross of brokerage payable and exclude taxes and duties levied on them. Estimates are made for pipeline premiums, representing amounts due but not yet notified to the syndicate year of account.

Outwards reinsurance premiums ceded are attributed to the same year as the original risk being protected.

- (c) Gross claims paid are allocated to the same year of account as that to which the corresponding premiums are allocated and include internal and external claims settlement expenses. Reinsurance recoveries are allocated to the year of account to which the claim was charged.
- (d) Outstanding claims comprise amounts set aside for claims notified and claims incurred but not yet reported (IBNR).

Notified claims are estimated on a case by case basis with regard to the circumstances as reported, any information available from loss adjusters and previous experience of the cost of settling claims with similar characteristics. The amount included in respect of the future development of notified claims and IBNR is based on statistical techniques of estimation applied by the external consulting actuaries. These techniques generally involve projecting from past experience of the development of claims over time to form a view of the likely ultimate claims to be experienced for more recent underwriting, having regard to variations in the business accepted and the underlying terms and conditions.

The provision for claims includes amounts in respect of internal and external claims handling costs.

NOTES TO THE ACCOUNTS

At 31 December 2006

Underwriting transactions (continued)

The reinsurers' share of provisions for claims is based on calculated amounts of outstanding claims and projections for IBNR, net of estimated irrecoverable amounts, having regard to the reinsurance programme in place for the class of business, the claims experience for the year and the current security rating of the reinsurance companies involved.

The syndicate uses a number of statistical techniques to assist in making the above estimates. The most critical assumption as regards claims provisions is that the past is a reasonable predictor of the likely level of claims development.

Investments and Investment Return

- (e) Investment return comprises investment income, realised and unrealised investment gains and losses, net of investment expenses, charges and interest. Investment return arising in each calendar year on all the syndicate's investments is allocated to open years of account in proportion to the average funds available for investment attributable to those years. Investment returns in respect of overseas deposits are allocated to the year of account which funded these deposits.

Realised gains and losses on investments carried at market value are calculated as the difference between sale proceeds and purchase price. Movements in unrealised gains and losses on investments represent the difference between their valuation at the balance sheet date and their purchase price or, if they have been previously valued, their valuation at the end of the previous calendar year, together with the reversal of unrealised gains and losses recognised in earlier calendar years in respect of investment disposals in the current period.

Investment return is initially recorded in the non-technical account. A transfer is made from the non-technical account to the general business technical account to reflect the investment return on funds supporting underwriting business. All investment return is considered to arise on such funds.

Investments are stated at current value at the balance sheet date and at purchase cost. For this purpose listed investments are stated at mid-market value and deposits with credit institutions and overseas deposits are stated at cost.

Syndicate Operating Expenses

- (f) Costs incurred by the managing agent in respect of the syndicate are charged to the syndicate. Where expenses do not relate to any specific year of account they are apportioned between years of account on a basis which reflects the benefit obtained by each year of account from each type of expense.

Where expenses are incurred jointly by the managing agent and the syndicate, they are apportioned as follows:

Salaries and related costs – according to time of each individual spent on syndicate matters
Accommodation costs – according to number of personnel
Other costs – as appropriate in each case

The managing agent operates a defined contribution pension scheme and its recharges to the syndicate, in respect of salaries and related costs, include an element for pension costs. These pension costs are expensed in full in the period to which the recharge relates.

Amounts recharged by the managing agent include costs arising from the use of assets in the period. These rental costs are expensed in full in the period to which the recharge relates.

Taxation

- (g) Under Schedule 19 of the Finance Act 1993 managing agents are not required to deduct basic rate income tax from trading income. In addition, all UK basic rate income tax deducted from syndicate investment income is recoverable by managing agents and consequently the distribution made to members or their members' agents is gross of tax.

Capital appreciation falls within trading income and is also distributed gross of tax. It is the responsibility of members to agree and settle their individual tax liabilities with HM Revenue & Customs.

No provision has been made for any United States Federal Income Tax or any overseas tax payable on the underwriting results or investment earnings.

Members resident overseas for tax purposes are responsible for agreeing and settling any tax liabilities with the taxation authorities of their country of residence.

NOTES TO THE ACCOUNTS

At 31 December 2006

Basis of Currency Translation

- (h) The syndicate maintains four separate currency funds of Sterling, United States dollars, Canadian dollars and Euros. Items expressed in United States dollars, Canadian dollars and Euros are translated to Sterling at the rates of exchange ruling at the balance sheet date. Items brought forward from previous years are therefore revalued at those rates. The differences arising from this revaluation are included in the calendar year movements disclosed for each underwriting account heading.

NOTES TO THE ACCOUNTS

At 31 December 2006

3. Segmental Analysis

TYPE OF BUSINESS

An analysis of the technical account balance after 72 months before investment return is set out below:

2006	Gross premiums written and earned £000	Gross claims incurred £000	Gross operating expenses £000	Reinsurance balance £000	Total £000
Direct insurance:					
Accident and health	2,698	(2,933)	(724)	(256)	(1,215)
Credit and suretyship	13,795	(15,633)	(8,844)	(1,585)	(12,267)
Motor (other classes)	1,069	501	(582)	(256)	732
Marine aviation and transport	17,920	(10,468)	(7,444)	(2,708)	(2,700)
Fire and other damage to property	17,526	(17,390)	(7,956)	2,808	(5,012)
Third party liability	11,935	(22,255)	(5,713)	1,562	(14,471)
Reinsurance acceptances	172,629	(214,661)	(18,752)	(8,125)	(68,909)
Total	£237,572	£(282,839)	£(50,015)	£(8,560)	£(103,842)

Reinsurance acceptances include the reinsurance to close premium of £70.0m received from the 2000 year of account.

GEOGRAPHICAL ANALYSIS BY ORIGIN

All business written by the syndicate is signed through X-Changing Insure Services (XIS) and is treated as having originated in the UK.

4. Technical Account Balance after 72 months before Allocated Investment Return and Net Operating Expenses

	2006 £000
Balance attributable to business allocated to the 2001 year of account	(52,319)
Balance attributable to the reinsurance to close the 2000 year of account	(1,508)
	£(53,827)

5. Net Operating Expenses

	At 60 months £000	Transactions in year £000	At 72 months £000
Acquisition costs	41,225	141	41,366
Administrative expenses	12,236	1,351	13,587
Profit on exchange	(7,248)	(1,113)	(8,361)
Personal expenses	3,423	-	3,423
	£ 49,636	£379	£50,015

NOTES TO THE ACCOUNTS

At 31 December 2006

5. Net Operating Expenses (continued)

The run-off account result is stated after charging:

	At 60 months £000	Transactions in year £000	At 72 months £000
Auditors' remuneration	£206	£57	£263

6. Debtors Arising out of Direct Insurance Operations

	2006 £000
Due within one year - intermediaries	£1,933

7. Debtors Arising out of Reinsurance Operations

	2006 £000
Due within one year	£4,747

8. Financial Investments

	Market Value 2006 £000	Cost 2006 £000
Debt securities and other fixed income securities	43,613	43,562
Deposits with credit institutions	24,805	24,805
	£68,418	£68,367

Shares and other variable yield securities and units in unit trusts and debt securities and other fixed income securities are all listed on recognised stock exchanges.

9. Calendar Year Investment Yield

The average amount of syndicate funds available for investment during 2006 and the investment return and yield for that were as follows:

	2006 £000
Average fund	105,197
Investment return	2,611
Calendar year investment yield	4.00%

NOTES TO THE ACCOUNTS

At 31 December 2006

9. Calendar Year Investment Yield (continued)

Average fund is the average of bank balances and investments held on behalf of the Members of the syndicate at the end of each month during the calendar year.

Analysis of calendar year investment yield by currency:

	2006
Sterling	4.36%
United States dollars	3.96%
Canadian dollars	3.72%
Euros	4.48%

10. Other Assets – Overseas Deposits

	2006
	£000
Illinois – USA	3,744
Joint Asset Trust Fund – USA	1,131
Australian Deposit	
Deposit	854
Joint Asset Trust Fund	50
Additional Securities Limited	
South Africa	424
Other Countries	408
Kentucky - USA	462
Canadian Margin Fund	784
	<u>£7,857</u>

11. Amounts due to/(from) Members

	2006
	£000
Result for the run-off account after 72 months	(82,649)
Cash calls paid	90,856
Unpaid cash calls	(408)
Members' balances carried forward at 31 December 2006	<u>£7,799</u>

12. Creditors Arising out of Reinsurance Operations

	2006
	£000
Due within one year	<u>£3,122</u>

13. Borrowings

As at 31 December 2006, the syndicate held a Letter of Credit from Lloyds TSB for \$12m (£6.1m) to replace the funds required by the New York Insurance Department to be deposited in the Surplus Lines Trust Fund. Notice has been given to cancel this facility from 31 March 2007.

14. Contingent Liabilities

There were no contingent liabilities that the board of directors were aware of at the date of signing these accounts.

NOTES TO THE ACCOUNTS

At 31 December 2006

15. Significant Uncertainties***Political Risks***

The residual Political Risks exposures remain significant and therefore continue to represent material uncertainty. There continues to be effort to reduce these exposures and attempts to purchase cost-effective reinsurance, but the level of exposure remains significant.

World Trade Center (WTC)

The syndicate sustained heavy losses related to this event, particularly in relation to the Accident and Health business reinsured by the syndicate. Despite having settled many claims to date, the level of outstanding loss notifications is still high and the ultimate outcome remains uncertain. Specific reinsurances have been exhausted; any gross movement is a net movement, implying potential volatility in the final result. A review of the syndicate's exposure to the WTC Accident and Health losses is carried out annually by external consultants.

Professional Indemnity

There has previously been Market-wide deterioration in this book of business. The account has experienced some late development and a number of uncertainties remain. Whilst the issues of IPO Laddering and the events surrounding the collapse of Enron and WorldCom have stabilised, there is significant exposure in the US Lawyers portfolio with regard to the well publicised litigation of US "Tax Shelters". In addition, there remain live exposures in this book.

Disputes and other outstanding claims

A key legal dispute in respect of Political Risks, and other outstanding claims, remain at the balance sheet date.

SEVEN YEAR SUMMARY OF RESULTS

	2001 (Run-off) At 72 months £	2000 (Closed) £	1999 (Closed) £	1998 (Closed) £	1997 (Closed) £	1996 (Closed) £	1995 (Closed) £
Syndicate allocated capacity (000s)	122,396	154,571	194,779	228,823	224,898	219,014	244,818
Capacity utilised (gross premium)	103.04%	105.77%	109.24%	90.00%	87.36%	85.60%	119.49%
Aggregate net premiums (000s)	76,020	98,989	109,664	128,975	138,625	145,558	210,566
Net capacity utilised (net premium)	62.11%	64.04%	56.30%	56.36%	61.64%	66.46%	86.01%
Underwriting profit/(loss) ratio	(79.63%)	(41.26%)	(11.50%)	(3.85%)	(0.63%)	10.45%	21.61%
Number of underwriting Members	1,427	1,529	1,594	1,633	1,699	1,887	2,084
Results for an illustrative share £10,000							
Gross premiums	10,304	10,577	10,924	9,000	8,736	8,560	11,949
Net premiums	6,211	6,404	5,630	5,636	6,164	6,646	8,601
Premium for the reinsurance to close an earlier year of account	5,727	4,283	4,618	5,112	4,436	3,450	2,472
Net claims	(11,325)	(7,849)	(7,658)	(6,241)	(5,036)	(4,219)	(4,208)
Amount retained to meet all known and unknown liabilities of the 2001 and prior years of account as at 31.12.06	(8,390)	-	-	-	-	-	-
Premium for the reinsurance to close the year of account	-	(6,975)	(3,549)	(4,536)	(5,293)	(4,636)	(4,107)
Profit/(loss) on exchange	683	373	(31)	(39)	10	(10)	43
Syndicate operating expenses	(1,110)	(600)	(396)	(380)	(410)	(413)	(300)
Other operating income	-	-	125	100	74	76	81
Underwriting (loss)/profit	(8,204)	(4,364)	(1,261)	(348)	(55)	894	2,582
Investment return	1,732	427	563	545	504	719	882
Exceptional income	-	-	183	158	129	-	-
(Loss)/profit before personal expenses	(6,472)	(3,937)	(515)	355	578	1,613	3,464
Managing Agent's fee	(75)	(60)	(50)	(50)	(50)	(50)	(65)
High Level Stop Loss	-	-	-	-	-	-	(33)
Contribution to Lloyd's Central Fund	(75)	(100)	(100)	(119)	(84)	(80)	(60)
Lloyd's Subscription	(25)	(25)	(35)	(50)	(66)	(50)	(50)
Members' Special Contribution	-	-	-	-	-	-	(150)
Managing Agent's profit commission	-	-	-	(33)	(69)	(215)	(463)
Other – see note 4. below	(22)	(15)	-	-	-	-	-
(Loss)/profit after personal expenses	£(6,669)	£(4,137)	£(700)	£103	£309	£1,218	£2,643

Notes to the seven year summary

1. The seven year summary has been prepared from the audited accounts of the syndicates.
2. Gross and net premium for the 2001 year of account have been stated net of acquisition costs for comparison purposes with 2000 and earlier years of account.
3. Personal expenses have been stated at the amount which would be incurred pro-rata by individual Members writing the illustrative premium income in the syndicate, disregarding any minimum charge applicable. Corporate Members may be charged at different rates. Foreign taxation, which may be treated as a credit for personal tax purposes, has been excluded.
4. Personal expenses exclude members' agents' fees.
5. Other personal expenses include interest charges on Members' outstanding balances and charges made to Members requesting schedule 9a accounts.

REPORT OF THE DIRECTORS OF THE MANAGING AGENT

At 31 December 2006

The directors of XL London Market Ltd (XLLM), the managing agent for Syndicate 861, present their report for the year ended 31 December 2006.

The financial statements have been prepared in accordance with the Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2004 ("the Regulations") which came into force on 31 December 2005 and essentially require the managing agent to prepare accounts for the syndicate in accordance with Schedule 9A of the Companies Act 1985 and applicable accounting standards.

Principal activity

Syndicate 861 underwrote general insurance business within the Lloyd's of London market. The business conducted was direct insurance and facultative reinsurance. The last year of account of Syndicate 861 was the 2001 year of account, which remains open and in run-off.

Key uncertainties preventing the closure of the 2001 account

The combination of a number of uncertainties prevents the calculation of a Reinsurance to Close Premium (RITC) including a risk premium, that is equitable to both the members of Syndicate 861 and the members of any potential receiving syndicate, there being no natural successor syndicate.

These key uncertainties preventing the closure of the 2001 year of account are as follows:

Political Risks

The residual Political Risks exposures remain significant and therefore continue to represent material uncertainty. There continues to be effort to reduce these exposures and attempts to purchase cost-effective reinsurance, but the level of exposure remains significant.

World Trade Center (WTC)

The syndicate sustained heavy losses related to this event, particularly in relation to the Accident and Health business reinsured by the syndicate. Despite having settled many claims to date, the level of outstanding loss notifications is still high and the ultimate outcome remains uncertain. Specific reinsurances have been exhausted; any gross movement is a net movement, implying potential volatility in the final result. A review of the syndicate's exposure to the WTC Accident and Health losses is carried out annually by external consultants.

Professional Indemnity

There has previously been market-wide deterioration in this book of business. The account has experienced some late development and a number of uncertainties remain. Whilst the issues of IPO Laddering and the events surrounding the collapse of Enron and WorldCom have stabilised, there is significant exposure in the US Lawyers portfolio with regard to the well publicised litigation of US "Tax Shelters". In addition, there remain live exposures in this book.

Disputes and other outstanding claims

A key legal dispute in respect of Political Risks, and other outstanding claims, remain at the balance sheet date.

Business Review

Results and performance

The syndicate's results and balance sheet, as set out on pages 25 to 28, show a profit for the financial year of £5.9m (2005: loss of £12.4m).

The principal reason for the profit in the period is an unrealised exchange gain of £9.8m. This mainly arises on the retranslation of cash calls which are denominated in US dollars. The syndicate has broadly matched all major currency exposures and accordingly the exchange profit booked through the profit and loss account under UK GAAP is offset by the fall in the converted GBP value of the USD denominated cash calls. In other words the amount due from or to members is not materially affected by exchange rate movements.

Ignoring the £9.8m exchange gain above, there has been a loss of £3.9m in the 2006 calendar year, principally due to:

- Deterioration on live exposures within the Political Risks account
- Attritional claims deterioration on Accident & Health business

As Syndicate 861 is in run-off, the KPIs which are relevant are the ultimate loss ratios, which are approved quarterly in the Lloyd's Reserving Committee (a sub committee of the Board) and the syndicate's quarterly cash flow forecasts, which are presented to the board.

REPORT OF THE DIRECTORS OF THE MANAGING AGENT

At 31 December 2006

Forecast ultimate loss

The cumulative retained loss as at 31 December 2006 amounts to 68% of capacity after personal expenses (2005: 73%). This loss is inclusive of unrealised foreign exchange gains and losses. The forecast ultimate loss is currently anticipated to be in the range of 70-90% of capacity. This forecast does not include unrealised foreign exchange gains and losses, which are required to be included within the account. In the directors' opinion the realisation of these unrealised gains or losses cannot be accurately predicted until such time as the syndicate closes by way of a RITC premium, and have therefore been excluded from the forecast ultimate loss. These unrealised foreign exchange gains and losses are offset by the change in value of cash calls to date, which are denominated in US dollars.

Future developments and strategy

XLLM remains committed to the closure of the 2001 year of account as soon as possible at a figure which is fair and equitable to all parties. The syndicate will continue to monitor and assess the Market's appetite for accepting a potential RITC premium including a risk premium that is both equitable to the members of Syndicate 861 and any potential receiving syndicate.

XLLM continues to dedicate resources to the management of legacy issues and pro-actively to resolving the uncertainties where this is possible. A dedicated claims run-off manager has been recruited to oversee all legacy claims issues for managed syndicates. XLLM has entered into a service agreement to validate lead claims reserves where there has been no movement on the reserve for at least 12 months.

Principal risks and uncertainties

The process of risk acceptance and risk management is addressed through a framework of policies, procedures and internal controls. This is reviewed annually as part of the Individual Capital Assessment (ICA) process. The Board of XLLM approved the overall framework and has charged day to day monitoring to the Risk Monitoring Committee (RMC) which reports to the Board. The RMC meets at least quarterly to review and update the risk register as appropriate and to monitor performance against risk appetite using a series of key risk indicators. The Board is responsible for satisfying itself that a proper internal control framework exists to manage financial risks and that controls operate effectively.

The principal risks from our general insurance business arise from inaccurate pricing, fluctuations in timing, frequency and severity of claims compared to our expectations; inadequate reinsurance protection; and inadequate reserving. Our underwriting and

reinsurance strategies are set within the context of the overall XL Capital strategies, approved by the Board and communicated clearly throughout the business through policy statements and guidelines.

The principal risks and uncertainties facing the syndicate are as follows:

Insurance risk

Insurance risk is the risk of loss arising from the inherent uncertainties about the occurrence, amount and timing of insurance liabilities and premiums arising from the risks accepted through insurance and reinsurance activities. The two main components are underwriting risk (i.e. the risks from live exposures) and reserving risk (i.e. risks from past exposures).

The syndicate continues to try to reduce its remaining live exposures where possible.

The syndicate aims to commute policies where possible and actively pursues subrogated claims recoveries. Consultants have been employed to investigate static claims which are also actively examined in-house. This has led to reductions in some gross reserves.

XLLM continues actively to pursue subrogated claims recoveries.

Legacy reinsurance, jointly protecting Syndicates 588, 861 and 1209, was renewed at the start of 2006 for a 24 month period, in so far as this could be placed in the market.

Financial Risks and Uncertainties

Credit risk

Credit risk is the impact arising from failure of counterparty to make full and timely payments on their financial obligations or from the change in the market value of assets due to a deterioration of a counterparty's creditworthiness.

The syndicate has stringent security requirements for all outwards reinsurance focusing on both level of security and aggregate exposure to any one reinsurer. The syndicate continues to pursue non-paying reinsurers.

Investments are almost entirely held in government or government backed securities or equivalent instruments.

Market risk

Market Risk is the impact arising from the uncertainty of asset prices, interest rates, foreign exchange rates, and other factors related to financial markets and investment asset management.

REPORT OF THE DIRECTORS OF THE MANAGING AGENT

At 31 December 2006

Market risk (continued)

At the start of the year the primary investment objective was capital preservation by investing in fixed income securities. A secondary objective was to achieve a risk adjusted total return by active investment management.

During the first quarter of the year the investment strategy was changed to move funds from fixed income securities to cash deposits as the investments matured, to more closely replicate the run-off nature of the liabilities and provide liquidity as the syndicate settles claims. Returns on deposits remain comparatively high.

The calendar year yield of 3.93% is higher than in the previous year, when a yield of 3.24% was achieved. The main reason for this increased yield is an increase in short dated US dollar denominated bond yields.

Liquidity risk

Liquidity risk is the risk that insufficient financial resources are available to meet obligations as they fall due or can only be secured at excessive cost.

The syndicate manages liquidity risk through regular cash flow forecasts, both on a short term and ultimate long term basis.

During the year the syndicate made a cash call of \$20m (£10.2m) due on 30 June 2006 of which 97% has been collected as at 31 December 2006. The purpose of this cash call was to fund forecast claims payments and to cover liquidity issues arising from funds tied up within regulatory trust funds.

Assuming normal claims settlement patterns, it is considered unlikely that the syndicate will need to make a cash call in 2007.

Managed syndicates and underwriting arrangements

XLLM is the managing agent of Syndicates 861, 588 and 1209. XLLM is, through other group companies, a wholly owned subsidiary of XL capital Ltd (XL), the Bermuda based holding company of an international insurance and reinsurance group. The immediate parent company of XLLM is XL London Market Services Ltd.

Syndicate 861, backed by third party members, underwrote in parallel alongside Syndicates 1209 until 31 December 2001. The underwriting splits between Syndicates 861 and 1209 for the 2001 year of account were determined on the basis of each of the syndicates' respective allocated capacities. The split across the relevant year of account was as follows:

	861	1209
	%	%
2001	36	64

The stamp capacity for the 2001 year of account is £122,396,136.

Directors of the managing agent

The directors who held office at any time during the year are shown below. None of the directors nor the run-off manager participated as members during this time.

S.C. Barrett	
M.J. Beane	
Sir Brian Corby	(non-executive)
P.J. Drake	(resigned 26/02/2006)
J. Loudon	(Chairman, non-executive)
E. E. McCusker	(appointed 16/02/2006)
D.J. O'Donohoe	
A. Ramage	
P. O. Sheridan	(non-executive, appointed 28/11/2006)
W.P. Thompson	(non-executive, resigned 31/12/2006)
C.R. Tobin	
M.D. Turner	

Run-off manager

Ian Bollons was appointed as Run-off manager in July 2004 following the retirement of his predecessor Mr. Clifford.

Company secretary

The company secretary of XLLM is Graham Brady.

Annual general meeting

XLLM will be applying to Lloyd's for consent not to hold an annual general meeting during 2007 and have issued notice to members' agents to this effect.

REPORT OF THE DIRECTORS OF THE MANAGING AGENT

At 31 December 2006

Employees

Employees are kept informed of the agency's and syndicate's affairs through both paper and electronic mail circulars. There are also quarterly meetings in the agency's principal operating centre, which all staff are encouraged to attend. Employees' views are taken into account through formal feedback after employee events, a suggestion box, quarterly staff breakfasts and lunch briefings with senior management and a London Communications Focus Group which meets six times a year.

The agency is committed to providing equal opportunities to all employees irrespective of sex, marital status, creed, colour, race, age, ethnic origin or disability. Applications for employment by disabled persons are always fully considered, bearing in mind the respective aptitudes and abilities of the applicant concerned. In the event of members of staff becoming disabled, every effort is made to ensure that their employment with the agency continues and the appropriate training is arranged. It is the policy of the agency that the training, career development and promotion of a disabled person should as far as possible, be identical to that of a person who does not suffer from a disability.

All employees, based in the UK, have service contracts with XL Services UK Ltd.

Charitable donations

Neither XLLM nor the syndicate made any charitable or political donations in the period (2005: Nil).

Registered office

The registered office of XLLM is XL House, 70 Gracechurch Street, London, EC3V 0XL. The accounting records are held at this site.

Auditors

XLLM intend re-appointing PricewaterhouseCoopers LLP as auditors to the syndicate and PricewaterhouseCoopers LLP have expressed their willingness to continue in office.

Dispensation has been granted by Lloyd's under the Audit Arrangements Byelaw in order for PricewaterhouseCoopers LLP to perform the audit of the syndicate as well as certain related companies within the XL Capital Group.

Approved by the Board of XL London Market Ltd on 14 March 2007

D.J. O'Donohoe
Chief Executive Officer

STATEMENT OF MANAGING AGENT'S RESPONSIBILITIES

The managing agent is responsible for preparing the syndicate annual accounts in accordance with applicable law and United Kingdom Generally Accepted Accounting Practice.

The Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2004 ("the Regulations") require the managing agent to prepare financial statements for each financial period, which give a true and fair view of the state of affairs of the syndicate as at the end of the financial period, and of the profit or loss for that financial period then ended. In preparing those financial statements, the managing agent is required to:

- select suitable accounting policies and then apply them consistently, with the exception of changes arising on the adoption of new standards during the year;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- prepare the financial statements on the basis that the syndicate is in run-off.

Each of the persons who is a director of the managing agent at the date of this report confirms that:

- so far as each director is aware, there is no information relevant to the audit of the syndicate's financial statements for the year ended 31 December 2006 of which the auditors are unaware;
- each director has taken all the steps that they ought to have taken as a director in order to make him/herself aware of any relevant audit information and to establish that the syndicate's auditors are aware of that information.

The managing agent is responsible for keeping proper accounting records, which disclose with reasonable accuracy at any time, the financial position of the syndicate, and to enable it to ensure that the financial statements comply with the Regulations and the relevant provisions of the Companies Act 1985. It is also responsible for safeguarding the assets of the syndicate, and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors of the managing agent confirm that they have complied with the above requirements in preparing the financial statements.

Approved by the Board of XL London Market Ltd on 14 March 2007

D.J. O'Donohoe
Chief Executive Officer

REPORT OF THE INDEPENDENT AUDITORS TO THE MEMBERS OF SYNDICATE 861

We have audited the syndicate annual accounts for the year ended 31 December 2006 which comprise the profit and loss account, the balance sheet and the cash flow statement and the related notes. These financial statements have been prepared under the accounting policies set out therein.

Respective responsibilities of managing agent and auditors

The managing agent's responsibilities for preparing the syndicate annual accounts in accordance with the Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2004 and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the statement of managing agent's responsibilities.

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

We report to you our opinion as to whether the syndicate annual accounts give a true and fair view and are properly prepared in accordance with the Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2004. We report to you whether, in our opinion, the information given in the managing agent's report is consistent with the syndicate annual accounts. In addition, we report to you if, in our opinion, the managing agent 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 managing agent's directors' remuneration and other transactions is not disclosed.

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

Basis of audit opinion

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

whether the accounting policies are appropriate to the syndicate's circumstances, consistently applied and adequately disclosed.

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

Opinion

In our opinion:

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

Emphasis of matter – Reserves Uncertainty

In forming our opinion, we have considered the disclosures made by the Managing Agent, in particular in Note 19 of the Annual Report relating to the uncertainties that prevent the 2001 year of account from closing. Future experience may show that, material adjustments, either favourable or adverse, are required in respect of the assumptions made in estimating the claims provisions and related reinsurance recoveries. In view of the significance of these uncertainties we consider that it should be drawn to your attention but our opinion is not qualified in this respect.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
London, United Kingdom
14 March 2007

PROFIT AND LOSS ACCOUNT

For the year ended 31 December 2006

Technical account – general business

	Notes	2006 £000	2005 £000
Earned premiums, net of reinsurance			
Gross premiums written	3	822	2,954
Reinsurers' share of premiums		(481)	(2,033)
		341	921
Change in the provision for unearned premiums			
Gross amount		525	476
Reinsurers' share		262	(310)
		787	166
Earned premiums, net of reinsurance		1,128	1,087
Allocated investment return transferred from the non-technical account		4,346	4,314
Claims incurred, net of reinsurance			
Claims paid			
Gross amount		(25,180)	(47,544)
Reinsurers' share		499	12,663
		(24,681)	(34,881)
Change in the provision for claims			
Gross amount		20,511	22,946
Reinsurers' share		(3,768)	4,768
		16,743	27,714
Claims incurred, net of reinsurance		(7,938)	(7,167)
Net operating expenses	5	8,392	(10,672)
Balance on the technical account for general business		£5,928	£(12,438)

All items relate to discontinued operations.

PROFIT AND LOSS ACCOUNT

For the year ended 31 December 2006

Non-technical account

	2006 £000	2005 £000
Balance on the general business technical account	5,928	(12,438)
Investment income	4,295	5,217
Realised gains on investments	89	169
Unrealised gains on investments	142	29
Realised losses on investments	(60)	(600)
Unrealised losses on investments	(89)	(470)
Investments expenses and charges	(31)	(31)
Allocated investment return transferred to the general business technical account	(4,346)	(4,314)
Profit/(loss) for the financial year	<u>£5,928</u>	<u>£(12,438)</u>

All items relate to discontinued operations.

There were no recognised gains or losses relating to the current or preceding year other than those included in the profit and loss account.

BALANCE SHEET

As at 31 December 2006

ASSETS	Notes	2006 £000	2005 £000
Investments			
Other financial investments	9	68,418	69,747
Reinsurers' share of technical provisions			
Provision for unearned premiums		290	49
Claims outstanding		38,624	47,019
		38,914	47,068
Debtors			
Debtors arising out of direct insurance operations - intermediaries	10	1,933	4,208
Debtors arising out of reinsurance operations	11	4,747	7,778
Other debtors		3,865	3,418
		10,545	15,404
Other assets			
Cash at bank and in hand		26,799	37,705
Overseas deposits	12	7,857	12,834
		34,656	50,539
Prepayments and accrued income			
Deferred acquisition costs		173	306
Other prepayments and accrued income		-	274
		173	580
TOTAL ASSETS		£152,706	£183,338

BALANCE SHEET

As at 31 December 2006

LIABILITIES	Notes	2006 £000	2005 £000
Capital and reserves			
Members' balances	13	7,799	3,266
Technical Provisions			
Provision for unearned premiums		1,120	1,741
Claims outstanding		140,655	177,324
		149,574	179,065
Creditors			
Creditors arising out of direct insurance operations	14	91	-
Creditors arising out of reinsurance operations	15	3,031	928
Other creditors including taxation and social security		10	79
		3,132	1,007
TOTAL LIABILITIES		£152,706	£183,338

The syndicate annual accounts were approved by the Board of XL London Market Ltd on 14 March 2007 and were signed on its behalf by

D.J. O'Donohoe
14 March 2007

STATEMENT OF CASH FLOWS

For the year ended 31 December 2006

	Notes	2006 £000	2005 £000
Reconciliation of profit/(loss) to net cash outflow from operating activities			
Profit/(loss) for the financial year		5,928	(12,438)
Realised and unrealised investments losses/(gains) including exchange	17	12,856	(10,399)
Decrease in net technical provisions		(29,136)	(18,531)
Decrease /(increase) in debtors		4,859	(4,980)
Decrease/(increase) in prepayments and accrued income		406	(197)
Increase/(decrease) in creditors and provisions for other risks		2,126	(284)
Foreign exchange (gain)/loss on balance due to members		(11,197)	9,566
Net cash outflow from operating activities		£(14,158)	£(37,263)
Financing:			
Open year cash calls made		10,210	-
Other		(408)	159
		£(4,356)	£(37,104)
Cash flows were invested as follows:			
Decrease in cash holdings	17	(7,911)	(42,802)
Decrease in overseas deposits	17	(3,587)	(1,508)
Increase in portfolio investments	18	7,142	7,206
Net cash outflow		£(4,356)	£(37,104)

NOTES TO THE ACCOUNTS

At 31 December 2006

1. Basis of Preparation

The financial statements have been prepared in accordance with the Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2004 ("the Regulations") which came into force on 31 December 2005 and essentially require the managing agent to prepare accounts for the syndicate in accordance with Schedule 9A of the Companies Act 1985 and applicable accounting standards.

Capital supporting the business of the syndicate is held in separate trust funds administered by Lloyd's. These amounts, referred to as Funds at Lloyd's ("FAL"), are available to meet the underwriting obligations of the syndicate, if required. The funds are not included in the syndicate balance sheet because they are not under the control of the managing agent and they are not hypothecated to any specific syndicate participation by a member. Furthermore, the Lloyd's central fund arrangements are available in the event that an individual member's funds are exhausted. The Managing Agent believes that in the light of these capital arrangements it is appropriate to prepare the accounts on a going concern basis.

2. Accounting Policies**(a) Basis of accounting**

The financial statements have been prepared on an annual basis of accounting, whereby the incurred cost of claims, commission and related expenses are charged against the earned proportion of premiums, net of reinsurance as follows:

(i) Premiums written

Premiums written comprise premiums on contracts incepted during the financial year, together with adjustments made in the year to premiums written in prior accounting periods. They also include estimates for pipeline premiums, representing amounts due to the syndicate not yet notified.

Premiums are shown gross of brokerage payable and exclude taxes and duties levied on them.

(ii) Unearned premiums

Written premium is earned according to the risk profile of the policy. Unearned premiums represent the proportion of premiums written in the year that relate to the unexpired terms of the policies in force at the balance sheet date, calculated on the basis of established earnings patterns or time apportionment as appropriate.

(iii) Reinsurance premium ceded

Outwards reinsurance premiums are accounted for in the same accounting period as the premiums for the related direct or inwards business being reinsured.

(iv) Claims incurred

Claims incurred comprise claims and settlement expenses (both internal and external) paid in the year and the movement in provision for outstanding claims and settlement expenses, including an allowance for the cost of claims incurred by the balance sheet date but not reported until after the year end. Claims outstanding are reduced by anticipated salvage and other recoveries.

(v) Claims provisions and related recoveries

The outstanding claims comprise amounts set aside for claims notified and claims incurred but not yet reported (IBNR).

Notified claims are estimated on a case by case basis with regard to the circumstances as reported, any information available from loss adjusters and previous experience of the cost of settling claims with similar characteristics.

The amount included in respect of IBNR is based on statistical techniques of estimation applied by the syndicate's external actuaries. These techniques generally involve projecting from past experience of the development of claims over time to form a view of the likely ultimate claims to be experienced for more recent underwriting, having regard to variations in the business accepted and the underlying terms and conditions. For the most recent years, where a high degree of volatility arises from projections, estimates may be based in part on output from rating and other models of the business accepted and assessments of underwriting conditions.

The provision for claims includes amounts in respect of internal and external claims handling costs.

The reinsurers' share of provisions for claims is based on calculated amounts of outstanding claims and projections for IBNR, net of estimated irrecoverable amounts, having regard to the reinsurance programme in place for the class of business, the claims experience for the year and the current security rating of the reinsurance companies involved.

The syndicate uses a number of statistical techniques to assist in making the above estimates. The most critical assumption as regards claims provisions is that the past is a reasonable predictor of the likely level of claims development.

NOTES TO THE ACCOUNTS

At 31 December 2006

2. Accounting Policies (continued)

The directors consider that the provisions for gross claims and related reinsurance recoveries are fairly stated on the basis of the information currently available to them. However, ultimate liability will vary as a result of subsequent information and events and this may result in significant adjustments to the amounts provided. Adjustments to the amounts of claims provisions established in prior years are reflected in the financial statements for the period in which the adjustments are made. The methods used, and the estimated made, are reviewed regularly.

(b) Unexpired risks provision

A provision for unexpired risks is made where claims, related expenses and deferred acquisition costs, likely to arise after the end of the financial period in respect of contracts concluded before that date are expected to exceed the unearned premiums and premiums receivable under these contracts, after the deduction of any acquisition costs deferred.

The provision for unexpired risks is calculated separately by reference to classes of business which are managed together.

(c) Acquisition costs

Acquisition costs, comprising commission and other internal and external costs related to the acquisition of new insurance contracts are deferred to the extent that they are attributable to premiums unearned at the balance sheet date.

(d) Foreign currencies

Transactions in US dollars, Canadian dollars and Euros are translated at the rate of exchange ruling at the date of the transaction or at an appropriate average rate. Underwriting transactions denominated in other foreign currencies are included at the rate of exchange ruling at the date the transaction is processed.

Monetary assets and liabilities are re-translated into sterling at the rate of exchange at the balance sheet date unless contracts to sell currency for sterling have been entered into prior to the year end, in which case the contracted rates are used. Non-monetary assets and liabilities at the balance sheet date, primarily deferred acquisition costs and unearned premiums, are maintained at the rate of exchange ruling when the contract was entered into (or the approximate average rate).

(e) Investments

Investments are stated at current value at the balance sheet date and at purchase cost. For this purpose

listed investments are stated at mid-market value and deposits with credit institutions and overseas deposits are stated at cost.

(f) Investment return

Investment return comprises all investment income, realised investment gains and losses and movements in unrealised gains and losses, net of investment expenses, charges and interest.

Realised gains and losses on investments carried at market value are calculated as the difference between sale proceeds and purchase price. Movements in unrealised gains and losses on investments represent the difference between their valuation at the balance sheet date and their purchase price or, if they have been previously valued, their valuation at the last balance sheet date, together with the reversal of unrealised gains and losses recognised in earlier accounting periods in respect of investment disposals in the current period.

Investment return is initially recorded in the non-technical account. A transfer is made from the non-technical account to the general business technical account to reflect the investment return on funds supporting underwriting business. All investment return is considered to arise on such funds.

(g) Taxation

Under Schedule 19 of the Finance Act 1993 managing agents are not required to deduct basic rate income tax from trading income. In addition, all UK basic rate income tax (currently at 22%) deducted from syndicate investment income is recoverable by managing agents and consequently the distribution made to members or their members' agents is gross of tax. Capital appreciation falls within trading income and is also distributed gross of tax. No provision has been made for any United States Federal Income Tax payable on underwriting results or investment earnings. Any payments on account made by the syndicate during the year have been included in the balance sheet under the heading "other debtors".

No provision has been made for any other overseas tax payable by members on underwriting results.

(h) Pension costs

XL Services UK Ltd operates a defined contribution pension scheme and its recharges to the syndicate in respect of staff costs included an element for pension costs. These pension costs are expensed in full in the period to which the recharge relates.

(i) Operating lease rentals

Amounts recharged by XL Services UK Ltd include costs arising from the use of assets in the period. These rental costs are expensed in full in the period to which the recharge relates.

NOTES TO THE ACCOUNTS

At 31 December 2006

3. Segmental Analysis

TYPE OF BUSINESS

An analysis of the technical account balance before investment return is set out below:

2006	Gross premiums written £000	Gross premiums earned £000	Gross claims incurred £000	Gross operating expenses £000	Reinsurance balance £000	Total £000
Direct insurance:						
Credit and suretyship	142	667	1,061	920	6,075	8,723
Marine aviation and transport	36	36	699	422	(2,886)	(1,729)
Third party liability	(15)	(15)	91	1,905	(8,304)	(6,323)
Other	(22)	(22)	2,168	864	(208)	2,802
Reinsurance acceptances	681	681	(8,688)	4,281	1,835	(1,891)
Total	£822	£1,347	£(4,669)	£8,392	£(3,488)	£1,582

2005	Gross premiums written £000	Gross premiums earned £000	Gross claims incurred £000	Gross operating expenses £000	Reinsurance balance £000	Total £000
Direct insurance:						
Credit and suretyship	730	848	(1,709)	(2,240)	381	(2,720)
Marine aviation and transport	284	330	(1,518)	(661)	851	(998)
Third party liability	167	194	(9,629)	(4,036)	6,140	(7,331)
Other	86	100	(1,782)	(447)	1,254	(875)
Reinsurance acceptances	1,687	1,958	(9,960)	(3,288)	6,462	(4,828)
Total	£2,954	£3,430	£(24,598)	£(10,672)	£15,088	£(16,752)

GEOGRAPHICAL ANALYSIS BY ORIGIN

All business written by the syndicate is signed through X-Changing Insure Services (XIS) and is treated as having originated in the UK.

CONTINUING AND DISCONTINUED OPERATIONS

All business is discontinued.

NOTES TO THE ACCOUNTS

At 31 December 2006

4. Movement in Prior Year's Provision for Claims Outstanding

During the year claims reserves net of claims payments were strengthened by £7.9m (2005: £7.2m).

5. Net Operating Expenses

	2006	2005
	£000	£000
Acquisition costs	140	604
Change in deferred acquisition costs	110	34
Administrative expenses	1,207	1,109
(Profit)/Loss on exchange	(9,849)	8,925
	<u>£(8,392)</u>	<u>£10,672</u>

Administrative expenses include:

	2006	2005
	£000	£000
Audit Services:		
Fees payable to the syndicate's auditor for the audit of the syndicate's accounts	35	35
Non-audit Services:		
Fees payable to the syndicate's auditor for other services:		
Other services pursuant to legislation, including the audit of the regulatory return	22	22
	<u>£57</u>	<u>£57</u>

6. Staff Numbers and Costs

The Company has no direct employees or directors. The staff and directors are employees of other XL Group companies and an expense recharge is charged to the company by XL Services UK Ltd. The expense recharge includes the cost of these employees, but it is not possible to ascertain separately the element of the expense recharge that relates directly to staff costs or staff numbers.

7. Emoluments of the Directors of XL London Market Ltd

XL Services UK Ltd charged the syndicate the following amounts in respect of emoluments paid to its directors:

	2006	2005
	£000	£000
Emoluments	£16	£39

NOTES TO THE ACCOUNTS

At 31 December 2006

8. Run-off Manager's Emoluments

The run-off manager received the following aggregate remuneration charged to the syndicate:

	2006 £000	2005 £000
Emoluments	£40	£40

9. Financial Investments

	Market Value		Cost	
	2006 £000	2005 £000	2006 £000	2005 £000
Debt securities and other fixed income securities	43,613	64,043	43,562	64,578
Deposits with credit institutions	24,805	5,704	24,805	5,704
	<u>£68,418</u>	<u>£69,747</u>	<u>£68,367</u>	<u>£70,282</u>

Shares and other variable yield securities and units in unit trusts and debt securities and other fixed income securities are all listed on recognised stock exchanges.

10. Debtors Arising out of Direct Insurance Operations

	2006 £000	2005 £000
Due within one year - intermediaries	1,933	2,989
Due after one year - intermediaries	-	1,219
	<u>£1,933</u>	<u>£4,208</u>

11. Debtors Arising out of Reinsurance Operations

	2006 £000	2005 £000
Due within one year	£4,747	£7,778

NOTES TO THE ACCOUNTS

At 31 December 2006

12. Other Assets – Overseas Deposits

	2006	2005
	£000	£000
Illinois – USA	3,744	7,814
Joint Asset Trust Fund – USA	1,131	2,211
Australian Deposit	854	765
Joint Asset Trust Fund	50	27
Additional Securities Limited		
South Africa	424	141
Other Countries	408	490
Kentucky - USA	462	518
Canadian Margin Fund	784	868
	<u>£7,857</u>	<u>£12,834</u>

13. Reconciliation of Members' Balances

	2006	2005
	£000	£000
Balance due to members as at 1 January 2006	3,266	6,157
Profit/(loss) for the financial year	5,928	(12,438)
Revaluation of cash call	(11,197)	9,547
Cash call made in year	10,210	-
Unpaid cash call	(408)	
	<u>£7,799</u>	<u>£3,266</u>

Members participate on syndicates by reference to years of account and their ultimate result, assets and liabilities are assessed with reference to policies incepting in that year of account in respect of their membership of a particular year.

14. Creditors Arising out of Direct Insurance Operations

	2006	2005
	£000	£000
Due within one year - intermediaries	<u>£91</u>	<u>-</u>

15. Creditors Arising out of Reinsurance Operations

	2006	2005
	£000	£000
Due within one year	<u>£3,031</u>	<u>£928</u>

NOTE TO THE ACCOUNTS

At 31 December 2006

16. Movement in Opening and Closing Portfolio Investments Net of Financing

	2006 £000	2005 £000
Net cash outflow for the year	(7,911)	(42,802)
Decrease in overseas deposits	(3,587)	(1,508)
Cash flow – portfolio investments	<u>7,142</u>	<u>7,206</u>
Movement arising from cash flows	(4,356)	(37,104)
Changes in market value and exchange rates	<u>(12,856)</u>	<u>10,399</u>
Total movement in portfolio investments net of financing	(17,212)	(26,705)
Balance brought forward at 1 January	120,286	146,991
Balance carried forward at 31 December	<u><u>£103,074</u></u>	<u><u>£120,286</u></u>

17. Movement in Opening and Closing Portfolio Investments Net of Financing

	At 1 January 2006 £000	Cash flow £000	Changes to market value and currencies £000	At 31 December 2006 £000
Cash at bank and in hand	37,705	(7,911)	(2,995)	26,799
Overseas deposits	12,834	(3,587)	(1,390)	7,857
Debt securities and other fixed income securities	64,043	(12,633)	(7,797)	43,613
Loans with credit institutions	-	(6)	6	-
Deposit with credit institutions	5,704	19,781	(680)	24,805
Total portfolio investments	<u>69,747</u>	<u>7,142</u>	<u>(8,471)</u>	<u>68,418</u>
	<u><u>£120,286</u></u>	<u><u>£(4,356)</u></u>	<u><u>£(12,856)</u></u>	<u><u>£103,074</u></u>

NOTES TO THE ACCOUNTS

At 31 December 2006

18. Net Increase in Portfolio Investments

	2006	2005
	£000	£000
Purchase of debt securities and other fixed income securities	(10,090)	(115,800)
Purchase of deposits with credit institutions	(19,781)	(5,704)
Sale of debt securities and other fixed income securities	22,723	114,298
Sale of loans with credit institutions	6	-
Net increase in portfolio investments	£(7,142)	£(7,206)

19. Significant Uncertainties***Political Risks***

The residual Political Risks exposures remain significant and therefore continue to represent material uncertainty. There continues to be effort to reduce these exposures and attempts to purchase cost-effective reinsurance, but the level of exposure remains significant.

World Trade Center (WTC)

The syndicate sustained heavy losses related to this event, particularly in relation to the Accident and Health business reinsured by the syndicate. Despite having settled many claims to date, the level of outstanding loss notifications is still high and the ultimate outcome remains uncertain. Specific reinsurances have been exhausted; any gross movement is a net movement, implying potential volatility in the final result. A review of the syndicate's exposure to the WTC Accident and Health losses is carried out annually by external consultants.

Professional Indemnity

There has previously been market-wide deterioration in this book of business. The account has experienced some late development and a number of uncertainties remain. Whilst the issues of IPO Laddering and the events surrounding the collapse of Enron and WorldCom have stabilised, there is significant exposure in the US Lawyers portfolio with regard to the well publicised litigation of US "Tax Shelters". In addition, there remain live exposures in this book.

Disputes and other outstanding claims

A key legal dispute in respect of Political Risks, and other outstanding claims, remain at the balance sheet date.

REPORT OF THE DIRECTORS OF THE MANAGING AGENT

At 31 December 2006

The directors of XL London Market Ltd (XLLM), the managing agent for Syndicate 588, present their report for the year ended 31 December 2006.

The financial statements have been prepared in accordance with the Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2004 ("the Regulations") which came into force on 31 December 2005 and essentially require the managing agent to prepare accounts for the syndicate in accordance with Schedule 9A of the Companies Act 1985 and applicable accounting standards.

Principal activity

Syndicate 588 underwrote direct and reinsurance business within the Lloyd's of London market. The last year of account of Syndicate 588 was the 2001 year of account, which remains open and in run-off.

Key uncertainties preventing the closure of the 2001 account

The combination of a number of uncertainties prevents the calculation of a Reinsurance to Close Premium (RITC) including a risk premium, that is equitable to both the members of Syndicate 588 and the members of any potential receiving syndicate, there being no natural successor syndicate.

These key uncertainties preventing the closure of the 2001 year of account are as follows:

Political Risks

The residual Political Risks exposures remain significant and therefore continue to represent material uncertainty. There continues to be effort to reduce these exposures and attempts to purchase cost-effective reinsurance, but the level of exposure remains significant.

Disputes and other outstanding claims

A key legal dispute in respect of Political Risks, and other outstanding claims, remain at the balance sheet date.

Business Review**Results and performance**

The syndicate's results and balance sheet, as set out on pages 43 and 45, show a cumulative loss after 72 months of £19.9m. During 2006 the cumulative loss has decreased by the profit in the year of £2.9m.

The principal reason for the profit in the period is an unrealised exchange gain mainly arising on the retranslation of cash calls which are denominated in US dollars. The syndicate has broadly matched all major currency exposures and accordingly the

exchange profit booked through the profit and loss account under UK GAAP is offset by the fall in the converted GBP value of the USD denominated cash calls. In other words the amount due from or to members is not materially affected by exchange rate movements.

Ignoring the exchange gains above, there has been a small loss in the 2006 calendar year, principally due to deterioration on live exposures within the Political Risks account.

Forecast ultimate loss

The cumulative retained loss as at 31 December 2006 amounts to 32% of capacity after personal expenses (2005: 37%). This loss is inclusive of unrealised foreign exchange gains and losses. The forecast ultimate loss is currently anticipated to be in the range of 35-40% of capacity. This forecast does not include unrealised foreign exchange gains and losses, which are required to be included within the account. In the directors' opinion the realisation of these unrealised gains or losses cannot be accurately predicted until such time as the syndicate closes by way of a RITC premium, and have therefore been excluded from the forecast ultimate loss. These unrealised foreign exchange gains and losses are offset by the change in value of cash calls to date, which are denominated in US dollars.

Future developments and strategy

XLLM remains committed to the closure of the 2001 year of account as soon as possible at a figure which is fair and equitable to all parties. The syndicate will continue to monitor and assess the Market's appetite for accepting a potential RITC premium including a risk premium that is both equitable to the members of Syndicate 588 and any potential receiving syndicate.

XLLM continues to dedicate resources to the management of legacy issues to pro-actively to resolving the uncertainties where this is possible. A dedicated claims run-off manager has been recruited to oversee all legacy claims issues for managed syndicates. XLLM has entered into a service agreement to validate lead claims reserves where there has been no movement on the reserve for at least 12 months.

REPORT OF THE DIRECTORS OF THE MANAGING AGENT

At 31 December 2006

Principal risks and uncertainties

The process of risk acceptance and risk management is addressed through a framework of policies, procedures and internal controls. This is reviewed annually as part of the Individual Capital Assessment (ICA) process. The Board of XLLM approved the overall framework and has charged day to day monitoring to the Risk Monitoring Committee (RMC) which reports to the Board. The RMC meets at least quarterly to review and update the risk register as appropriate and to monitor performance against risk appetite using a series of key risk indicators. The Board is responsible for satisfying itself that a proper internal control framework exists to manage financial risks and that controls operate effectively.

The principal risks from our general insurance business arise from inaccurate pricing, fluctuations in timing, frequency and severity of claims compared to our expectations; inadequate reinsurance protection; and inadequate reserving. Our underwriting and reinsurance strategies are set within the context of the overall XL Capital strategies, approved by the Board and communicated clearly throughout the business through policy statements and guidelines.

The principal risks and uncertainties facing the syndicate are as follows:

Insurance risk

Insurance risk is the risk of loss arising from the inherent uncertainties about the occurrence, amount and timing of insurance liabilities and premiums arising from the risks accepted through insurance and reinsurance activities. The two main components are Underwriting risk (i.e. the risks from live exposures) and reserving risk (i.e. risks from past exposures).

The syndicate continues to try to reduce its remaining live exposures where possible.

The syndicate aims to commute policies where possible and actively pursues subrogated claims recoveries. Consultants have been employed to investigate static claims which are also actively examined in-house. This has led to reductions in some gross reserves.

XLLM continues actively to pursue subrogated claims recoveries.

Legacy reinsurance, jointly protecting Syndicates 588, 861 and 1209, was renewed at the start of 2006 for a 24 month period, in so far as this could be placed in the market.

Financial Risks and Uncertainties

Credit risk

Credit risk is the impact arising from failure of a counterparty to make full and timely payments on their financial obligations or from the change in the market value of assets due to a deterioration of a counterparty's creditworthiness.

The syndicate has stringent security requirements for all outwards reinsurance focusing on both level of security and aggregate exposure to any one reinsurer. The syndicate continues to pursue non-paying reinsurers.

Investments are almost entirely held in government or government backed securities or equivalent instruments.

Market risk

Market Risk is the impact arising from the uncertainty of asset prices, interest rates, foreign exchange rates, and other factors related to financial markets and investment asset management.

At the start of the year the primary investment objective was capital preservation by investing in fixed income securities. A secondary objective was to achieve a risk adjusted total return by active investment management.

During the first quarter of the year the investment strategy was changed to move funds from fixed income securities to cash deposits as the investments matured, to more closely replicate the run-off nature of the liabilities and provide liquidity as the syndicate settles claims. Returns on deposits remain comparatively high.

The calendar year yield of 4.03% is higher than in the previous year, when a yield of 3.37% was achieved. The main reason for this increased yield is an increase in short dated US dollar denominated bond yields.

Liquidity risk

Liquidity risk is the risk that insufficient financial resources are available to meet obligations as they fall due or can only be secured at excessive cost.

The syndicate manages liquidity risk through regular cash flow forecasts, both on a short term and ultimate long term basis.

During the year the syndicate made a cash call of \$5m (£2.5m) due on 30 June 2006 of which 97% has been collected as at 31 December 2006. The purpose of this cash call was to fund forecast claims payments and to cover liquidity issues arising from funds tied up within regulatory trust funds.

Assuming normal claims settlement patterns, it is considered unlikely that the syndicate will need to make a cash call in 2007.

REPORT OF THE DIRECTORS OF THE MANAGING AGENT

At 31 December 2006

Managed syndicates and underwriting arrangements

XLLM is the managing agent of Syndicates 588, 861 and 1209. XLLM is, through other group companies, a wholly owned subsidiary of XL Capital Ltd (XL), the Bermuda based holding company of an international insurance and reinsurance group. The immediate parent company of XLLM is XL London Market Services Ltd.

Syndicate 588, backed by third party members, underwrote in parallel alongside Syndicate 1209 until 31 December 2001. The underwriting splits between Syndicates 588 and 1209 for the 2001 year of account were determined on the basis of each of the syndicates' respective allocated capacities. The split across the relevant year of account was as follows:

	588	1209
	%	%
2001	53	47

The stamp capacity for the 2001 year of account is £61,546,192.

Members' Agents

Hampden Agencies Ltd provided 51.3% of the syndicate's capacity. SOC Private Capital Ltd provided 26.8% of capacity.

No other Members' Agents or direct participant for the 2001 year of account has provided in excess of 20% of syndicate allocated capacity.

Directors of the managing agent

The directors who held office at any time during the year are shown below. None of the directors nor the run-off manager participated as members during this time.

S.C. Barrett	
M.J. Beane	
Sir Brian Corby	(non-executive)
P.J. Drake	(resigned 26/02/2006)
J. Loudon	(Chairman, non-executive)
E. E. McCusker	(appointed 16/02/2006)
D.J. O'Donohoe	
A. Ramage	
P. O. Sheridan	(non-executive, appointed 28/11/2006)
W.P. Thompson	(non-executive, resigned 31/12/2006)
C.R. Tobin	
M.D. Turner	

Run-off manager

Mr. Ian Bollons was appointed as Run-off manager in July 2004 following the retirement of his predecessor Mr. Clifford.

Company secretary

The company secretary of XLLM is Graham Brady.

Annual general meeting

XLLM will be applying to Lloyd's for consent not to hold an annual general meeting during 2007 and have issued notice to members' agents to this effect.

Charitable donations

Neither XLLM nor the syndicate made any charitable or political donations in the period (2005: Nil).

Registered office

The registered office of XLLM is XL House, 70 Gracechurch Street, London, EC3V 0XL. The accounting records are held at this site.

Auditors

XLLM intend re-appointing PricewaterhouseCoopers LLP as auditors to the syndicate and PricewaterhouseCoopers LLP have expressed their willingness to continue in office.

Dispensation has been granted by Lloyd's under the Audit Arrangements Byelaw in order for PricewaterhouseCoopers LLP to perform the audit of the syndicate as well as certain related companies within the XL Capital Group.

Approved by the Board of XL London Market Ltd on 14 March 2007

D.J. O'Donohoe
Chief Executive Officer

STATEMENT OF MANAGING AGENT'S RESPONSIBILITIES

The managing agent is responsible for preparing the syndicate underwriting year accounts in accordance with Lloyd's Syndicate Accounting Byelaw.

The Syndicate Accounting Byelaw requires the managing agent to prepare underwriting year accounts for each syndicate in respect of any underwriting year which is in run-off at 31 December.

In preparing the underwriting year accounts, the managing agent is required to:

- select suitable accounting policies which are applied consistently and where there are items which affect more than one year of account, ensure a treatment which is equitable as between the members of the syndicate affected;
- take into account all income and charges relating to the underwriting year without regard to the date of receipt or payment;
- make judgements and estimates that are reasonable and prudent; and
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;

Each of the persons who is a director of the managing agent at the date of this report confirms that:

- so far as each director is aware, there is no information relevant to the audit of the syndicate's financial statements for the year ended 31 December 2006 of which the auditors are unaware;
- each director has taken all the steps that they ought to have taken as a director in order to make him/herself aware of any relevant audit information and to establish that the syndicate's auditors are aware of that information.

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

The directors of the managing agent confirm that they have complied with the above requirements in preparing the financial statements.

Approved by the Board of XL London Market Ltd on 14 March 2007

D.J. O'Donohoe
Chief Executive Officer

REPORT OF THE INDEPENDENT AUDITORS TO THE MEMBERS ON THE 2001 RUN-OFF ACCOUNT OF SYNDICATE 588

We have audited the syndicate underwriting year accounts for the 2001 run-off underwriting year of account as at 31 December 2006 which comprise the profit and loss account, the balance sheet and the related notes. These financial statements have been prepared under the accounting policies set out therein.

Respective responsibilities of the managing agent and auditors

The managing agent's responsibilities for preparing the syndicate underwriting year accounts in accordance with the Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2004, Lloyd's Syndicate Accounting Byelaw (No.8 of 2005) and applicable United Kingdom Generally Accepted Accounting Practice are set out in the statement of managing agent's responsibilities.

Our responsibility is to audit the syndicate underwriting year accounts in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the syndicate's members and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or in to whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the syndicate underwriting year accounts have been properly prepared in accordance with the Lloyd's Syndicate Accounting Byelaw. In addition we report to you if, in our opinion, the managing agent has not kept proper accounting records in respect of the syndicate, if the syndicate underwriting year accounts are not in agreement with the accounting records or if we have not received all the information and explanation we require for our audit.

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

Basis of audit opinion

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

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

Opinion

In our opinion the syndicate underwriting year accounts for the 2001 run-off underwriting year of account have been properly prepared in accordance with the Lloyd's Syndicate Accounting Byelaw.

Emphasis of matter – Reserves Uncertainty

In forming our opinion, we have considered the disclosures made by the Managing Agent, in particular in Note 16 of the Run-Off Account relating to the uncertainties that prevent the 2001 year of account from closing. Future experience may show that, material adjustments, either favourable or adverse, are required in respect of the assumptions made in estimating the claims provisions and related reinsurance recoveries. In view of the significance of these uncertainties we consider that it should be drawn to your attention but our opinion is not qualified in this respect.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
London, United Kingdom
14 March 2007

PROFIT AND LOSS ACCOUNT

As at 31 December 2006

Technical account – general business

	Notes	At 60 months £000	Transactions in year £000	At 72 months £000
Earned premiums, net of reinsurance				
Gross premiums written		80,066	(5,708)	74,358
Reinsurers' share of premiums		(32,992)	3,080	(29,912)
		<u>47,074</u>	<u>(2,628)</u>	<u>44,446</u>
Reinsurance to close premiums received, net of reinsurance		23,909	(4,034)	19,875
Earned premiums, net of reinsurance		<u>70,983</u>	<u>(6,662)</u>	<u>64,321</u>
Allocated investment return transferred from the non-technical account		4,848	492	5,340
Claims incurred, net of reinsurance				
Claims paid				
Gross amount		(106,321)	6,661	(99,660)
Reinsurers' share		58,361	(5,743)	52,618
		<u>(47,960)</u>	<u>918</u>	<u>(47,042)</u>
Amount retained to meet all known and unknown outstanding liabilities, net of reinsurance		(30,816)	8,432	(22,384)
Claims incurred, net of reinsurance		<u>(78,776)</u>	<u>9,350</u>	<u>(69,426)</u>
Net operating expenses	5	(19,828)	(263)	(20,091)
Balance on the technical account for general business		<u>£(22,773)</u>	<u>£2,917</u>	<u>£(19,856)</u>

All items relate to discontinued operations.

PROFIT AND LOSS ACCOUNT

As at 31 December 2006

Non-technical account

	At 60 months £000	Transactions in year £000	At 72 months £000
Balance on the general business technical account	(22,773)	2,917	(19,856)
Investment income	5,039	465	5,504
Realised gains on investments	1,086	222	1,308
Unrealised gains on investments	366	(343)	23
Realised losses on investments	(1,281)	27	(1,254)
Unrealised losses on investments	(211)	111	(100)
Investments expenses and charges	(151)	10	(141)
Allocated investment return transferred to the general business technical account	(4,848)	(492)	(5,340)
Result for the five years ended 31 December 2005 for the 2001 run-off account	£(22,773)		
		£2,917	
Result for the six years ended 31 December 2006 for the 2001 run-off account			£(19,856)

There are no recognised gains or losses in the accounting period other than those dealt with in the technical and non-technical accounts.

All items relate to discontinued operations.

BALANCE SHEET

As at 31 December 2006

ASSETS	Notes	2006 £000	£000
Investments	8		15,695
Debtors			
Debtors arising out of direct insurance operations - intermediaries	6	8	
Debtors arising out of reinsurance operations	7	557	
Other debtors		236	
		<hr/>	801
Reinsurance recoveries anticipated on gross amounts retained to meet all known and unknown outstanding liabilities			14,819
Other assets			
Cash at bank and in hand		7,387	
Overseas deposits	10	1,151	
		<hr/>	8,538
TOTAL ASSETS			<hr/> £39,853 <hr/>
LIABILITIES			
Amounts due from members	11		999
Amounts retained to meet all known and unknown outstanding liabilities – gross amount			37,203
Creditors			
Creditors arising out of direct insurance operations	12	441	
Creditors arising out of reinsurance operations	13	1,210	
		<hr/>	1,651
TOTAL LIABILITIES			<hr/> £39,853 <hr/>

The Run-Off accounts were approved by the Board of XL London Market Ltd on 14 March 2007 and were signed on its behalf by

D.J. O'Donohoe
Chief Executive Officer

14 March 2007

NOTES TO THE ACCOUNTS

At 31 December 2006

1. Basis of Preparation

The underwriting year accounts have been prepared in accordance with the Syndicate Accounting Byelaw and applicable accounting standards in the United Kingdom. They comply with the Statement of Recommended Practice issued by the Association of British Insurers in December 2005 ("the ABI SORP"), as applicable.

Members participate on a syndicate by reference to a year of account and each syndicate year of account is a separate annual venture. These accounts relate to the 2001 year of account which remains in run-off at 31 December 2006; consequently the balance sheet at that date represents the assets and liabilities of the 2001 year of account and the profit and loss account reflects the transactions for that year of account during the 72 months then ended. As required by the Syndicate Accounting Byelaw, the profit and loss account also shows transactions for the 12 months ended 31 December 2006.

2. Accounting Policies***Underwriting transactions***

- (a) The underwriting accounts for each year of account are normally kept open for three years before the result on that year is determined. At the end of the three year period, outstanding liabilities can normally be determined with sufficient accuracy to permit the year of account to be closed by payment of a reinsurance to close premium to the successor year of account. Where this is not possible, an amount to meet all known and unknown outstanding liabilities is retained at each year end until an equitable reinsurance to close can be effected. The 2001 year of account remains open for the reasons detailed in note 15.

The directors consider that the net amount retained to meet all known and unknown outstanding liabilities is fairly stated on the basis of the information currently available to them. However, ultimate liability will vary as a result of subsequent information and events and this may result in significant adjustments to the amounts retained. Adjustments to the amounts of claims provisions established in prior years are reflected in the financial statements for the period in which the adjustments are made.

The methods used, and the estimates made, are reviewed regularly.

The amount retained to meet all known and unknown outstanding liabilities comprises the outstanding technical provisions at 31 December and includes those for outstanding claims.

- (b) Gross premiums are allocated to years of account on the basis of the inception date of the policy. Commission and brokerage are charged to the year of account to which the relevant policy is allocated. Policies written under binding authorities, lineslips or consortium arrangements are allocated to the year of account into which the arrangement incepts. Additional and return premiums follow the year of account of the original premium. Premiums are shown gross of brokerage payable and exclude taxes and duties levied on them. Estimates are made for pipeline premiums, representing amounts due but not yet notified to the syndicate year of account.

Outwards reinsurance premiums ceded are attributed to the same year as the original risk being protected.

- (c) Gross claims paid are allocated to the same year of account as that to which the corresponding premiums are allocated and include internal and external claims settlement expenses. Reinsurance recoveries are allocated to the year of account to which the claim was charged.
- (d) Outstanding claims comprise amounts set aside for claims notified and claims incurred but not yet reported (IBNR).

Notified claims are estimated on a case by case basis with regard to the circumstances as reported, any information available from loss adjusters and previous experience of the cost of settling claims with similar characteristics. The amount included in respect of the future development of notified claims and IBNR is based on statistical techniques of estimation applied by the external consulting actuaries. These techniques generally involve projecting from past experience of the development of claims over time to form a view of the likely ultimate claims to be experienced for more recent underwriting, having regard to variations in the business accepted and the underlying terms and conditions.

The provision for claims includes amounts in respect of internal and external claims handling costs.

NOTES TO THE ACCOUNTS

At 31 December 2006

Underwriting transactions (continued)

The reinsurers' share of provisions for claims is based on calculated amounts of outstanding claims and projections for IBNR, net of estimated irrecoverable amounts, having regard to the reinsurance programme in place for the class of business, the claims experience for the year and the current security rating of the reinsurance companies involved.

The syndicate uses a number of statistical techniques to assist in making the above estimates. The most critical assumption as regards claims provisions is that the past is a reasonable predictor of the likely level of claims development.

Investments and Investment Return

- (e) Investment return comprises investment income, realised and unrealised investment gains and losses, net of investment expenses, charges and interest. Investment return arising in each calendar year on all the syndicate's investments is allocated to open years of account in proportion to the average funds available for investment attributable to those years. Investment returns in respect of overseas deposits are allocated to the year of account which funded these deposits.

Realised gains and losses on investments carried at market value are calculated as the difference between sale proceeds and purchase price. Movements in unrealised gains and losses on investments represent the difference between their valuation at the balance sheet date and their purchase price or, if they have been previously valued, their valuation at the end of the previous calendar year, together with the reversal of unrealised gains and losses recognised in earlier calendar years in respect of investment disposals in the current period.

Investment return is initially recorded in the non-technical account. A transfer is made from the non-technical account to the general business technical account to reflect the investment return on funds supporting underwriting business. All investment return is considered to arise on such funds.

Investments are stated at current value at the balance sheet date. For this purpose listed investments are stated at mid-market value and deposits with credit institutions and overseas deposits are stated at cost. Unlisted investments for which a market exists are stated at the average price at which they were traded on the balance sheet date or the last trading day before that date.

Syndicate Operating Expenses

- (f) Costs incurred by the managing agent in respect of the syndicate are charged to the syndicate. Where expenses do not relate to any specific year of account they are apportioned between years of account on a basis which reflects the benefit obtained by each year of account from each type of expense.

Where expenses are incurred jointly by the managing agent and the syndicate, they are apportioned as follows:

Salaries and related costs – according to time of each individual spent on syndicate matters
Accommodation costs – according to number of personnel
Other costs – as appropriate in each case

The managing agent operates a defined contribution pension scheme and its recharges to the syndicate, in respect of salaries and related costs, include an element for pension costs. These pension costs are expensed in full in the period to which the recharge relates.

Amounts recharged by the managing agent include costs arising from the use of assets in the period. These rental costs are expensed in full in the period to which the recharge relates.

Taxation

- (g) Under Schedule 19 of the Finance Act 1993 managing agents are not required to deduct basic rate income tax from trading income. In addition, all UK basic rate income tax deducted from syndicate investment income is recoverable by managing agents and consequently the distribution made to members or their members' agents is gross of tax.

Capital appreciation falls within trading income and is also distributed gross of tax. It is the responsibility of members to agree and settle their individual tax liabilities with HM Revenue & Customs.

No provision has been made for any United States Federal Income Tax or any overseas tax payable on the underwriting results or investment earnings.

Members resident overseas for tax purposes are responsible for agreeing and settling any tax liabilities with the taxation authorities of their country of residence.

NOTES TO THE ACCOUNTS

At 31 December 2006

Basis of Currency Translation

- (h) The syndicate maintains four separate currency funds of Sterling, United States dollars, Canadian dollars and Euros. Items expressed in United States dollars, Canadian dollars and Euros are translated to Sterling at the rates of exchange ruling at the balance sheet date. Items brought forward from previous years are therefore revalued at those rates. The differences arising from this revaluation are included in the calendar year movements disclosed for each underwriting account heading.

NOTES TO THE ACCOUNTS

At 31 December 2006

3. Segmental Analysis

TYPE OF BUSINESS

An analysis of the technical account balance after 72 months before investment return is set out below:

2006	Gross premiums written £000	Gross claims incurred £000	Gross operating expenses £000	Reinsurance balance £000	Total £000
Direct insurance:					
Accident and health	3	(4)	(1)	(3)	(5)
Credit and suretyship	5,118	(6,171)	(2,142)	(3,431)	(6,626)
Motor (other classes)	303	(175)	(129)	(73)	(74)
Marine aviation and transport	13,677	(7,500)	(4,984)	(1,773)	(580)
Fire and other damage to property	6,417	(5,602)	(2,456)	965	(676)
Third party liability	1,407	(267)	(297)	219	1,062
Reinsurance acceptances	67,308	(79,941)	(10,082)	4,418	(18,297)
Total	£94,233	£(99,660)	£(20,091)	£322	£(25,196)

Reinsurance acceptances include the reinsurance to close premium of £19.9m received from the 2000 year of account.

GEOGRAPHICAL ANALYSIS BY ORIGIN

All business written by the syndicate is signed through X-Changing Insure Services (XIS) and is treated as having originated in the UK.

4. Technical Account Balance after 72 months before Allocated Investment Return and Net Operating Expenses

	2006 £000
Balance attributable to business allocated to the 2001 year of account	(2,872)
Balance attributable to the reinsurance to close the 2000 year of account	(2,233)
	£(5,105)

NOTES TO THE ACCOUNTS

At 31 December 2006

5. Net Operating Expenses

	At 60 months £000	Transactions in year £000	At 72 months £000
Acquisition costs	14,617	129	14,746
Administrative expenses	5,624	(16)	5,608
Profit on exchange	(2,092)	150	(1,942)
Personal expenses	1,679	-	1,679
	<u>£19,828</u>	<u>£263</u>	<u>£20,091</u>

The run-off account result is stated after charging:

	At 60 months £000	Transactions in year £000	At 72 months £000
Auditors' remuneration	£141	£38	£179
	<u>£141</u>	<u>£38</u>	<u>£179</u>

6. Debtors Arising out of Direct Insurance Operations

	2006 £000
Due within one year - intermediaries	<u>£8</u>

7. Debtors Arising out of Reinsurance Operations

	2006 £000
Due within one year	<u>£557</u>

8. Financial Investments

	Market Value 2006 £000	Cost 2006 £000
Debt securities and other fixed income securities	11,570	11,568
Deposits with credit institutions	4,084	4,084
Loans with credit institutions	41	41
	<u>£15,695</u>	<u>£15,652</u>

Shares and other variable yield securities and units in unit trusts and debt securities and other fixed income securities are all listed on recognised stock exchanges.

NOTES TO THE ACCOUNTS

At 31 December 2006

9. Calendar Year Investment Yield

The average amount of syndicate funds available for investment during 2006 and the investment return and yield for that (for both run-off and closed years of account) were as follows:

	2006 £000
Average fund	26,667
Investment return	492
Calendar year investment yield	4.03%

Average fund is the average of bank balances and investments held on behalf of the Members of the syndicate at the end of each month during the calendar year.

Analysis of calendar year investment yield by currency:

	2006
Sterling	4.60%
United States dollars	3.95%
Canadian dollars	3.80%
Euros	3.00%

10. Other Assets – Overseas Deposits

	2006 £000
Illinois – USA	558
Joint Asset Trust Fund – USA	
Australian Deposit	138
Deposit	7
Joint Asset Trust Fund	1
Additional Securities Limited	
South Africa	21
Other Countries	183
Kentucky - USA	139
Canadian Margin Fund	104
	<u>£1,151</u>

11. Amounts due to/(from) Members

	2006 £000
Result for the run-off account after 72 months	(19,856)
Cash calls paid	20,923
Unpaid cash calls	(68)
Members' balances carried forward at 31 December 2006	<u>£999</u>

NOTES TO THE ACCOUNTS

At 31 December 2006

12. Creditors Arising out of Direct Insurance Operations

	2006 £000
Due after one year - intermediaries	£441

13. Creditors Arising out of Reinsurance Operations

	2006 £000
Due within one year	£1,210

14. Borrowings

The syndicate held a Letter of Credit from Lloyds TSB for \$1m (£0.5m) to replace the funds required by the New York Insurance Department to be deposited in the Surplus Lines Trust Fund. This letter of credit was cancelled with effect from 30 August 2006.

15. Contingent Liabilities

There were no contingent liabilities that the board of directors were aware of at the date of signing these accounts.

16. Significant Uncertainties***Political Risks***

The residual Political Risks exposures remain significant and therefore continue to represent material uncertainty. There continues to be effort to reduce these exposures and attempts to purchase cost-effective reinsurance, but the level of exposure remains significant.

Disputes and other outstanding claims

A key legal dispute in respect of Political Risks, and other outstanding claims, remain at the balance sheet date.

SEVEN YEAR SUMMARY OF RESULTS

	2001 (Run-off) At 72 months £	2000 (Closed)	1999 (Closed)	1998 (Closed)	1997 (Closed)	1996 (Closed)	1995 (Closed)
Syndicate allocated capacity (000s)	61,546	70,686	76,103	84,612	107,938	115,213	119,179
Capacity utilised (gross premium)	96.86%	98.28%	97.17%	83.81%	76.71%	63.41%	86.85%
Aggregate net premiums (000s)	29,700	41,051	44,620	50,767	51,722	49,248	67,567
Net capacity utilised (net premium)	48.26%	58.08%	58.63%	60.00%	47.92%	42.75%	56.69%
Underwriting profit/(loss) ratio	(38.78%)	(9.12%)	1.14%	1.79%	15.93%	20.50%	30.41%
Number of underwriting Members	952	942	952	940	1,040	1,183	1,219
Results for an illustrative share £10,000							
Gross premiums	9,685	9,828	9,717	8,381	7,671	6,341	8,685
Net premiums	4,826	5,808	5,863	6,000	4,792	4,275	5,669
Premium for the reinsurance to close an earlier year of account	3,229	4,105	5,194	4,477	3,583	2,509	1,577
Net claims	(7,643)	(6,156)	(5,838)	(4,679)	(2,522)	(1,822)	(1,772)
Premium for the reinsurance to close the year of account	-	(4,216)	(4,557)	(5,132)	(4,195)	(3,350)	(2,545)
Amount retained to meet all known and unknown liabilities of the 2001 and prior years of account	(3,637)	-	-	-	-	-	-
Profit/(loss) on exchange	316	194	(14)	(55)	14	(14)	37
Syndicate operating expenses	(912)	(631)	(537)	(461)	(450)	(298)	(325)
Balance on technical account	(3,821)	(896)	111	150	1,222	1,300	2,641
Investment return	867	373	548	508	428	548	627
(Loss)/profit before personal expenses	(2,954)	(523)	659	658	1,650	1,848	3,268
Managing Agent's fee	(75)	(60)	(50)	(50)	(50)	(50)	(65)
High Level Stop Loss	-	-	-	-	-	-	(33)
Contribution to Lloyd's Central Fund	(75)	(100)	(100)	(113)	(71)	(72)	(60)
Lloyd's Subscription	(25)	(25)	(35)	(50)	(65)	(50)	(50)
Members' Special Contribution	-	-	-	-	-	-	(150)
Managing Agent's profit commission	-	-	(81)	(79)	(230)	(251)	(435)
Other – see note 4. below	(15)	(10)	-	-	-	-	-
(Loss)/profit after personal expenses	£(3,144)	£(718)	£393	£366	£1,234	£1,425	£2,475

Notes to the seven year summary

1. The seven year summary has been prepared from the audited accounts of the syndicates.
2. Gross and net premium for the 2001 year of account have been stated net of acquisition costs for comparison purposes with 2000 and earlier years of account.
3. Personal expenses have been stated at the amount which would be incurred pro-rata by individual Members writing the illustrative premium income in the syndicate, disregarding any minimum charge applicable. Corporate Members may be charged at different rates. Foreign taxation, which may be treated as a credit for personal tax purposes, has been excluded.
4. Personal expenses exclude members' agents' fees.
5. Other personal expenses include interest charges on Members' outstanding balances and charges made to Members requesting schedule 9a accounts.

REPORT OF THE DIRECTORS OF THE MANAGING AGENT

At 31 December 2006

The directors of XL London Market Ltd (XLLM), the managing agent for Syndicate 588, present their report for the year ended 31 December 2006.

The financial statements have been prepared in accordance with the Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2004 ("the Regulations") which came into force on 31 December 2005 and essentially require the managing agent to prepare accounts for the syndicate in accordance with Schedule 9A of the Companies Act 1985 and applicable accounting standards.

Principal activity

Syndicate 588 underwrote direct and reinsurance business within the Lloyd's of London market. The last year of account of Syndicate 588 was the 2001 year of account, which remains open and in run-off.

Key uncertainties preventing the closure of the 2001 account

The combination of a number of uncertainties prevents the calculation of a Reinsurance to Close Premium (RITC) including a risk premium, that is equitable to both the members of Syndicate 588 and the members of any potential receiving syndicate, there being no natural successor syndicate.

These key uncertainties preventing the closure of the 2001 year of account are as follows:

Political Risks

The residual Political Risks exposures remain significant and therefore continue to represent material uncertainty. There continues to be effort to reduce these exposures and attempts to purchase cost-effective reinsurance, but the level of exposure remains significant.

Disputes and other outstanding claims

A key legal dispute in respect of Political Risks, and other outstanding claims, remain at the balance sheet date.

Business Review

Results and performance

The syndicate's results and balance sheet, as set out on pages 60 to 63, show a profit for the financial year of £3.4m (2005: loss of £3.7m).

The principal reason for the profit in the period is an unrealised exchange gain of £2.7m. This mainly arises on the retranslation of cash calls which are denominated in US dollars. The syndicate has broadly matched all major currency exposures and accordingly

the exchange profit booked through the profit and loss account under UK GAAP is offset by the fall in the converted GBP value of the USD denominated cash calls. In other words the amount due from or to members is not materially affected by exchange rate movements.

Ignoring the £2.7m exchange gain above, there has been a loss of £0.7m in the 2006 calendar year, principally due to deterioration on live exposures within the Political Risks account.

As Syndicate 588 is in run-off, the KPIs which are relevant are the ultimate loss ratios, which are approved quarterly in the Lloyd's Reserving Committee (a sub committee of the Board) and the syndicate's quarterly cash flow forecasts, which are presented to the board.

Forecast ultimate loss

The cumulative retained loss as at 31 December 2006 amounts to 32% of capacity after personal expenses (2005: 37%). This loss is inclusive of unrealised foreign exchange gains and losses. The forecast ultimate loss is currently anticipated to be in the range of 35-40% of capacity. This forecast does not include unrealised foreign exchange gains and losses, which are required to be included within the account. In the directors' opinion the realisation of these unrealised gains or losses cannot be accurately predicted until such time as the syndicate closes by way of a RITC premium, and have therefore been excluded from the forecast ultimate loss. These unrealised foreign exchange gains and losses are offset by the change in value of cash calls to date, which are denominated in US dollars.

Future developments and strategy

XLLM remains committed to the closure of the 2001 year of account as soon as possible at a figure which is fair and equitable to all parties. The syndicate will continue to monitor and assess the Market's appetite for accepting a potential RITC premium including a risk premium that is both equitable to the members of Syndicate 588 and any potential receiving syndicate.

XLLM continues to dedicate resources to the management of legacy issues and pro-actively to resolving the uncertainties where this is possible. A dedicated claims run-off manager has been recruited to oversee all legacy claims issues for managed syndicates. XLLM has entered into a service agreement to validate lead claims reserves where there has been no movement on the reserve for at least 12 months.

REPORT OF THE DIRECTORS OF THE MANAGING AGENT

At 31 December 2006

Principal risks and uncertainties

The process of risk acceptance and risk management is addressed through a framework of policies, procedures and internal controls. This is reviewed annually as part of the Individual Capital Assessment (ICA) process. The Board of XLLM approved the overall framework and has charged day to day monitoring to the Risk Monitoring Committee (RMC) which reports to the Board. The RMC meets at least quarterly to review and update the risk register as appropriate and to monitor performance against risk appetite using a series of key risk indicators. The Board is responsible for satisfying itself that a proper internal control framework exists to manage financial risks and that controls operate effectively.

The principal risks from our general insurance business arise from inaccurate pricing, fluctuations in timing, frequency and severity of claims compared to our expectations; inadequate reinsurance protection; and inadequate reserving. Our underwriting and reinsurance strategies are set within the context of the overall XL Capital strategies, approved by the Board and communicated clearly throughout the business through policy statements and guidelines.

The principal risks and uncertainties facing the syndicate are as follows:

Insurance risk

Insurance risk is the risk of loss arising from the inherent uncertainties about the occurrence, amount and timing of insurance liabilities and premiums arising from the risks accepted through insurance and reinsurance activities. The two main components are Underwriting risk (i.e. the risks from live exposures) and reserving risk (i.e. risks from past exposures).

The syndicate continues to try to reduce its remaining live exposures where possible.

The syndicate aims to commute policies where possible and actively pursues subrogated claims recoveries. Consultants have been employed to investigate static claims which are also actively examined in-house. This has led to reductions in some gross reserves.

XLLM continues actively to pursue subrogated claims recoveries.

Legacy reinsurance, jointly protecting Syndicates 588, 861 and 1209, was renewed at the start of 2006 for a 24 month period, in so far as this could be placed in the market.

Financial Risks and Uncertainties

Credit risk

Credit risk is the impact arising from failure of a counterparty to make full and timely payments on their financial obligations or from the change in the market value of assets due to a deterioration of a counterparty's creditworthiness.

The syndicate has stringent security requirements for all outwards reinsurance focusing on both level of security and aggregate exposure to any one reinsurer.

Investments are almost entirely held in government or government backed securities or equivalent instruments.

Market risk

Market Risk is the impact arising from the uncertainty of asset prices, interest rates, foreign exchange rates, and other factors related to financial markets and investment asset management.

At the start of the year the primary investment objective was capital preservation by investing in fixed income securities. A secondary objective was to achieve a risk adjusted total return by active investment management.

During the first quarter of the year the investment strategy was changed to move funds from fixed income securities to cash deposits as the investments matured, to more closely replicate the run-off nature of the liabilities and provide liquidity as the syndicate settles claims. Returns on deposits remain comparatively high.

The calendar year yield of 3.57% is higher than in the previous year, when a yield of 3.37% was achieved. The main reason for this increased yield is an increase in short dated US dollar denominated bond yields.

Liquidity risk

Liquidity risk is the risk that insufficient financial resources are available to meet obligations as they fall due or can only be secured at excessive cost.

The syndicate manages liquidity risk through regular cash flow forecasts, both on a short term and ultimate long term basis.

During the year the syndicate made a cash call of \$5m (£2.5m) due on 30 June 2006 of which 97% has been collected as at 31 December 2006. The purpose of this cash call was to fund forecast claims payments and to cover liquidity issues arising from funds tied up within regulatory trust funds.

Assuming normal claims settlement patterns, it is considered unlikely that the syndicate will need to make a cash call in 2007.

REPORT OF THE DIRECTORS OF THE MANAGING AGENT

At 31 December 2006

Managed syndicates and underwriting arrangements

XLLM is the managing agent of Syndicates 588, 861 and 1209. XLLM is, through other group companies, a wholly owned subsidiary of XL Capital Ltd (XL), the Bermuda based holding company of an international insurance and reinsurance group. The immediate parent company of XLLM is XL London Market Services Ltd.

Syndicate 588, backed by third party members, underwrote in parallel alongside Syndicate 1209 until 31 December 2001. The underwriting splits between Syndicates 588 and 1209 for the 2001 year of account were determined on the basis of each of the syndicates' respective allocated capacities. The split across the relevant year of account was as follows:

	588	1209
	%	%
2001	53	47

The stamp capacity for the 2001 year of account is £61,546,192.

Directors of the managing agent

The directors who held office at any time during the year are shown below. None of the directors nor the run-off manager participated as members during this time.

S.C. Barrett	
M.J. Beane	
Sir Brian Corby	(non-executive)
P.J. Drake	(resigned 26/02/2006)
J. Loudon	(Chairman, non-executive)
E. E. McCusker	(appointed 16/02/2006)
D.J. O'Donohoe	
A. Ramage	
P. O. Sheridan	(non-executive, appointed 28/11/2006)
W.P. Thompson	(non-executive, resigned 31/12/2006)
C.R. Tobin	
M.D. Turner	

Run-off manager

Ian Bollons was appointed as Run-off manager in July 2004 following the retirement of his predecessor Mr. Clifford.

Company secretary

The company secretary of XLLM is Graham Brady.

Annual general meeting

XLLM will be applying to Lloyd's for consent not to hold an annual general meeting during 2007 and have issued notice to members' agents to this effect.

Charitable donations

Neither XLLM nor the syndicate made any charitable or political donations in the period (2005: Nil).

Employees

Employees are kept informed of the agency's and syndicate's affairs through both paper and electronic mail circulars. There are also quarterly meetings in the agency's principal operating centre, which all staff are encouraged to attend. Employees' views are taken into account through formal feedback after employee events, a suggestion box, quarterly staff breakfasts and lunch briefings with senior management and a London Communications Focus Group which meets six times a year.

The agency is committed to providing equal opportunities to all employees irrespective of sex, marital status, creed, colour, race, age, ethnic origin or disability. Applications for employment by disabled persons are always fully considered, bearing in mind the respective aptitudes and abilities of the applicant concerned. In the event of members of staff becoming disabled, every effort is made to ensure that their employment with the agency continues and the appropriate training is arranged. It is the policy of the agency that the training, career development and promotion of a disabled person should as far as possible, be identical to that of a person who does not suffer from a disability.

All employees, based in the UK, have service contracts with XL Services UK Ltd.

Registered office

The registered office of XLLM is XL House, 70 Gracechurch Street, London, EC3V 0XL. The accounting records are held at this site.

**REPORT OF THE DIRECTORS OF THE MANAGING
AGENT**

At 31 December 2006

Auditors

XLLM intend re-appointing PricewaterhouseCoopers LLP as auditors to the syndicate and PricewaterhouseCoopers LLP have expressed their willingness to continue in office.

Dispensation has been granted by Lloyd's under the Audit Arrangements Byelaw in order for PricewaterhouseCoopers LLP to perform the audit of the syndicate as well as certain related companies within the XL Capital Group.

**Approved by the Board of XL London Market Ltd
on 14 March 2007**

D.J. O'Donohoe
Chief Executive Officer

STATEMENT OF MANAGING AGENT'S RESPONSIBILITIES

The managing agent is responsible for preparing the syndicate annual accounts in accordance with applicable law and United Kingdom Generally Accepted Accounting Practice.

The Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2004 ("the Regulations") require the managing agent to prepare financial statements for each financial period, which give a true and fair view of the state of affairs of the syndicate as at the end of the financial period, and of the profit or loss for that financial period then ended. In preparing those financial statements, the managing agent is required to:

- select suitable accounting policies and then apply them consistently, with the exception of changes arising on the adoption of new standards during the year;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- prepare the financial statements on the basis that the syndicate is in run-off.

Each of the persons who is a director of the managing agent at the date of this report confirms that:

- so far as each director is aware, there is no information relevant to the audit of the syndicate's financial statements for the year ended 31 December 2006 of which the auditors are unaware;
- each director has taken all the steps that they ought to have taken as a director in order to make him/herself aware of any relevant audit information and to establish that the syndicate's auditors are aware of that information.

The managing agent is responsible for keeping proper accounting records, which disclose with reasonable accuracy at any time, the financial position of the syndicate, and to enable it to ensure that the financial statements comply with the Regulations and the relevant provisions of the Companies Act 1985. It is also responsible for safeguarding the assets of the syndicate, and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors of the managing agent confirm that they have complied with the above requirements in preparing the financial statements.

**Approved by the Board of XL London Market Ltd
on 14 March 2007**

D.J. O'Donohoe
Chief Executive Officer

REPORT OF THE INDEPENDENT AUDITORS TO THE MEMBERS OF SYNDICATE 588

We have audited the syndicate annual accounts for the year ended 31 December 2006 which comprise the profit and loss account, the balance sheet and the cash flow statement and the related notes. These financial statements have been prepared under the accounting policies set out therein.

Respective responsibilities of managing agent and auditors

The managing agent's responsibilities for preparing the syndicate annual accounts in accordance with the Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2004, and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the statement of managing agent's responsibilities.

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

We report to you our opinion as to whether the syndicate annual accounts give a true and fair view and are properly prepared in accordance with the Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2004. We report to you whether, in our opinion, the information given in the managing agent's report is consistent with the syndicate annual accounts. In addition, we report to you if, in our opinion, the managing agent 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 managing agent's directors' remuneration and other transactions is not disclosed.

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

Basis of audit opinion

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

preparation of the syndicate annual accounts, and of whether the accounting policies are appropriate to the syndicate's circumstances, consistently applied and adequately disclosed.

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

Opinion

In our opinion:

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

Emphasis of matter – Reserves Uncertainty

In forming our opinion, we have considered the disclosures made by the Managing Agent, in particular in Note 19 of the Annual Report relating to the uncertainties that prevent the 2001 year of account from closing. Future experience may show that, material adjustments, either favourable or adverse, are required in respect of the assumptions made in estimating the claims provisions and related reinsurance recoveries. In view of the significance of these uncertainties we consider that it should be drawn to your attention but our opinion is not qualified in this respect.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
London, United Kingdom
14 March 2007

PROFIT AND LOSS ACCOUNT

For the year ended 31 December 2006

Technical account – general business

	Notes	2006 £000	2005 £000
Earned premiums, net of reinsurance			
Gross premiums written	3	920	268
Reinsurers' share of premiums		(183)	519
		737	787
Change in the provision for unearned premiums			
Gross amount		236	(218)
Reinsurers' share		156	(23)
		392	546
Earned premiums, net of reinsurance		1,129	1,333
Allocated investment return transferred from the non-technical account		1,003	1,005
Claims incurred, net of reinsurance			
Claims paid			
Gross amount		(4,783)	(17,782)
Reinsurers' share		(1,601)	3,919
		(6,384)	(13,863)
Change in the provision for claims			
Gross amount		4,525	14,789
Reinsurers' share		1,135	(2,892)
		5,660	11,897
Claims incurred, net of reinsurance		(724)	(1,966)
Net operating expenses	5	1,966	(3,331)
Balance on the technical account for general business		£3,374	£(3,746)

All items relate to discontinued operations.

PROFIT AND LOSS ACCOUNT

For the year ended 31 December 2006

Non-technical account

	2006	2005
	£000	£000
Balance on the general business technical account	3,374	(3,746)
Investment income	999	1,330
Realised gains on investments	27	50
Unrealised gains on investments	32	8
Realised losses on investments	(18)	(236)
Unrealised losses on investments	(28)	(137)
Investments expenses and charges	(9)	(10)
Allocated investment return transferred to the general business technical account	(1,003)	(1,005)
	<hr/>	<hr/>
Profit/(loss) for the financial year	£3,374	£(3,746)
	<hr/> <hr/>	<hr/> <hr/>

All items relate to discontinued operations.

There were no recognised gains or losses relating to the current or preceding year other than those included in the profit and loss account.

BALANCE SHEET

As at 31 December 2006

ASSETS	Notes	2006 £000	2005 £000
Investments			
Other financial investments	9	15,695	18,935
Reinsurers' share of technical provisions			
Provision for unearned premiums		168	24
Claims outstanding		14,651	15,465
		14,819	15,489
Debtors			
Debtors arising out of direct insurance operations			
Intermediaries	10	8	1,005
Debtors arising out of reinsurance operations	11	557	2,738
Other debtors		236	541
		801	4,284
Other assets			
Cash at bank and in hand		7,387	5,503
Overseas deposits	12	1,151	1,549
		8,538	7,052
Prepayments and accrued income			
Deferred acquisition costs		89	153
Other prepayments and accrued income		-	44
		89	197
TOTAL ASSETS		£39,942	£45,957

BALANCE SHEET

As at 31 December 2006

LIABILITIES	Notes	2006 £000	2005 £000
Capital and reserves			
Members' balances	13	999	(2,309)
Technical Provisions			
Provision for unearned premiums		568	853
Claims outstanding		36,724	46,024
		37,292	46,877
Provisions for other risks			
Creditors			
Creditors arising out of direct insurance operations	14	441	661
Creditors arising out of reinsurance operations	15	1,210	624
Other creditors including taxation and social security		-	104
		1,651	1,389
TOTAL LIABILITIES		£39,942	£45,957

The syndicate annual accounts were approved by the Board of XL London Market Ltd on 14 March 2007 and were signed on its behalf by

D.J. O'Donohoe
14 March 2007

STATEMENT OF CASH FLOWS

For the year ended 31 December 2006

	Notes	2006 £000	2005 £000
Reconciliation of profit/(loss) to net cash outflow from operating activities			
Profit/(Loss) for the financial year		3,374	(3,746)
Realised and unrealised investments losses/(gains) including exchange	17	2,628	2,973
Decrease in net technical provisions		(8,915)	(8,759)
Decrease/(Increase) in debtors		3,483	(373)
Decrease/(Increase) in prepayments and accrued income		108	(31)
Increase/(Decrease) in creditors and provisions for other risks		262	(7,204)
Foreign exchange (gain)/loss on balance due to members		(2,551)	2,189
		<hr/>	<hr/>
Net cash outflow from operating activities		£(1,611)	£(14,951)
Financing:			
Open year cash call made		2,552	-
Other		(67)	5
		<hr/>	<hr/>
		£874	£(14,946)
Cash flows were invested as follows:			
Increase in cash holdings	17	2,022	(16,210)
Decrease in overseas deposits	17	(226)	(578)
(Decrease)/increase in portfolio investments	18	(922)	1,842
		<hr/>	<hr/>
Net investment/(outflow) of cash flows		£874	£(14,946)
		<hr/> <hr/>	<hr/> <hr/>

NOTES TO THE ACCOUNTS

At 31 December 2006

1. Basis of Preparation

The financial statements have been prepared in accordance with the Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2004 ("the Regulations") which came into force on 31 December 2005 and essentially require the managing agent to prepare accounts for the syndicate in accordance with Schedule 9A of the Companies Act 1985 and applicable accounting standards.

Capital supporting the business of the syndicate is held in separate trust funds administered by Lloyd's. These amounts, referred to as Funds at Lloyd's ("FAL"), are available to meet the underwriting obligations of the syndicate, if required. The funds are not included in the syndicate balance sheet because they are not under the control of the managing agent and they are not hypothecated to any specific syndicate participation by a member. Furthermore, the Lloyd's central fund arrangements are available in the event that an individual member's funds are exhausted. The Managing Agent believes that in the light of these capital arrangements it is appropriate to prepare the accounts on a going concern basis.

2. Accounting Policies**(a) Basis of accounting**

The financial statements have been prepared on an annual basis of accounting, whereby the incurred cost of claims, commission and related expenses are charged against the earned proportion of premiums, net of reinsurance as follows:

(i) Premiums written

Premiums written comprise premiums on contracts incepted during the financial year, together with adjustments made in the year to premiums written in prior accounting periods. They also include estimates for pipeline premiums, representing amounts due to the syndicate not yet notified.

Premiums are shown gross of brokerage payable and exclude taxes and duties levied on them.

(ii) Unearned premiums

Written premium is earned according to the risk profile of the policy. Unearned premiums represent the proportion of premiums written in the year that relate to the unexpired terms of the policies in force at the balance sheet date, calculated on the basis of established earnings patterns or time apportionment as appropriate.

(iii) Reinsurance premium ceded

Outwards reinsurance premiums are accounted for in the same accounting period as the premiums for the related direct or inwards business being reinsured.

(iv) Claims incurred

Claims incurred comprise claims and settlement expenses (both internal and external) paid in the year and the movement in provision for outstanding claims and settlement expenses, including an allowance for the cost of claims incurred by the balance sheet date but not reported until after the year end. Claims outstanding are reduced by anticipated salvage and other recoveries.

(v) Claims provisions and related recoveries

The outstanding claims comprise amounts set aside for claims notified and claims incurred but not yet reported (IBNR).

Notified claims are estimated on a case by case basis with regard to the circumstances as reported, any information available from loss adjusters and previous experience of the cost of settling claims with similar characteristics.

The amount included in respect of IBNR is based on statistical techniques of estimation applied by the syndicate's external actuaries. These techniques generally involve projecting from past experience of the development of claims over time to form a view of the likely ultimate claims to be experienced for more recent underwriting, having regard to variations in the business accepted and the underlying terms and conditions. For the most recent years, where a high degree of volatility arises from projections, estimates may be based in part on output from rating and other models of the business accepted and assessments of underwriting conditions.

The provision for claims includes amounts in respect of internal and external claims handling costs.

The reinsurers' share of provisions for claims is based on calculated amounts of outstanding claims and projections for IBNR, net of estimated irrecoverable amounts, having regard to the reinsurance programme in place for the class of business, the claims experience for the year and the current security rating of the reinsurance companies involved.

The syndicate uses a number of statistical techniques to assist in making the above estimates. The most critical assumption as regards claims provisions is that the past is a reasonable predictor of the likely level of claims development.

NOTES TO THE ACCOUNTS

At 31 December 2006

2. Accounting Policies (continued)

The directors consider that the provisions for gross claims and related reinsurance recoveries are fairly stated on the basis of the information currently available to them. However, ultimate liability will vary as a result of subsequent information and events and this may result in significant adjustments to the amounts provided. Adjustments to the amounts of claims provisions established in prior years are reflected in the financial statements for the period in which the adjustments are made. The methods used, and the estimated made, are reviewed regularly.

(b) Unexpired risks provision

A provision for unexpired risks is made where claims, related expenses and deferred acquisition costs, likely to arise after the end of the financial period in respect of contracts concluded before that date are expected to exceed the unearned premiums and premiums receivable under these contracts, after the deduction of any acquisition costs deferred.

The provision for unexpired risks is calculated separately by reference to classes of business which are managed together.

(c) Acquisition costs

Acquisition costs, comprising commission and other internal and external costs related to the acquisition of new insurance contracts are deferred to the extent that they are attributable to premiums unearned at the balance sheet date.

(d) Foreign currencies

Transactions in US dollars, Canadian dollars and Euros are translated at the rate of exchange ruling at the date of the transaction or at an appropriate average rate. Underwriting transactions denominated in other foreign currencies are included at the rate of exchange ruling at the date the transaction is processed.

Monetary assets and liabilities are re-translated into sterling at the rate of exchange at the balance sheet date unless contracts to sell currency for sterling have been entered into prior to the year end, in which case the contracted rates are used. Non-monetary assets and liabilities at the balance sheet date, primarily deferred acquisition costs and unearned premiums, are maintained at the rate of exchange ruling when the contract was entered into (or the approximate average rate).

(e) Investments

Investments are stated at current value at the balance sheet date. For this purpose listed investments are stated at mid-market value and deposits with credit institutions and overseas deposits are stated at cost.

Unlisted investments for which a market exists are stated at the average price at which they were traded on the balance sheet date or the last trading day before that date.

(f) Investment return

Investment return comprises all investment income, realised investment gains and losses and movements in unrealised gains and losses, net of investment expenses, charges and interest.

Realised gains and losses on investments carried at market value are calculated as the difference between sale proceeds and purchase price. Movements in unrealised gains and losses on investments represent the difference between their valuation at the balance sheet date and their purchase price or, if they have been previously valued, their valuation at the last balance sheet date, together with the reversal of unrealised gains and losses recognised in earlier accounting periods in respect of investment disposals in the current period.

Investment return is initially recorded in the non-technical account. A transfer is made from the non-technical account to the general business technical account to reflect the investment return on funds supporting underwriting business. All investment return is considered to arise on such funds.

(g) Taxation

Under Schedule 19 of the Finance Act 1993 managing agents are not required to deduct basic rate income tax from trading income. In addition, all UK basic rate income tax (currently at 22%) deducted from syndicate investment income is recoverable by managing agents and consequently the distribution made to members or their members' agents is gross of tax. Capital appreciation falls within trading income and is also distributed gross of tax. No provision has been made for any United States Federal Income Tax payable on underwriting results or investment earnings. Any payments on account made by the syndicate during the year have been included in the balance sheet under the heading "other debtors".

No provision has been made for any other overseas tax payable by members on underwriting results.

(h) Pension costs

XL Services UK Ltd operates a defined contribution pension scheme and its recharges to the syndicate in respect of staff costs included an element for pension costs. These pension costs are expensed in full in the period to which the recharge relates.

(i) Operating lease rentals

Amounts recharged by XL Services UK Ltd include costs arising from the use of assets in the period. These rental costs are expensed in full in the period to which the recharge relates.

NOTES TO THE ACCOUNTS

At 31 December 2006

3. Segmental Analysis

TYPE OF BUSINESS

An analysis of the technical account balance before investment return is set out below:

2006	Gross premiums written £000	Gross premiums earned £000	Gross claims incurred £000	Gross operating expenses £000	Reinsurance balance £000	Total £000
Direct insurance:						
Credit and suretyship	91	-	44	384	851	1,279
Marine, aviation and transport	34	-	275	294	(1,438)	(869)
Third party liability	7	1,156	48	243	(27)	1,420
Other	55	-	39	71	48	158
Reinsurance acceptances:	733	-	(664)	974	73	383
Total	£920	£1,156	£(258)	£1,966	£(493)	£2,371

2005	Gross premiums written £000	Gross premiums earned £000	Gross claims incurred £000	Gross operating expenses £000	Reinsurance balance £000	Total £000
Direct insurance:						
Credit and suretyship	69	13	(455)	(941)	83	(1,301)
Marine aviation and transport	35	7	(1,174)	(516)	609	(1,075)
Third party liability	9	2	(412)	(271)	391	(290)
Other	11	2	(133)	(31)	84	(78)
Reinsurance acceptances:	144	26	(819)	(1,572)	356	(2,007)
Total	£268	£50	£(2,993)	£(3,331)	£1,523	£(4,751)

GEOGRAPHICAL ANALYSIS BY ORIGIN

All business written by the syndicate is signed through X-Changing Insure Services (XIS) and is treated as having originated in the UK.

CONTINUING AND DISCONTINUED OPERATIONS

All business is discontinued.

4. Movement in Prior Year's Provision for Outstanding Claims

During the year claims reserves net of claims payments were strengthened by £0.7m (£2005: £2m).

NOTES TO THE ACCOUNTS

At 31 December 2006

5. Net Operating Expenses

	2006 £000	2005 £000
Acquisition costs	129	385
Change in deferred acquisition costs	53	(49)
Administrative expenses	534	515
(Profit)/loss on exchange	(2,682)	2,480
	<u>£(1,966)</u>	<u>£3,331</u>

Administrative expenses include:

	2006 £000	2005 £000
Audit Services:		
Fees payable to the syndicate's auditor for the audit of the syndicate's accounts	21	21
Non-audit Services:		
Fees payable to the Company's auditor for other services:		
Other services pursuant to legislation, including the audit of the regulatory return	17	17
	<u>£38</u>	<u>£38</u>

6. Staff Numbers and Costs

The Company has no direct employees or directors. The staff and directors are employees of other XL Group companies and an expense recharge is charged to the company by XL Services UK Limited. The expense recharge includes the cost of these employees, but it is not possible to ascertain separately the element of the expense recharge that relates directly to staff costs or staff numbers.

7. Emoluments of the Directors of XL London Market Ltd

XL Services UK Ltd charged the syndicate the following amounts in respect of emoluments paid to its directors:

	2006 £000	2005 £000
Emoluments	<u>£16</u>	<u>£20</u>

8. Run-off Manager's Emoluments

The run-off manager received the following aggregate remuneration charged to the syndicate:

	2006 £000	2005 £000
Emoluments	<u>£20</u>	<u>£20</u>

NOTES TO THE ACCOUNTS

At 31 December 2006

9. Financial Investments

	Market value		Cost	
	2006 £000	2005 £000	2006 £000	2005 £000
Debt securities and other fixed income securities	11,570	18,397	11,568	18,428
Deposits with credit institutions	4,084	538	4,084	538
Loans with credit institutions	41	-	41	-
	<u>£15,695</u>	<u>£18,935</u>	<u>£15,693</u>	<u>£18,966</u>

Shares and other variable yield securities and units in unit trusts and debt securities and other fixed income securities are all listed on recognised stock exchanges.

10. Debtors Arising out of Direct Insurance Operations

	2006 £000	2005 £000
Due within one year - intermediaries	<u>£8</u>	<u>£1,005</u>

11. Debtors Arising out of Reinsurance Operations

	2006 £000	2005 £000
Due within one year	<u>£557</u>	<u>£2,738</u>

12. Other Assets – Overseas Deposits

	2006 £000	2005 £000
Illinois – USA	558	808
Joint Asset Trust Fund – USA	138	375
Australian Deposit		
Deposit	7	23
Joint Asset Trust Fund	1	1
Additional Securities Limited		
South Africa	21	37
Other Countries	183	69
Kentucky - USA	139	157
Canadian Margin Fund	104	79
	<u>£1,151</u>	<u>£1,549</u>

NOTES TO THE ACCOUNTS

At 31 December 2006

13. Reconciliation of Members' Balances

	2006 £000	2005 £000
Balance due (from)/to members as at 1 January	(2,309)	(742)
Profit/(loss) for the financial year	3,374	(3,746)
Revaluation of cash call	(2,550)	2,179
Open year cash calls made	2,552	-
Unpaid cash call	(68)	
	<u>£999</u>	<u>£(2,309)</u>

Members participate on syndicates by reference to years of account and their ultimate result, assets and liabilities are assessed with reference to policies incepting in that year of account in respect of their membership of a particular year.

14. Creditors Arising out of Direct Insurance Operations

	2006 £000	2005 £000
Due after one year - intermediaries	<u>£441</u>	<u>£661</u>

15. Creditors Arising out of Reinsurance Operations

	2006 £000	2005 £000
Due within one year	<u>£1,210</u>	<u>£624</u>

NOTES TO THE ACCOUNTS

At 31 December 2006

16. Movement in Opening and Closing Portfolio Investments Net of Financing

	2006 £000	2005 £000
Net cash inflow/(outflow) from the year	2,022	(16,210)
Decrease in overseas deposits	(226)	(578)
Cash flow – portfolio investments	<u>(922)</u>	<u>1,842</u>
Movement arising from cash flows	874	(14,946)
Changes in market value and exchange rates	<u>(2,628)</u>	<u>(2,974)</u>
Total movement in portfolio investments net of financing	(1,754)	(17,920)
Balance brought forward at 1 January	25,987	43,907
Balance carried forward at 31 December	<u><u>£24,233</u></u>	<u><u>£25,987</u></u>

17. Movement in Opening and Closing Portfolio Investments Net of Financing

	At 1 January 2006 £000	Cash flow £000	Changes to market value and currencies £000	At 31 December 2006 £000
Cash at bank and in hand	5,503	2,022	(138)	7,387
Overseas deposits	1,549	(226)	(172)	1,151
Debt securities and other fixed income securities	18,397	(4,568)	(2,259)	11,570
Deposit with credit institutions	538	3,610	(64)	4,084
Loans with credit institutions	-	36	5	41
Total portfolio investments	<u>18,935</u>	<u>(922)</u>	<u>(2,318)</u>	<u>15,695</u>
	<u><u>£25,987</u></u>	<u><u>£874</u></u>	<u><u>(£2,628)</u></u>	<u><u>£24,233</u></u>

NOTES TO THE ACCOUNTS

At 31 December 2006

18. Net Decrease/(Increase) in Portfolio Investments

	2006	2005
	£000	£000
Purchase of debt securities and other fixed income securities	(3,172)	(41,509)
Purchase of deposits with credit institutions	(3,610)	(538)
Purchase of loans with credit institutions	(36)	-
Sale of debt securities and other fixed income securities	7,740	40,205
	<hr/>	<hr/>
Net decrease/(increase) in portfolio investments	£922	£(1,842)
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19. Significant Uncertainties***Political Risks***

The residual Political Risks exposures remain significant and therefore continue to represent material uncertainty. There continues to be effort to reduce these exposures and attempts to purchase cost-effective reinsurance, but the level of exposure remains significant.

Disputes and other outstanding claims

A key legal dispute in respect of Political Risks, and other outstanding claims, remain at the balance sheet date.