OneBeacon Insurance Group, Ltd.
Form 10-K
February 29, 2008

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# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-K

ý **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the fiscal year ended December 31, 2007**

**OR**

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from to**
**Commission file number 1-33128**

# ONEBEACON INSURANCE GROUP, LTD.

(Exact name of Registrant as specified in its charter)

| | |
|---|---|
| **Bermuda**<br>(State or other jurisdiction of incorporation or organization) | **98-0503315**<br>(I.R.S. Employer Identification No.) |
| **601 Carlson Parkway**<br>**Minnetonka, Minnesota**<br>(Address of principal executive offices) | **55305**<br>(Zip Code) |

Registrant's telephone number, including area code: **(952) 852-2431**

Securities registered pursuant to Section 12(b) of the Act:

| Title of each class | Name of each exchange on which registered |
|---|---|
| Class A Common Shares, par value $0.01 per share | New York Stock Exchange |

Securities registered pursuant to Section 12(g) of the Act:

**None**

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Act. Yes o No ý

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes o No ý

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ý

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

| | | | |
|---|---|---|---|
| Large accelerated filer o | Accelerated Filer ý | Non-accelerated filer o<br>(Do not check if a smaller reporting company) | Smaller reporting company o |

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No ý

The aggregate market value of voting shares (based on the closing price of Class A common shares listed on the New York Stock Exchange and the consideration received for those shares not listed on a national or regional exchange) held by non-affiliates of the Registrant as of June 30, 2007, was $713,920,123.

As of February 27, 2008, 25,719,656 Class A common shares, par value of $0.01 per share, and 71,754,738 Class B common shares, par value $0.01 per share, were outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Registrant's Definitive Proxy Statement to be filed with the Securities and Exchange Commission ("SEC") pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), relating to the Registrant's Annual General Meeting of Members scheduled to be held May 28, 2008 are incorporated by reference into Part III of this Form 10-K. With the exception of the portions of the Proxy Statement specifically incorporated herein by reference, the Proxy Statement is not deemed to be filed as part of this Form 10-K.

## PART I



## PART II



## PART III



## PART IV

**ITEM 1. BUSINESS**

**Overview**

OneBeacon Insurance Group, Ltd. (the Company or the Registrant), an exempted Bermuda limited liability company, through its subsidiaries (collectively, OneBeacon, we, us, or our) is a property and casualty insurance writer that provides a range of specialty insurance products as well as a variety of segmented commercial and personal insurance products. With roots dating back to 1831, we have been operating for more than 175 years and have many long-standing relationships with independent agencies, which constitute our primary distribution channel. OneBeacon was acquired by White Mountains Insurance Group, Ltd. (White Mountains) from Aviva plc (Aviva, formerly CGNU) in 2001 (the OneBeacon Acquisition). White Mountains is a holding company whose businesses provide property and casualty insurance, reinsurance and certain other products. During the fourth quarter of 2006, White Mountains sold 27.6 million or 27.6% of our common shares in an initial public offering. Prior to the initial public offering, OneBeacon was a wholly-owned subsidiary of White Mountains. As of December 31, 2007 White Mountains owned 72.9% of our common shares.

Our headquarters are located at the Bank of Butterfield Building, 42 Reid Street, 6th Floor, Hamilton HM 12, Bermuda. Our U.S. headquarters are located at 1 Beacon Lane, Canton, Massachusetts 02021, our principal executive office is located at 601 Carlson Parkway, Minnetonka, Minnesota 55305 and our registered office is located at Clarendon House, 2 Church Street, Hamilton HM 11, Bermuda.

Our reportable segments are Primary Insurance Operations, Affiliate Quota Shares and Other Operations. We manage our Primary Insurance Operations segment through three major underwriting units: specialty lines, commercial lines and personal lines. Our Affiliate Quota Shares segment reflects the results of two quota share reinsurance agreements we entered into with subsidiaries of White Mountains primarily for White Mountains' capital management purposes. These agreements were commuted in the fourth quarter of 2006 in connection with our initial public offering. Certain other activities are conducted through our top holding company, OneBeacon Insurance Group, Ltd. and our intermediate subsidiaries and are included in our Other Operations segment.

Our specialty lines businesses are national in scope, while our commercial and personal lines businesses have been concentrated primarily in the Northeastern United States. We have added, and expect to continue to add, new specialty businesses both organically and through acquisition. With licenses in 50 states and the District of Columbia, we have begun to selectively expand geographically into new territories in our commercial lines business that align well with our targeted approach to specific customer segments. In this expansion, we are guided by our focus on profitable growth while prudently managing underwriting risk.

Our principal operating subsidiaries are rated "A" (Excellent, the third highest of fifteen ratings) by A.M. Best, "A" (Strong, the sixth highest of twenty-one ratings) by Standard & Poor's, "A2" (Good, the sixth highest of twenty-one ratings) by Moody's and "A" (Strong, the sixth highest of twenty-one ratings) by Fitch.

In 2007, our net written premiums totaled approximately $1.9 billion and we had total assets of approximately $9.5 billion and total common shareholders' equity of approximately $1.9 billion at December 31, 2007.

**Our Operating Principles**

We strive to operate within the spirit of four operating principles. These are:

**Underwriting Comes First.** An insurance enterprise must respect the fundamentals of insurance. There must be a realistic expectation of underwriting profit on all business written, and demonstrated fulfillment of that expectation over time, with focused attention to the loss ratio and to all the professional insurance disciplines of pricing, underwriting and claims management.

**Maintain a Disciplined Balance Sheet.** The first concern here is that insurance liabilities must always be fully recognized. Loss reserves and expense reserves must be solid before any other aspect of the business can be solid. Pricing, marketing and underwriting all depend on informed judgment of ultimate loss costs and that can be managed effectively only with a disciplined balance sheet.

**Invest for Total Return.** Historical insurance accounting tends to hide unrealized gains and losses in the investment portfolio and over-reward reported investment income (interest and dividends). Regardless of the accounting, OneBeacon must invest for the best growth in after-tax value over time. In addition to investing our bond portfolios for total after-tax return, that will also mean prudent investment in a balanced portfolio consistent with leverage and insurance risk considerations.

**Think Like Owners.** Thinking like owners has a value all its own. There are stakeholders in a business enterprise and doing good work requires more than this quarter's profit. But thinking like an owner embraces all that without losing the touchstone of a capitalist enterprise.

**Property and Casualty Insurance Overview**

Generally, property and casualty insurance companies write insurance policies in exchange for premiums paid by their customers (the insured). An insurance policy is a contract between the insurance company and the insured where the insurance company agrees to pay for losses suffered by the insured that are covered under the contract. Such contracts often are subject to subsequent legal interpretation by courts, legislative action and arbitration. Property insurance generally covers the financial consequences of accidental losses to the insured's property, such as a home and the personal property in it, or a business' building, inventory and equipment. Casualty insurance (often referred to as liability insurance) generally covers the financial consequences of a legal liability of an individual or an organization resulting from negligent acts and omissions causing bodily injury and/or property damage to a third party. Claims on property coverage generally are reported and settled in a relatively short period of time, whereas those on casualty coverage can take years, even decades, to settle.

Insurance companies derive substantially all of their revenues from earned premiums, investment income and net gains and losses from sales of investment securities. Earned premiums represent premiums received from insureds, which are recognized as revenue over the period of time that insurance coverage is provided (i.e., ratably over the life of the policy). A significant period of time normally elapses between the receipt of insurance premiums and the payment of insurance claims. During this time, investment income is generated, consisting primarily of interest earned on fixed maturity investments and dividends earned on equity securities. Net realized investment gains and losses result from sales of securities from the insurance companies' investment portfolios.

Insurance companies incur a significant amount of their total expenses from policyholder losses, which are commonly referred to as claims. In settling policy holder losses, various loss adjustment expenses (LAE) are incurred such as insurance adjusters' fees and litigation expenses. In addition, insurance companies incur policy acquisition expenses, such as commissions paid to agents and premium taxes, and other expenses related to the underwriting process, including compensation and benefits for professional and clerical staff.

The key measure of relative underwriting performance for an insurance company is the combined ratio. An insurance company's combined ratio under accounting principles generally accepted in the United States (GAAP) is calculated by adding the ratio of incurred loss and LAE to earned premiums (the loss and LAE ratio) and the ratio of policy acquisition and other underwriting expenses to earned premiums (the expense ratio). A combined ratio under 100% indicates that an insurance company is generating an underwriting profit. However, when considering investment income and investment gains or losses, insurance companies operating at a combined ratio of greater than 100% can be profitable.

**Primary Insurance Operations**

Our Primary Insurance Operations segment provides specialty lines insurance products, a variety of segmented commercial lines insurance products for businesses and personal lines insurance products for individuals. The Primary Insurance Operations segment also includes run-off business which primarily consists of national accounts, certain specialty programs and regional agency business transferred to Liberty Mutual Insurance Group (Liberty Mutual) effective November 1, 2001. See "Business Run-off".

In the fourth quarter of 2006, we began to include OneBeacon Specialty Property (OBSP) within commercial lines and AutoOne Insurance (AutoOne) within personal lines. Both OBSP and AutoOne were formerly reported in specialty lines. The reporting change was undertaken to better align the reported results of our underwriting units with their product and management structure. Prior periods have been reclassified to conform to the current presentation.

For the twelve months ended December 31, 2007, 2006 and 2005, our net written premiums by line of business were as follows:

| | Year ended December 31, | | |
|---|---|---|---|
| | 2007 | 2006 | 2005 |
| | | ($ in millions) | |
| Specialty | $ 446.2 | $ 437.6 | $ 416.3 |
| Commercial | 727.7 | 718.3 | 654.4 |
| Personal | 690.4 | 800.6 | 910.2 |
| Total(1) | $ 1,864.4 | $ 1,957.6 | $ 1,988.6 |

(1) Includes run-off business. See "Business Run-off."

***Specialty lines***

Our specialty lines underwriting unit is a collection of niche businesses that focus on solving the unique needs of particular customer groups on a national scale. We provide distinct products and offer tailored coverages and services, managed by seasoned teams of market specialists. Our specialty businesses currently include:

*OneBeacon Professional Partners* (OBPP): Formed in 2002, OBPP is a provider of specialty liability products primarily focused on the health-care industry. Additional products include media liability and lawyers' professional liability insurance. Our health-care products include hospital professional liability, or HPL, long-term care liability, or LTC, HMO reinsurance, provider excess insurance and managed care errors and omissions, or MCE&O. These products protect against claims for negligence arising from direct patient treatment, such as diagnoses, rendering opinions or referrals, and coverage for professional committee activities, with the exception of HMO reinsurance and provider excess insurance which is a financial product designed to protect capitated providers or facilities from catastrophic medical events. In 2005, OBPP broadened its capabilities through two acquisitions and the formation of a new business. First Media Insurance Specialists, Inc. was acquired to distribute OBPP's new product line of primary and excess media liability coverages targeting small-to-midsized media companies (that include publishers, broadcasters and authors). OBPP also acquired the renewal rights to the HPL and MCE&O business of Chubb Specialty Insurance. In November 2005, OBPP began offering lawyers' professional liability coverage targeting law firms employing fewer than 150 attorneys.

*International Marine Underwriters* (IMU): A leading provider of marine insurance, this business traces its roots back to the early 1900s. The IMU acquisition from Crum & Forster in the early 1990s doubled our book of marine business. IMU coverages include physical damage or loss, and general liability for cargo and commercial hull, both at primary and excess levels, marinas, including a "package" product (comprehensive property and liability coverage) and yachts (the offerings for which were strengthened by IMU's acquisition in October 2006 of yacht-specialist National Marine Underwriters, Inc., a yacht insurance managing general agency). IMU does not offer offshore energy products. Target customers include ferry operators and charter boats (hull), marina operators and boat dealers (package product) and private-pleasure yachts with hull values of less than $1 million.

*A.W.G. Dewar* (Dewar): A provider of tuition reimbursement insurance since 1930, Dewar's product protects both schools and parents from the financial consequences of a student's withdrawal or dismissal from school. The tuition refund plan reimburses parents up to 100% of tuition, room and board fees when a student is obliged to leave school due to covered reasons, such as medical or expulsion. Dewar provides customized policies to independent schools and colleges in North America.

*Specialty Accident and Health (A&H):* Formed in November 2006, this group provides accident insurance coverages principally to large employers (generally Fortune 1000) on a group basis. The full array of product coverages includes corporate accident, travel accident and occupational accident coverage primarily targeted to the trucking industry. This group conducts business through independent agents and brokers and selectively markets directly to customers.

*Government Risk Solutions (GRS):* Formed in March 2007, this group offers property and casualty products for government entities. The products include automobile, property, general liability and professional liability coverages. The professional liability offerings consist of law enforcement, public officials and employment practice coverage. Markets served include cities/towns/townships, counties, transit authorities, government agencies, special districts and pools (groups of public entities). GRS strategically distributes its products through agents and brokers.

Each of these businesses maintains stand-alone operations and distribution channels targeting their specific customer groups. Our specialty lines include several businesses focused on smaller property-casualty insurance segments where particular expertise and relationships with similarly focused distribution partners has resulted historically in strong operating results from our businesses. These businesses maintain their competitive advantage through a deep knowledge of their respective customers and marketplace.

For the years ended December 31, 2007, 2006, and 2005, our specialty lines net written premiums were as follows:

| | Year ended December 31,(1) | | |
|---|---|---|---|
| | 2007 | 2006 | 2005 |
| | ($ in millions) | | |
| OBPP | $ 213.9 | $ 179.3 | $ 149.5 |
| IMU | 158.6 | 139.9 | 133.6 |
| Other specialty lines(2) | 73.7 | 118.4 | 133.2 |
| Total specialty lines | $ 446.2 | $ 437.6 | $ 416.3 |

(1) In the fourth quarter of 2006, we began to include OBSP within commercial lines and AutoOne within personal lines. Both OBSP and AutoOne were formerly reported in specialty lines. The reporting change was undertaken to better align the reported results of our underwriting units with their product and management structure. Prior periods have been reclassified to conform to the current presentation.

(2) Includes Agri which was sold to a third party on September 29, 2006. Net written premiums for Agri were $64.7 million and $84.0 million for the years ended December 31, 2006 and 2005, respectively. See "Management's Discussion and Analysis of Financial Condition and Results of Operations Other Acquisitions and Dispositions".

***Commercial lines***

We provide insurance solutions for middle market and small businesses through products that target particular industry groups with customized coverages and services. Our targeted industry focus has resulted in favorable loss ratios and strong customer retention levels, and we have begun to expand selectively into new territories that align well with our targeted approach to specific customer segments.

Our middle market accounts typically produce annualized gross premiums ranging from $25,000 to $1,000,000 and principally purchase "package" property policies (combination policies offering property and liability coverage). We target 14 distinct customer groups including technology, financial institutions, professional services, wholesalers, metalworkers and commercial real estate, among others. We also produce some standard commercial business that is not targeted to a specific industry group. By partnering with our specialty lines businesses, our middle market commercial lines business can deliver a seamless, comprehensive OneBeacon solution, which is a competitive advantage for us and for our agents. We have also formed strategic partnerships with specialized insurance agencies to offer OneBeacon coverage to targeted customer groups such as technology companies and community banks.

Included in the middle market division is OBSP. Formed in 2004, OBSP provides excess property coverage against certain damages over and above those covered by primary policies or a large self-insured retention. Target classes include apartments and condominiums, commercial real estate, small-to-medium manufacturing, retail/wholesale and public entity and educational institutions. OBSP has a well-defined preference for principally low catastrophe-exposed risks. However, OBSP is exposed to large catastrophes, like Hurricane Katrina, that may cause losses to insured property in excess of its policies' attachment points. OBSP manages its catastrophic wind, earthquake and terrorism risks within the OneBeacon catastrophe management programs, including individual risk and portfolio-loss modeling and reinsurance protection. Our excess property solutions are provided primarily through surplus lines wholesalers in all 50 states and the District of Columbia.

We also market package, automobile, workers compensation and umbrella coverage to small businesses which typically generate annualized premiums ranging from $500 to $25,000. We target 14 general industry groups as well as some association and group businesses that provide a highly competitive solution for select agents. Our small-business growth strategy is targeting insurance networks of typically suburban and rural agents that represent a strong customer base in those areas. Our proprietary web platform that expedites underwriting at the point of sale has enabled such growth in new territories while limiting the need for much incremental infrastructure. In the first quarter of 2006 we introduced a small business service center to handle customer administration for enrolled agents.

Our commercial lines products across all customer accounts include:

*Package:* consists of combination policies offering property and liability coverage.

*Automobile:* consists of physical damage and liability coverage. Automobile physical damage insurance covers loss or damage to vehicles from collision, vandalism, fire, theft or other causes. Automobile liability insurance covers bodily injury of others, damage to their property and costs of legal defense resulting from a collision caused by the insured.

*Multi-peril:* consists of a package policy sold to small to mid-sized insureds or to members of trade associations or other groups that includes general liability insurance and commercial property insurance.

*Workers compensation:* covers an employer's liability for injuries, disability or death of employees, without regard to fault, as prescribed by state workers compensation law and other statutes.

*Excess and surplus property:* provides excess property coverage against certain damages over and above those covered by primary policies or a large self-insured retention.

*Umbrella:* supplements existing insurance policies by covering losses from a broad range of insurance risks in excess of coverage provided by the primary insurance policy up to a specified limit.

*Inland marine:* covers property that may be in transit or held by a bailee at a fixed location, movable goods that are often stored at different locations or property with an unusual antique or collector's value.

*Property:* covers losses to a business' premises, inventory and equipment as a result of weather, fire, theft and other causes.

*General liability:* covers businesses for any liability resulting from bodily injury and property damage arising from its general business operations, accidents on its premises and the products it manufactures or sells.

For the years ended December 31, 2007, 2006 and 2005, commercial lines net written premiums were as follows:

| | **Year ended December 31,(1)** | | |
|---|---|---|---|
| | **2007** | **2006** | **2005** |
| | | **($ in millions)** | |
| Middle market excluding OBSP | $ 557.6 | $ 564.8 | $ 531.6 |
| OBSP | 32.2 | 51.2 | 43.6 |
| Total middle market | 589.8 | 616.0 | 575.2 |
| Small business | 137.9 | 102.3 | 79.2 |
| Total commercial lines | $ 727.7 | $ 718.3 | $ 654.4 |

| | Year ended December 31,(1) | | |
|---|---|---|---|

(1) In the fourth quarter of 2006, we began to include OBSP, formerly a specialty lines business in the middle market division of commercial lines to better align the product and management structure of our underwriting units. Prior periods have been reclassified to conform to the current presentation.

***Personal lines***

Our personal lines underwriting unit provides homeowners insurance, segmented private passenger automobile and package policies (package products are combination policies offering home and automobile coverage with optional umbrella, boatowners and other coverages) sold through select independent agents. We refer to this business, management services provided to reciprocal insurance exchanges and the consolidation of reciprocal insurance exchanges described below as traditional personal lines.

To maintain a high degree of flexibility, in 2004 we created a highly segmented product suite, called OneChoice, under which we are able to offer the appropriate risk-adjusted product and pricing to our customers. OneChoice is a multi-tiered product suite that enables us to offer a broader range of coverages to a full spectrum of customers through more sophisticated pricing models that have a greater statistical correlation between historical loss experience and price than traditional pricing models. This product suite offers both automobile and homeowners coverages as well as package policies. OneChoice products rely on multiple, objective pricing tiers and rules-based underwriting that enable agents to offer OneBeacon solutions to a broad array of their customers and increase our market penetration. We regularly refine our product features and rating plans to optimize target market production. Ease of use is a critical aspect of this business. Investments in technology have provided opportunities for agents to access OneChoice through either our proprietary agent portal or through comparative rating engines. We believe that the availability of multiple channels to access our product offerings provides increased opportunities for new business.

Within our personal lines underwriting unit, we provide management services for a fee to three reciprocal insurance exchanges, which we refer to as reciprocals, that we have created and capitalized by lending them funds in exchange for surplus notes. Reciprocals are not-for-profit, policyholder-owned insurance carriers organized as unincorporated associations. We have no ownership interest in these reciprocals. As required by GAAP, our consolidated financial statements reflect the consolidation of these reciprocals. See Note 16 "Variable Interest Entities" of the accompanying consolidated financial statements.

In the long term, as the reciprocals produce positive operating results and/or as third party capital is invested, we expect to derive value from reduced volatility in our year-to-year underwriting results, the generation of steady fee income for the various management services we provide to these associations and repayment of principal and interest on the surplus notes.

Our personal lines products include:

*Automobile:* consists of physical damage and liability coverage. Automobile physical damage insurance covers loss or damage to vehicles from collision, vandalism, fire, theft or other causes. Automobile liability insurance covers bodily injury of others, damage to their property and costs of legal defense resulting from a collision caused by the insured.

*Homeowners:* covers losses to an insured's home, including its contents, as a result of weather, fire, theft and other causes and losses resulting from liability for acts of negligence by the insured or the insured's immediate family. OneBeacon also offers identity theft resolution assistance and identity theft expense reimbursement coverage as part of its homeowners policies.

*Package:* consists of customized combination policies offering home and automobile coverage with optional umbrella and boatowners coverage.

Also included in our personal lines underwriting unit is AutoOne. Formed in 2001, AutoOne is a market leader in "assigned risk" business in New York. Assigned risk plans provide automobile insurance for individuals unable to secure coverage in the voluntary market. Insurance carriers are obliged to accept future assignments from state assigned risk pools as a condition of maintaining a license to write automobile business in the state. However, carriers may satisfy their assigned risk obligation by transferring their assignments to another insurer or by utilizing various "credits" (i.e., take-out, territorial and youthful driver credits). AutoOne offers services known as Limited Assigned Distribution, or LAD, and Commercial Limited Assigned Distribution, or CLAD, and credit programs to insurance carriers. While AutoOne was able to expand its product offerings to an additional 12 states in 2006, the volume of business decreased due to a significant decrease in the involuntary market in New York and New Jersey, where the majority of AutoOne's assigned risk business is generated. AutoOne now provides 28 LAD and CLAD programs in 22 states where assigned risk obligations may be assumed by a servicing carrier under a negotiated fee arrangement.

AutoOne also writes "voluntary take-out business" (policies "taken out" of the assigned risk pool and written in the voluntary market) by selecting policies from the assigned risk business it manages for its clients and from select insurance brokers that replace their clients assigned risk policy with an AutoOne policy. AutoOne receives credits for all policies taken out of the assigned risk plan which it can use either to reduce its future assigned risk obligations, or to sell to other carriers that can use the credits to reduce their own quota obligations. In 2007, AutoOne wrote more take-out business than all other carriers in New York combined and all of its take-out credits were sold to other carriers or used internally to reduce OneBeacon's own assigned risk quota obligation.

For the years ended December 31, 2007, 2006 and 2005, our personal lines net written premiums were as follows:

| | Year ended December 31,(1) | | |
|---|---|---|---|
| | 2007 | 2006 | 2005 |
| | | ($ in millions) | |
| Traditional personal lines excluding reciprocals | $ 338.0 | $ 492.7 | $ 618.8 |
| Reciprocals(2) | 221.3 | 93.2 | 43.5 |
| Traditional personal lines | 559.3 | 585.9 | 662.3 |
| AutoOne | 134.6 | 222.6 | 248.8 |
| Total personal lines(3) | $ 690.4 | $ 800.6 | $ 910.2 |

(1) In the fourth quarter of 2006, we began to include AutoOne, formerly a specialty lines business, in personal lines to better align the product and management structure of our underwriting units. Prior periods have been reclassified to conform to the current presentation.

(2) Adirondack Insurance Exchange (Adirondack), a reciprocal insurance exchange, was approved to write business in New York in 2006. Adirondack began writing new and renewing traditional personal lines policies in the second half of 2006.

(3) Includes elimination between traditional personal lines and AutoOne.

***Run-off***

Run-off primarily consists of national accounts, certain specialty programs and regional agency business transferred to Liberty Mutual effective November 1, 2001. Beginning in 2001, national accounts and certain specialty programs were discontinued. On November 1, 2001, we transferred our regional agency business, agents and operations in 42 states and the District of Columbia to Liberty Mutual pursuant to a renewal rights agreement (the Liberty Agreement). The operating results and cash flows of policies renewed from November 1, 2001 through October 31, 2003 pursuant to the Liberty Agreement were shared between Liberty Mutual and OneBeacon. The Liberty Agreement pro-rated results so that OneBeacon assumed approximately two-thirds of the operating results from renewals through October 31, 2002 and approximately one-third of the operating results from renewals through October 31, 2003. The renewal rights under the Liberty Agreement expired on October 31, 2003. We continue to manage claims from the discontinued national accounts and specialty programs business as well as the claims related to the business that was subject to the Liberty Agreement.

**Geographic Concentration**

Our net written premiums are derived solely from business produced in the United States.

Business from specialty lines was produced in the following states:

| | Year ended December 31, | | |
|---|---|---|---|
| | **2007** | **2006** | **2005** |
| Florida | 9.1% | 8.8% | 7.9% |
| California | 9.0 | 13.7 | 14.0 |
| New York | 8.0 | 7.3 | 7.7 |
| Massachusetts | 5.7 | 5.2 | 6.4 |
| Texas | 5.0 | 7.0 | 7.1 |
| Louisiana | 4.4 | 1.8 | 1.3 |
| Pennsylvania | 4.2 | 3.9 | 3.5 |
| Other(1) | 54.6 | 52.3 | 52.1 |
| Total | 100.0% | 100.0% | 100.0% |

(1) No individual state was greater than 4% of net written premiums for specialty lines.

Business from commercial lines was produced in the following states:

| | Year ended December 31, | | |
|---|---|---|---|
| | **2007** | **2006** | **2005** |
| Massachusetts | 16.3% | 17.7% | 19.0% |
| California | 14.2 | 13.1 | 11.4 |
| New York | 13.7 | 13.6 | 13.7 |
| Maine | 6.8 | 7.8 | 9.0 |
| New Jersey | 6.6 | 7.1 | 7.5 |
| Connecticut | 6.0 | 6.5 | 7.5 |
| Other(1) | 36.4 | 34.2 | 31.9 |
| Total | 100.0% | 100.0% | 100.0% |

(1) No individual state was greater than 3% of net written premiums for commercial lines.

Business from personal lines was produced in the following states:

| | Year ended December 31, | | |
|---|---|---|---|
| | 2007 | 2006 | 2005 |
| New York | 40.3% | 46.6% | 46.5% |
| Massachusetts | 23.0 | 21.7 | 22.1 |
| New Jersey | 12.0 | 11.4 | 14.0 |
| Maine | 7.7 | 7.3 | 7.2 |
| Connecticut | 6.5 | 4.6 | 4.1 |
| Rhode Island | 3.3 | 3.0 | 2.7 |
| Other(1) | 7.2 | 5.4 | 3.4 |
| Total | 100.0% | 100.0% | 100.0% |

(1) No individual state was greater than 3% of net written premiums for personal lines.

**Marketing**

We offer our products through a network comprised of independent agents, regional and national brokers and wholesalers. Our distribution relationships consist of approximately 2,840 select agencies and brokers. No agency or broker produced more than 3% of our direct written premiums during 2007.

Our specialty lines businesses are managed from locations logistically appropriate to their target markets. OBPP is based in Avon, Connecticut and distributes its products through select national and regional brokers and agents. IMU is headquartered in New York City and operates through nine branch locations throughout the United States. Its products are distributed through a network of select agencies that specialize in marine business. Dewar's affiliate, A.W.G. Dewar Agency, which is located in Quincy, Massachusetts, distributes tuition refund products to independent schools and colleges throughout North America. A&H conducts business through independent agents and brokers and selectively markets directly to customers. GRS strategically distributes its products through agents and brokers.

The majority of our commercial and personal lines products are distributed through select independent insurance agents. We protect the integrity of our franchise value by selectively appointing agents that demonstrate business and geographic profiles that align with our target markets and specialized capabilities. We believe in the added value provided by independent insurance agents as they conduct more complete assessments of their clients' needs, which result in more appropriate coverages and prudent risk management. We also believe that independent agents will continue to be a significant force in overall industry premium production including facilitating the cross-selling of specialty, commercial and personal business products. Our commercial lines middle-market business, OBSP, provides its excess property solutions primarily through surplus lines wholesalers. In New York, our AutoOne personal lines business generates take-out credits by writing policies from select insurance brokers that were previously in the New York Automobile Insurance Plan, or NYAIP, and sells these credits to insurance companies subject to NYAIP assignments. AutoOne markets its LAD and CLAD services and New York take-out credits directly to insurance carriers seeking assigned risk solutions.

In addition, each year we designate our top-performing agencies as our "Lighthouse Partners", a program designed to strengthen these priority relationships and build those books of business. This program was introduced in the second quarter of 2006 and provides enhanced benefits such as priority account handling, access to our entire franchise of products, preferred profit-sharing opportunities, and priority access to our producer development school and co-op advertising program. There were 95 agencies that achieved this designation in 2007. In 2007, these Lighthouse Partners agencies represented fewer than 3% of our overall agency plant but wrote approximately 20% of our business and over 20% of our new business. We believe our Lighthouse Partners are the core of our distribution and marketing system and that this deeper mutual commitment will benefit both these agencies and us, and ultimately our policyholders and shareholders.

**Underwriting and Pricing**

We believe there must be a realistic expectation of attaining an underwriting profit on all the business we write, as well as a demonstrated fulfillment of that expectation over time. Consistent with our "underwriting comes first" operating principle, adequate pricing is a critical component for achieving an underwriting profit. We underwrite our book with a disciplined approach towards pricing our insurance products and are willing to forgo a business opportunity if we believe it is not priced appropriately to the exposure.

Specialization  or a heightened focus on certain customer groups and/or geographies through products, pricing and expertise  is a key driver of our success in specialty lines and is being extended into our commercial and personal businesses. The proprietary knowledge we develop regarding the industry, class and risk characteristics provides us with a competitive edge for our terms and conditions on individual accounts. We believe specialization will result in superior returns as compared to a more "generalist" underwriting approach.

We have used tiered rating plans since 2003 in both our commercial and personal lines that permit us to offer more tailored price quotes to our customers based on underwriting criteria applicable to each tier. The enhanced accuracy and precision of our rate plans enable us to more confidently price our products to the exposure, and thereby permit our agency partners to deliver solutions to a broader range of customers.

We also monitor pricing activity on a weekly basis and regularly measure usage of tiers, credits, debits and limits. In addition, we regularly update base rates to achieve targeted returns on capital and attempt to shift writings away from lines and classes where pricing is inadequate. To the extent changes in premium rates, policy forms or other matters are subject to regulatory approval (see "Risk Factors  Regulation may restrict our ability to operate" and "Regulatory Matters  General"), we proactively monitor our pending regulatory filings to facilitate, to the extent possible, their prompt processing and approval. Lastly, we expend considerable effort to measure and verify exposures and insured values.

**Claims Management**

Effective claims management is a critical factor in achieving satisfactory underwriting results. We maintain an experienced staff of appraisers, medical specialists, managers, staff attorneys and field adjusters strategically located throughout our operating territories. We also maintain a special investigative unit designed to detect insurance fraud and abuse, and support efforts by regulatory bodies and trade associations to curtail fraud.

Claims are separately organized by specialty, commercial, personal and run-off operations. This approach allows us to better identify and manage claims handling costs. In addition, a shared claims service unit manages costs related to both staff and vendors. We also adopted a total claims cost management approach that gives equal importance to controlling claims handling expenses, legal expenses and claims payments, enabling us to lower the sum of the three. This approach requires the utilization of a considerable number of conventional metrics to monitor the effectiveness of various programs implemented to lower total loss cost. The metrics are designed to guard against our implementing an expense containment program that will cost us more than we expect to save. As an example, an internal legal bill audit team has contributed to savings by reducing legal invoices submitted by outside counsel.

Our claims department utilizes a modern claims workstation that records reserves, payments and adjuster activity and assists each claim handler in evaluating bodily injury claims, determining liability and identifying fraud. Our commitment and performance in fighting insurance fraud has reduced claim costs and aided law enforcement investigations. Under our staff counsel program, our in-house attorneys defend the majority of new lawsuits, which has resulted in savings when compared to the cost of using outside counsel.

Calendar year reported claims in our run-off operations were 1,800 in 2007 compared to 2,400 in 2006, a 25% reduction, in part due to the lapse of time and the nature of run-off operations. These levels of reported claims are down from 3,400 in 2005, 5,900 in 2004 and 64,800 in 2003. Total open claims for run-off operations were 5,500 at December 31, 2007 compared to 7,300 at December 31, 2006, a 25% reduction, which reflects the success of our focus on settling claims from our run-off operations. Total open claims for run-off operations were 10,200 in 2005, 14,600 in 2004 and 33,000 in 2003. These numbers included all of the claims that were previously handled by Liberty Mutual as a Third Party Administrator, or TPA. Most of our claims for run-off operations are handled by in-house adjusters.

In connection with the OneBeacon Acquisition, Aviva caused OneBeacon to purchase a reinsurance contract with National Indemnity Company (NICO) to help protect against potential asbestos and environmental (A&E) claims relating to the pre-acquisition period. See "Business  Reinsurance Protection and Catastrophe Management." NICO has retained a TPA, Resolute New England (Resolute), formerly Cavell USA, to manage the claims processing for A&E claims reinsured under the NICO Cover. Our claims department personnel are consulted by NICO and Resolute on major claims. As with all TPAs, claims department personnel perform claim audits on Resolute to ensure their controls, processes and settlements are appropriate. See "Management's Discussion and Analysis of Financial Condition and Results of Operations  Critical Accounting Estimates  Asbestos and Environmental Reserves."

**Reinsurance Protection and Catastrophe Management**

In the ordinary course of our business, we purchase reinsurance from high-quality, highly rated, third party reinsurers in order to minimize loss from large risks or catastrophic events.

The timing and size of catastrophe losses are unpredictable and the level of losses experienced in any year could be material to our operating results and financial position. Examples of catastrophes include losses caused by earthquakes, wildfires, hurricanes and other types of storms and terrorist acts. The extent of losses caused by catastrophes is both a function of the amount and type of insured exposure in an area affected by the event and the severity of the event. We use models (primarily AIR V.9) to estimate the losses our exposures would generate under various scenarios as well as the probability of those losses occurring. We use this model output in conjunction with other data to manage our exposure to catastrophe losses through individual risk selection and by limiting our concentration of insurance written in catastrophe-prone areas, such as coastal regions. In addition, we impose wind deductibles on existing coastal windstorm exposures. We believe that our largest single event natural catastrophe exposures are Northeastern United States windstorms and California earthquakes.

We seek to further reduce our potential loss from catastrophe exposures through the purchase of catastrophe reinsurance. Effective July 1, 2007, we renewed our property catastrophe reinsurance program through June 30, 2008. The program provides coverage for our property business including automobile physical damage, as well as terrorism coverage for non-Terrorism Risk Insurance Act of 2002 (the Terrorism Act) events (excluding nuclear, biological, chemical and radiological). Under the program, the first $150 million of losses resulting from any single catastrophe are retained and $650 million of the next $700 million of losses resulting from the catastrophe are reinsured. Any loss above $850 million would be retained. In the event of a catastrophe, our property catastrophe reinsurance program is reinstated for the remainder of the original contract term by paying a reinstatement premium that is based on the percentage of coverage reinstated and the original property catastrophe coverage premium. We anticipate this $850 million limit is sufficient to cover Northeast windstorm losses with a 0.4%-0.5% probability of occurrence (1-in-250-year event to 1-in-200-year event). Actual losses incurred by us resulting from any particular catastrophic event may be substantially different than modeled losses from such event.

Our property catastrophe reinsurance program does not cover personal or commercial property losses resulting from nuclear, biological or chemical terrorist attacks. The program covers personal property losses resulting from "certified" events as defined under the Terrorism Act, such as foreign terrorism, provided such losses were not caused by nuclear, biological or chemical means. The program also covers personal and commercial property losses resulting from "non-certified" events as defined under the Terrorism Act, such as domestic terrorist attacks, provided such losses were not caused by nuclear, biological or chemical means.

We also purchase individual property reinsurance coverage for certain risks to reduce large loss volatility. The property-per-risk reinsurance program reinsures losses in excess of $5 million up to $100 million. Individual risk facultative reinsurance may be purchased above $100 million where we deem it appropriate. The property-per-risk treaty also provides one limit of reinsurance protection for losses in excess of $10 million up to $100 million on an individual risk basis for terrorism losses. However, nuclear, biological and chemical events are not covered.

We also maintain a casualty reinsurance program that provides protection for individual risk or catastrophe losses involving workers compensation, general liability, automobile liability or umbrella liability in excess of $6 million up to $81 million. This program provides coverage for terrorism losses but does not provide coverage for losses resulting from nuclear, biological or chemical attacks.

In connection with the OneBeacon Acquisition in 2001, Aviva caused OneBeacon to purchase reinsurance contracts with two reinsurance companies rated "AAA" ("Extremely Strong", the highest of twenty-one ratings) by Standard & Poor's and "A++" ("Superior", the highest of fifteen ratings) by A.M. Best. One is a reinsurance cover with NICO which entitles us to recover up to $2.5 billion in ultimate loss and LAE incurred related primarily to A&E claims arising from business written by our predecessor prior to 1992 and 1987, respectively (the NICO Cover). As of December 31, 2007, we have ceded estimated incurred losses of approximately $2.1 billion to the NICO Cover. Net losses paid totaled $986.0 million as of December 31, 2007, with $139.0 million paid in 2007. The other contract is a reinsurance cover with General Reinsurance Corporation, or GRC, for up to $570 million of additional losses on all claims arising from accident years 2000 and prior (the GRC Cover). As of December 31, 2007, we have ceded estimated incurred losses of $550 million to the GRC Cover. Pursuant to the GRC Cover, we are not entitled to recover losses to the full contract limit if such losses are reimbursed by GRC more quickly than anticipated at the time the contract was signed. We intend to only seek reimbursement from GRC for claims which result in payment patterns similar to those supporting our recoverables recorded pursuant to the GRC Cover. The economic cost of not submitting certain other eligible claims to GRC is primarily the investment spread between the rate credited by GRC and the rate achieved by us on our own investments. This cost, if any, is expected to be small.

Reinsurance contracts do not relieve us of our obligation to our policyholders. Therefore, collectibility of balances due from reinsurers is critical to our financial strength. See Note 5 "Reinsurance" of the accompanying consolidated financial statements.

**Terrorism**

Since the terrorist attacks of September 11, 2001, we have sought to mitigate the risk associated with any future terrorist attacks by limiting the aggregate insured value of policies in geographic areas with exposure to losses from terrorist attacks. This is accomplished by either limiting the total insured values exposed, or, where applicable, through the use of terrorism exclusions.

In December 2007, the United States government extended the Terrorism Act for seven more years until December 31, 2014. The Terrorism Act, originally enacted in 2002, established a Federal "backstop" for commercial property and casualty losses, including workers compensation, resulting from acts of terrorism by or on behalf of any foreign person or foreign interest. As extended, the law now also covers domestic acts of terrorism. The law limits the industry's aggregate liability by requiring the Federal government to share 85% of certified losses once a company meets a specific retention or deductible as determined by its prior year's direct written premiums and limits the aggregate liability to be paid by the government and industry without further action by Congress at $100.0 billion. In exchange for this "back-stop," primary insurers are required to make coverage available to commercial insureds for losses from acts of terrorism as specified in the Terrorism Act. The following types of coverage are excluded from the program: commercial automobile, burglary and theft, surety, farmowners multi-peril and all professional liability coverage except directors and officers coverage.

We estimate our individual retention level for commercial policies subject to the Terrorism Act to be approximately $170.0 million in 2008. The aggregate industry retention level is $27.5 billion for 2008. The Federal government will pay 85% of covered terrorism losses that exceed our or the industry's retention levels in 2008, up to a total of $100.0 billion.

Our current property and casualty catastrophe reinsurance programs provide coverage for "non-certified" events as defined under the Terrorism Act provided such losses are not the result of a nuclear, biological or chemical attack. See "Business Reinsurance Protection and Catastrophe Management."

We closely monitor and manage our concentration of risk by geographic area. Our guideline is to control our exposures so that our total maximum expected loss from a likely terrorism event within any half-mile radius in a metropolitan area or around a target risk will not exceed $200 million, or $300 million in all other areas. Reports monitoring our terrorism exposures are generated quarterly, and the exposure of potential new business located in areas of existing concentration or that individually present significant exposure is evaluated during the underwriting process. As a result, we believe that we have taken appropriate actions to limit our exposure to losses from terrorist attacks and will continue to monitor our terrorism exposure in the future. Nonetheless, risks insured by us, including those covered by the Terrorism Act, remain exposed to terrorist attacks and the possibility remains that losses resulting from future terrorist attacks could prove to be material.

**Loss and LAE Reserves**

We establish loss and LAE reserves that are estimates of amounts needed to pay claims and related expenses in the future for insured events that have already occurred. The process of estimating reserves involves a considerable degree of judgment by management and, as of any given date, is inherently uncertain. See "Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Estimates."

The following tables summarize our loss and LAE reserve activities for the years ended December 31, 2007, 2006 and 2005:

| Year ended December 31, 2007 | Primary Insurance Operations | Affiliate Quota Shares | Other Operations(1) | Consolidated |
|---|---|---|---|---|
| Gross beginning balance | $ 5,108.2 | $ | $ (270.5) | $ 4,837.7 |
| Less beginning reinsurance recoverable on unpaid losses | (3,079.7) | | 237.1 | (2,842.6) |
| Net loss and LAE reserves | 2,028.5 | | (33.4) | 1,995.1 |
| Loss and LAE reserves sold Traders & Pacific Insurance Company, or TPIC | | | | |
| Loss and LAE incurred relating to: | | | | |
| Current year losses | 1,138.1 | | | 1,138.1 |
| Prior year losses | (48.3) | | | (48.3) |
| Total incurred loss and LAE | 1,089.8 | | | 1,089.8 |
| Accretion of fair value adjustment to net loss and LAE reserves | | | 16.0 | 16.0 |
| Loss and LAE paid relating to: | | | | |
| Current year losses | (527.1) | | | (527.1) |
| Prior year losses | (723.0) | | | (723.0) |
| Total loss and LAE payments | (1,250.1) | | | (1,250.1) |
| Net ending balance | 1,868.2 | | (17.4) | 1,850.8 |
| Plus ending reinsurance recoverable on unpaid losses | 2,850.6 | | (221.1) | 2,629.5 |
| Gross ending balance | $ 4,718.8 | $ | $ (238.5) | $ 4,480.3 |

| Year ended December 31, 2006 | Primary Insurance Operations | Affiliate Quota Shares | Other Operations(1) | Consolidated |
|---|---|---|---|---|
| Gross beginning balance | $ 5,713.4 | $ (41.6) | $ (317.5) | $ 5,354.3 |
| Less beginning reinsurance recoverable on unpaid losses | (3,382.0) | | 261.1 | (3,120.9) |
| Net loss and LAE reserves | 2,331.4 | (41.6) | (56.4) | 2,233.4 |
| Loss and LAE reserves sold TPIC | | | | |
| Loss and LAE incurred relating to: | | | | |
| Current year losses | 1,157.4 | 114.9 | | 1,272.3 |
| Prior year losses | 22.9 | (11.6) | | 11.3 |
| Total incurred loss and LAE | 1,180.3 | 103.3 | | 1,283.6 |
| Accretion of fair value adjustment to net loss and LAE reserves | | | 23.0 | 23.0 |
| Loss and LAE paid relating to: | | | | |
| Current year losses | (474.6) | (114.9) | | (589.5) |
| Prior year losses | (1,008.6) | 53.2 | | (955.4) |
| Total loss and LAE payments | (1,483.2) | (61.7) | | (1,544.9) |
| Net ending balance | 2,028.5 | | (33.4) | 1,995.1 |
| Plus ending reinsurance recoverable on unpaid losses | 3,079.7 | | (237.1) | 2,842.6 |
| Gross ending balance | $ 5,108.2 | $ | $ (270.5) | $ 4,837.7 |

| Year ended December 31, 2005 | Primary Insurance Operations | Affiliate Quota Shares | Other Operations(1) | Consolidated |
|---|---|---|---|---|
| Gross beginning balance | $ 5,328.2 | $ (44.5) | $ (361.5) | $ 4,922.2 |
| Less beginning reinsurance recoverable on unpaid losses | (2,670.9) | | 279.1 | (2,391.8) |
| Net loss and LAE reserves | 2,657.3 | (44.5) | (82.4) | 2,530.4 |
| Loss and LAE reserves sold TPIC | (11.8) | | | (11.8) |
| Loss and LAE incurred relating to: | | | | |
| Current year losses | 1,229.7 | 61.7 | | 1,291.4 |
| Prior year losses | 105.9 | (6.9) | | 99.0 |
| Total incurred loss and LAE | 1,335.6 | 54.8 | | 1,390.4 |
| Accretion of fair value adjustment to net loss and LAE reserves | | | 26.0 | 26.0 |
| Loss and LAE paid relating to: | | | | |
| Current year losses | (421.0) | (76.8) | | (497.8) |
| Prior year losses | (1,228.7) | 24.9 | | (1,203.8) |
| Total loss and LAE payments | (1,649.7) | (51.9) | | (1,701.6) |
| Net ending balance | 2,331.4 | (41.6) | (56.4) | 2,233.4 |
| Plus ending reinsurance recoverable on unpaid losses | 3,382.0 | | (261.1) | 3,120.9 |
| Gross ending balance | $ 5,713.4 | $ (41.6) | $ (317.5) | $ 5,354.3 |

| Year ended December 31, 2005 | Primary Insurance Operations | Affiliate Quota Shares | Other Operations(1) | Consolidated |
|---|---|---|---|---|

(1) In connection with purchase accounting for the OneBeacon Acquisition, we were required to adjust to fair value our loss and LAE reserves and the related reinsurance recoverables by

$646.9 million and $346.9 million, respectively, on our acquired balance sheet as of June 1, 2001. This next reduction to loss and LAE reserves of $300.0 million is being accreted through an income statement charge ratably with and over the period the claims are settled.

The following information presents (1) our reserve development over the preceding 10 years and (2) a reconciliation of reserves in accordance with accounting principles and practices prescribed or permitted by insurance authorities ("Statutory" basis) to such reserves determined in accordance with GAAP, each as prescribed by Securities Act Industry Guide No. 6.

Section I of the 10 year table shows the estimated liability that was recorded at the end of each of the indicated years for all current and prior accident year unpaid loss and LAE. The liability represents the estimated amount of loss and LAE for claims that were unpaid at the balance sheet date, including incurred but not reported, or IBNR, reserves. In accordance with GAAP, the liability for unpaid loss and LAE is recorded in the balance sheet gross of the effects of reinsurance with an estimate of reinsurance recoverables arising from reinsurance contracts reported separately as an asset. The net balance represents the estimated amount of unpaid loss and LAE outstanding as of the balance sheet date, reduced by estimates of amounts recoverable under reinsurance contracts.

Section II shows the cumulative amount of net loss and LAE paid relating to recorded liabilities as of the end of each succeeding year. Section III shows the re-estimated amount of the previously recorded net liability as of the end of each succeeding year. Estimates of the liability for unpaid loss and LAE are increased or decreased as payments are made and more information regarding individual claims and trends, such as overall frequency and severity patterns, becomes known. Section IV shows the cumulative net (deficiency)/redundancy representing the aggregate change in the liability from original balance sheet dates and the re-estimated liability through December 31, 2007. Section V shows the re-estimated gross liability and re-estimated reinsurance recoverables through December 31, 2007. Section VI shows the cumulative gross (deficiency)/redundancy representing the aggregate change in the liability from original balance sheet dates and the re-estimated liability through December 31, 2007.

**Primary Insurance Operations Loss and LAE (1), (2), (4)**
**Year ended December 31,**

| | 1997 | 1998(3) | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | ($ in millions) | | | | | |
| I. Liability for unpaid loss and LAE: | | | | | | | | | | | |
| Gross balance | $ 5,655.9 | $ 6,869.5 | $ 6,276.0 | $ 6,875.4 | $ 8,320.2 | $ 7,507.0 | $ 6,109.0 | $ 5,328.2 | $ 5,713.4 | $ 5,108.2 | $ 4,718.8 |
| Less reinsurance recoverable on unpaid | (1,159.2) | (1,641.0) | (1,262.7) | (1,252.1) | (3,591.5) | (3,534.4) | (2,954.8) | (2,670.9) | (3,382.0) | (3,079.7) | (2,850.6) |
| Net balance | $ 4,496.7 | $ 5,228.5 | $ 5,013.3 | $ 5,623.3 | $ 4,728.7 | $ 3,972.6 | $ 3,154.2 | $ 2,657.3 | $ 2,331.4 | $ 2,028.5 | $ 1,868.2 |
| II. Cumulative amount of net liability paid through: | | | | | | | | | | | |
| 1 year later | 1,684.3 | 1,784.3 | 1,938.1 | 1,965.3 | 1,851.6 | 1,610.2 | 1,421.1 | 1,146.7 | 1,004.6 | 769.8 | |
| 2 years later | 2,732.5 | 2,908.5 | 3,065.1 | 3,153.0 | 3,039.5 | 2,764.2 | 2,274.5 | 1,833.5 | 1,547.8 | | |
| 3 years later | 3,515.0 | 3,643.7 | 3,824.9 | 3,984.7 | 3,963.6 | 3,489.6 | 2,809.9 | 2,264.2 | | | |
| 4 years later | 4,028.8 | 4,061.7 | 4,330.3 | 4,596.8 | 4,529.5 | 3,941.0 | 3,135.9 | | | | |
| 5 years later | 4,282.8 | 4,353.7 | 4,666.9 | 4,957.3 | 4,876.0 | 4,209.3 | | | | | |
| 6 years later | 4,464.4 | 4,555.9 | 4,887.2 | 5,194.4 | 5,092.4 | | | | | | |
| 7 years later | 4,584.6 | 4,701.7 | 5,044.7 | 5,351.0 | | | | | | | |
| 8 years later | 4,694.6 | 4,801.6 | 5,149.1 | | | | | | | | |
| 9 years later | 4,767.3 | 4,875.1 | | | | | | | | | |
| 10 years later | 4,817.2 | | | | | | | | | | |
| III. Net Liability re-estimated as of: | | | | | | | | | | | |
| 1 year later | 5,370.1 | 5,237.1 | 5,829.0 | 4,730.8 | 4,781.3 | 4,110.3 | 3,253.4 | 2,763.2 | 2,354.3 | 1,980.2 | |
| 2 years later | 5,424.7 | 5,916.1 | 4,942.0 | 4,824.2 | 5,059.4 | 4,227.0 | 3,380.4 | 2,765.5 | 2,387.2 | | |
| 3 years later | 5,965.0 | 4,929.6 | 4,927.0 | 5,294.3 | 5,143.8 | 4,344.8 | 3,396.2 | 2,852.7 | | | |
| 4 years later | 4,980.5 | 4,857.5 | 5,221.8 | 5,336.0 | 5,222.8 | 4,365.1 | 3,520.4 | | | | |
| 5 years later | 4,911.8 | 5,042.9 | 5,165.8 | 5,383.6 | 5,244.3 | 4,497.0 | | | | | |
| 6 years later | 5,069.3 | 4,929.1 | 5,197.2 | 5,385.8 | 5,372.8 | | | | | | |
| 7 years later | 4,902.3 | 4,936.5 | 5,169.2 | 5,490.1 | | | | | | | |
| 8 years later | 4,910.2 | 4,902.9 | 5,242.0 | | | | | | | | |
| 9 years later | 4,881.2 | 4,951.3 | | | | | | | | | |
| 10 years later | 4,906.0 | | | | | | | | | | |
| IV. Cumulative net (deficiency)/ redundancy(5) | $ (409.3) | $ 277.2 | $ (228.7) | $ 133.2 | $ (644.1) | $ (524.4) | $ (366.2) | $ (195.4) | $ (55.8) | $ 48.3 | |
| Percent (deficient)/ redundant | (9.1)% | 5.3% | (4.6)% | 2.4% | (13.6)% | (13.2)% | (11.6)% | (7.4)% | (2.4)% | 2.4% | |
| V. Reconciliation of net liability re-estimated as of the end of the latest re-estimation period (see III above): | | | | | | | | | | | |
| Gross unpaid loss and LAE latest re-estimate | $ 8,918.6 | $ 9,438.4 | $ 9,456.9 | $ 9,674.8 | $ 9,993.8 | $ 9,063.2 | $ 7,402.9 | $ 6,365.1 | $ 5,793.1 | $ 5,055.0 | |
| Reinsurance recoverable latest re-estimate | (4,012.6) | (4,487.1) | (4,214.9) | (4,184.7) | (4,621.0) | (4,566.2) | (3,882.5) | (3,512.4) | (3,405.9) | (3,074.8) | |
| Net unpaid loss and LAE latest re-estimate | $ 4,906.0 | $ 4,951.3 | $ 5,242.0 | $ 5,490.1 | $ 5,372.8 | $ 4,497.0 | $ 3,520.4 | $ 2,852.7 | $ 2,387.2 | $ 1,980.2 | |
| VI. Cumulative Gross (deficiency)/redundancy | $ (3,262.7) | $ (2,568.9) | $ (3,180.9) | $ (2,799.4) | $ (1,673.6) | $ (1,556.2) | $ (1,293.9) | $ (1,036.9) | $ (79.7) | $ 53.2 | |
| Percent (deficient)/ redundant | (57.7)% | (37.4)% | (50.7)% | (40.7)% | (20.1)% | (20.7)% | (21.2)% | (19.5)% | (1.4)% | 1.0% | |

(1) In 1998, Commercial General Union or CGU, the predecessor company to OneBeacon, was formed as a result of a pooling of interests between Commercial Union Corporation and General Accident Corporation of America. All historical balances have been restated as though the companies had been merged throughout the periods presented.

(2) This table reflects the effects of the NICO Cover and the GRC Cover as if they had been in effect for all periods presented.

(3)

CGU acquired Houston General Insurance Company or HGIC, in 1998. In 2005, OneBeacon contributed HGIC to Houston General Insurance Exchange. All liabilities related to this entity have been shown from 1998 forward in this table as it is still consolidated by OneBeacon.

(4)

The 10-year table is reflective of activity related to our loss and LAE reserves from our Primary Insurance Operations segment and does not include the effect of any reserve activity from the affiliate quota share agreements or other operations.

(5)

Our December 31, 2006 net liability for unpaid loss and LAE for our Primary Insurance Operations segment re-estimated as of one year later resulted in a net redundancy of $48.3 million.

The cumulative net (deficiency)/redundancy in the table above reflects reinsurance recoverables recorded under the NICO Cover and the GRC Cover. These covers apply to losses incurred in 2000 and prior years. As a result, they have the effect of significantly increasing our reinsurance recoverables in 2001 and reducing our net reserve deficiency for each of the years presented prior to 2001 by the amount of the gross reserves ceded at the time these covers were purchased. See "Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Estimates." In addition, in June 2005, we completed an internal study of our A&E exposures. Based on the study, we increased our best estimate of our incurred losses ceded to NICO, net of underlying reinsurance, by $353.0 million ($841.0 million gross) to $2.1 billion, which is within the $2.5 billion coverage provided by the NICO Cover. This had the effect of significantly increasing our reinsurance recoverables in 2005 and reducing our net reserve deficiency for each of the years presented prior to 2001 by the amount of the gross reserves ceded to NICO upon completion of this study. See "Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Estimates."

The following table reconciles loss and LAE reserves for our Primary Insurance Operations determined on a statutory basis to loss and LAE reserves determined in accordance with GAAP at December 31, as follows:

| | December 31, | | |
|---|---|---|---|
| | 2007 | 2006 | 2005 |
| | ($ in millions) | | |
| Statutory reserves | $ 3,564.5 | $ 3,863.9 | $ 4,253.4 |
| Reinsurance recoverable on unpaid losses(1) | 1,190.9 | 1,280.5 | 1,455.2 |
| Reserves allocated from other segments, net | | | 41.6 |
| Other(2) | (36.6) | (36.2) | (36.8) |
| GAAP reserves | $ 4,718.8 | $ 5,108.2 | $ 5,713.4 |

(1)

Represents adjustments made to add back reinsurance recoverables on unpaid losses included with the presentation of reserves under GAAP.

(2)

Represents long-term workers compensation loss and LAE reserve discount in excess of statutorily defined discount.

**Affiliate Quota Shares**

Our consolidated financial statements reflect two quota share reinsurance agreements we entered into with subsidiaries of White Mountains. Under the Esurance Insurance Company (Esurance) Quota Share (the Esurance Quota Share), which was effective on January 1, 2005, we assumed approximately 85% of business written by Esurance, which includes business written by its wholly-owned subsidiary. Under the Sirius International Insurance Corporation (Sirius) Quota Share (the Sirius Quota Share), we ceded between 6% and 12% of business written, effective April 1, 2004, to Sirius.

The affiliate quota shares were entered into primarily for White Mountains' capital management purposes and therefore, financial information reflected in Primary Insurance Operations are prior to the quota share reinsurance agreements consistent with how management measures our financial performance. Further, the affiliate quota shares were commuted during the fourth quarter of 2006 in connection with our initial public offering.

**Other Operations**

Our Other Operations segment consists of the activities of OneBeacon Insurance Group, Ltd. and our intermediate subsidiary holding companies. Our Other Operations segment primarily consists of financing activities, purchase accounting adjustments relating to the OneBeacon Acquisition and other assets and general and administrative expenses incurred at the holding company level.

In May 2003, Fund American Companies, Inc. (Fund American), our wholly-owned subsidiary, issued $700.0 million face value of senior unsecured debt (the Senior Notes) through a public offering, at an issue price of 99.7%. The Senior Notes bear an annual interest rate of 5.875%, payable semi-annually in arrears on May 15 and November 15, until maturity on May 15, 2013. White Mountains currently provides an irrevocable and unconditional guarantee as to the payment of principal and interest (the Guarantee) on the Senior Notes. In consideration of this Guarantee, we have agreed to pay a specified fee to White Mountains in the amount of 25 basis points per annum on the outstanding principal amount of the Senior Notes. We have further agreed that if White Mountains' voting interest in us ceases to represent more than 50% of all our voting securities, we will redeem, exchange or otherwise modify the Senior Notes in order to fully and permanently eliminate White Mountains' obligations under the Guarantee. See "Management's Discussion of Financial Condition and Results of Operations Financing".

As part of the financing for the OneBeacon Acquisition, Berkshire Hathaway Inc., or Berkshire, invested a total of $300 million in cash, of which (1) $225 million was for the purchase of cumulative non-voting preferred stock of Fund American (the Berkshire Preferred Stock), which has a $300 million redemption value; and (2) $75 million was for the purchase of warrants to acquire 1,724,200 common shares of White Mountains. The Berkshire Preferred Stock is entitled to a dividend of no less than 2.35% per quarter and is mandatorily redeemable on May 31, 2008.

Also in connection with the OneBeacon Acquisition, Zenith Insurance Company, or Zenith, purchased $20.0 million in cumulative non-voting preferred stock of Fund American Enterprises Holdings, Inc. (Fund American Enterprises), a subsidiary of the Company (the Zenith Preferred Stock). The Zenith Preferred Stock was entitled to a dividend of no less than 2.5% per quarter through June 30, 2007. At the Company's option, the Zenith Preferred Stock was redeemed in the second quarter of 2007 for $20 million, its redemption value.

In connection with the initial public offering, we created two irrevocable grantor trusts and funded them with assets sufficient to provide for the remaining dividend and redemption payments for the $20 million Zenith Preferred Stock and the $300 million Berkshire Preferred Stock. The creation and funding of the trusts does not legally defease the preferred stock or create any additional rights for the holders of the preferred stock, although the assets in the trusts remain segregated from our other general assets and are not available for any use other than the payment of the Zenith Preferred Sock and the Berkshire Preferred Stock. Assets held in one of the trusts were used to redeem the Zenith Preferred Stock in June 2007, for $20 million, its redemption value, while assets held in the remaining trust will be used to redeem the Berkshire Preferred Stock in May of 2008. The assets held in trust remain subject to the claims of Fund American's creditors, in the event that Fund American becomes insolvent. See "Management's Discussion of Financial Condition and Results of Operations Economic Defeasance".

In connection with our initial public offering, Fund American established a $75 million revolving credit facility that matures in November 2011 (the Bank Facility). As of December 31, 2007, the Bank Facility was undrawn.

**Investments**

*Overview*

Our investment portfolios are managed under agreements with White Mountains Advisors, LLC (WM Advisors), a registered investment adviser that is owned by White Mountains, and Prospector Partners, LLC (Prospector), a registered investment adviser. See Note 18 "Related Party Disclosures" of the accompanying consolidated financial statements. Our investment philosophy is to maximize our after-tax total risk-adjusted return over the long term. Under this approach, each dollar of after-tax investment income and realized and unrealized gains and losses is valued equally. Our investment portfolio mix as of December 31, 2007 consisted in large part of high quality, fixed maturity investments and short-term investments, as well as a smaller allocation to equity investments and other investments, such as hedge funds, limited partnerships and private equity interests. Our management believes that prudent levels of investments in common equity securities and other investments within our investment portfolio are likely to enhance long term after-tax total returns without significantly increasing the risk profile of the portfolio.

*Fixed Income*

WM Advisors manages our fixed income portfolio. WM Advisors' overall fixed maturity investment strategy is to purchase securities that are attractively priced in relation to credit risks. WM Advisors generally manages the interest rate risk associated with holding fixed maturity investments by actively maintaining the average duration of the portfolio to achieve an adequate after-tax total return without subjecting the portfolio to an unreasonable level of interest rate risk.

*Common Stock and Convertible Bonds*

Prospector manages our common stock and convertible bond portfolios. Prospector's investment strategy is to maximize absolute total return through investments in a variety of equity, equity-related and convertible bond instruments. Using a value orientation, Prospector invests in relatively concentrated positions in the United States and other developed markets. Prospector's philosophy is to invest for total risk-adjusted return using a bottom-up, value discipline. Preservation of capital is of the utmost importance.

**Investment in Unconsolidated Affiliate**

*Main Street America Holdings, Inc., or MSA.* Our investment in unconsolidated affiliate represents an operating investment in MSA in which we had a significant voting and economic interest but did not control the entity. On October 31, 2006, we received a $70 million cash dividend from MSA, a subsidiary of Main Street America Group Mutual Holdings, Inc., or Main Street Group, a Florida-domiciled mutual property and casualty insurance holding company, which insures risks located primarily in New York, Massachusetts, Connecticut, Pennsylvania, New Hampshire, Virginia and Florida. Following this transaction, we sold our 50% common stock investment in MSA to Main Street America Group, Inc., or Group, for (i) $70.0 million in 9.0% non-voting cumulative perpetual preferred stock of Group and (ii) 4.9% of the common stock of Group. These transactions resulted in a net after-tax realized gain of $8.5 million.

Prior to the exchange of our common stock investment in MSA, we accounted for this investment using the equity method of accounting. MSA's net written premiums for the ten months ended October 31, 2006 and the year ended December 31, 2005 totaled $424.2 million and $481.6 million, respectively, and its net income totaled $32.3 million and $16.1 million, respectively.

**Regulatory Matters**

*General*

Our insurance operations are subject to regulation and supervision in each of the jurisdictions where they are domiciled and licensed to conduct business. Generally, regulatory authorities have broad supervisory and administrative powers over such matters as licenses, standards of solvency, premium rates, policy forms, investments, security deposits, methods of accounting, form and content of the consolidated financial statements, reserves for unpaid loss and LAE, reinsurance, minimum capital and surplus requirements, dividends and other distributions to shareholders, periodic examinations and annual and other report filings. In general, such regulation is for the protection of policyholders rather than shareholders. Loss ratio trends in property and casualty insurance underwriting may be improved by, among other things, changing the kinds of coverages provided by policies, providing loss prevention and risk management services, increasing premium rates, purchasing reinsurance or by a combination of these factors. The ability of our insurance subsidiaries to meet emerging adverse loss ratio trends may be delayed, from time to time, by the effects of laws which require prior approval by insurance regulatory authorities of changes in policy forms and premium rates. We believe that we are in compliance with all applicable laws and regulations applicable to our business that would have a material effect on our financial position in the event of non-compliance.

*State Accreditation and Monitoring*

Over the last several years most states have implemented laws that establish standards for current, as well as continued, state accreditation. In addition, the National Association of Insurance Commissioners, or NAIC, has adopted risk-based capital, or RBC, standards for property and casualty companies, which are designed to determine minimum capital requirements and to raise the level of protection that statutory surplus provides for policyholder obligations. The RBC formula for property and casualty insurance companies measures three major areas of risk facing property and casualty insurers: underwriting, which encompasses the risk of adverse loss developments and inadequate pricing; declines in asset values arising from market and/or credit risk; and off-balance sheet risk arising from adverse experience from non-controlled assets, guarantees for affiliates or other contingent liabilities and excessive premium growth. Under laws adopted by individual states, insurers having less total adjusted capital than that required by the RBC calculation will be subject to varying degrees of regulatory action, depending on the level of capital inadequacy. Our current RBC ratios are satisfactory and such ratios are not expected to result in any adverse regulatory action. We are not aware of any current recommendations by regulatory authorities that would be expected to have a material effect on our results of operations or liquidity.

The NAIC has developed a set of financial relationships or tests known as the Insurance Regulatory Information System to assist state regulators in monitoring the financial condition of insurance companies and identifying companies that require special attention or action by insurance regulatory authorities. Insurance companies generally submit data annually to the NAIC, which in turn analyzes the data using prescribed financial data ratios, each with defined "usual ranges." Generally, regulators will begin to investigate or monitor an insurance company if its ratios fall outside the usual ranges for four or more of the ratios. If an insurance company has insufficient capital, regulators may act to reduce the amount of insurance it can issue. We are not aware that any of our insurance companies are currently subject to regulatory investigation based on these ratios.

State insurance laws require us to analyze the adequacy of our reserves annually. Our actuaries must submit an opinion that our reserves, when considered in light of the assets we hold with respect to those reserves, make adequate provision for our contractual obligations and related expenses.

Many states have laws and regulations that limit an insurer's ability to exit a market. For example, certain states limit a private passenger automobile insurer's ability to cancel or renew policies. Furthermore, certain states prohibit an insurer from withdrawing from one or more lines of insurance business in the state without the state regulator's approval. State regulators may refuse to approve withdrawal plans on the grounds that they could lead to market disruption.

*Mandatory Shared Market Mechanisms*

As a condition of our license to do business in certain states, we are required to participate in mandatory shared market mechanisms. Each state dictates the types of insurance and the level of coverage that must be provided. The most common type of shared market mechanism in which we are required to participate is an assigned risk plan. Many states operate assigned risk plans. The NYAIP and New Jersey commercial automobile insurance plans are two such shared market mechanisms in which we are required to participate. The total number of such policies an insurer is required to accept is based on its market share of voluntary business in the state. Underwriting results related to assigned risk plans are typically adverse. Accordingly, we may be required to underwrite policies with a higher risk of loss than we would otherwise accept.

Reinsurance facilities are another type of shared market mechanism. Reinsurance facilities require an insurance company to accept all applications submitted by certain state designated agents. The reinsurance facility then allows the insurer to cede some of its business to the reinsurance facility so that the facility will reimburse the insurer for claims paid on ceded business. Typically, however, reinsurance facilities operate at a deficit, which is funded through assessments against the same insurers. The Massachusetts Commonwealth Automobile Reinsurers is one such reinsurance facility in which we are required to participate.

*Guaranty Associations*

The insurance laws of many states generally provide that property and casualty insurers doing business in those states belong to a statutory property and casualty guaranty association. The purpose of these guaranty associations is to protect policyholders by requiring that solvent property and casualty insurers pay certain insurance claims of insolvent insurers. These guaranty associations generally pay these claims by assessing solvent insurers proportionately based on the insurer's share of voluntary written premiums in the state. While most guaranty associations provide for recovery of assessments through rate increases, surcharges or premium tax credits, there is no assurance that insurers will ultimately recover these assessments. At December 31, 2007, our aggregate reserve for such assessments totaled $16.5 million.

*Pricing, Investment and Dividends*

Nearly all states have insurance laws requiring property and casualty insurers to file price schedules, policy or coverage forms, and other information with the state's regulatory authority. In most cases, such price schedules and/or policy forms must be approved prior to use. While pricing laws vary from state to state, their objectives are generally to ensure that prices are adequate, not excessive and not discriminatory. For example, Massachusetts, a state where we have a sizable presence, had previously set virtually all aspects of automobile insurance rates, including agent commissions. While the state is now transitioning to a system of managed competition, existing regulations continue to challenge an insurer's ability to adequately price its product, which often leads to unsatisfactory underwriting results.

We are subject to state laws and regulations that require investment portfolio diversification and that limit the amount of investment in certain categories. Non-compliance may cause non-conforming investments to be non-admitted in measuring statutory surplus and, in some instances, may require divestiture.

One of the primary sources of cash inflows for us and certain of our intermediary holding companies is dividends received from our operating subsidiaries. Under the insurance laws of the jurisdictions under which our insurance subsidiaries are domiciled, an insurer is restricted with respect to the timing or the amount of dividends it may pay without prior approval by regulatory authorities. Accordingly, there is no assurance regarding the amount of such dividends that may be paid by such subsidiaries in the future. During 2007, our first-tier insurance subsidiaries declared and paid $393.9 million in cash and non-cash dividends to OneBeacon Insurance Group LLC. Our first tier insurance subsidiaries have the ability to pay dividends of approximately $346 million to their parent, in 2008 without approval of regulatory authorities.

*Holding Company Structure*

We are subject to regulation under certain state insurance holding company acts. These regulations contain reporting requirements relating to our capital structure, ownership, financial condition and general business operations. These regulations also contain special reporting and prior approval requirements with respect to certain transactions among affiliates. Since we are an insurance holding company, the domiciliary states of our insurance subsidiaries impose regulatory application and approval requirements on acquisitions of common shares which may be deemed to confer control over those subsidiaries, as that concept is defined under the applicable state laws. Acquisition of as little as 10% of our common shares may be deemed to confer control under the insurance laws of some jurisdictions, and the application process for approval can be extensive and time consuming.

*Terrorism*

While the Federal government does not directly regulate the insurance business, Federal legislation and administrative policies affect the insurance industry. In December 2007, the United States government extended the Terrorism Act for seven more years until December 31, 2014. The Terrorism Act, originally enacted in 2002, established a Federal "backstop" for commercial property and casualty losses, including workers compensation, resulting from acts of terrorism by or on behalf of any foreign person or foreign interest. As extended, the law also covers domestic acts of terrorism. The law limits the industry's aggregate liability by requiring the Federal government to share 85% of certified losses in 2008 once a company meets a specific retention or deductible as determined by its prior year's direct written premiums and limits the aggregate liability to be paid by the government and industry without further action by Congress at $100.0 billion. In exchange for this "back-stop," primary insurers are required to make coverage available to commercial insureds for losses from acts of terrorism as specified in the Terrorism Act. The following types of coverage are excluded from the program: commercial automobile, burglary and theft, surety, farmowners multi-peril and all professional liability coverage except directors and officers coverage. We are actively complying with the requirements of the Terrorism Act in order to ensure our ability to be reimbursed by the Federal government for any losses we may incur as a result of future terrorist acts.

*Legislation*

In addition, legislation has been introduced in recent years that, if enacted, could result in the state and Federal government assuming a more direct role in the regulation of the insurance industry. Furthermore, a number of additional enacted and pending state and Federal legislative measures could lead to increased consolidation and increased competition for business and for capital in the financial services industry. We cannot predict whether any state or Federal measures will be adopted to change the nature or scope of the regulation of the insurance business or what effect such measures may have on our insurance and reinsurance operations.

*Environmental*

Both Federal and state laws and regulations govern the environmental cleanup of contaminated sites by, or for the account of, potentially responsible parties (PRPs). Superfund and comparable state statutes can impose liability for the entire cost of clean-up upon any responsible party, regardless of fault. The insurance industry in general is involved in extensive litigation regarding coverage issues arising out of the cleanup of such sites by insured PRPs and as a result has disputed many such claims.

From time to time, comprehensive Superfund reform proposals are introduced in Congress, but none has yet been enacted. At this time, it remains unclear as to whether Superfund reform legislation will be enacted or that any such legislation will provide for a fair, effective and cost-efficient system for settlement of Superfund related claims. The NICO Cover includes coverage for such exposures at our company, however, there can be no assurance that the coverage provided under the NICO Cover will ultimately prove to be adequate for our incurred environmental losses.

*Certain Other Bermuda Law Considerations*

We are an exempted company organized under the Companies Act. As a result, we will need to comply with the provisions of the Companies Act regulating the payment of dividends and making of distributions from contributed surplus. A company is prohibited from declaring or paying a dividend, or making a distribution out of contributed surplus, if there are reasonable grounds for believing that:

- the company is, or would after the payment be, unable to pay its liabilities as they become due; or

- the realizable value of the company's assets would thereby be less than the aggregate of its liabilities and its issued share capital and share premium accounts.

Under our bye-laws, each common share is entitled to dividends if, and when, dividends are declared by our board of directors (the Board), subject to any preferred dividend right of the holders of any preference shares. Issued share capital is the aggregate par value of the company's issued shares, and the share premium account is the aggregate amount paid for issued shares over and above their par value. Share premium accounts may be reduced in certain limited circumstances. In addition, the Companies Act regulates return of capital, reduction of capital and any purchase or redemption of shares by OneBeacon.

Although we are incorporated in Bermuda, we have been designated as a non-resident of Bermuda for exchange control purposes by the Bermuda Monetary Authority, or the BMA. Pursuant to our non-resident status, we may hold any currency other than Bermuda dollars and convert that currency into any other currency, other than Bermuda dollars, without restriction.

Shares may be offered or sold in Bermuda only in compliance with the provisions of the Investment Business Act 2003 and the Exchange Control Act 1972, and related regulations of Bermuda which regulate the sale of securities in Bermuda. In addition, specific permission is required from the BMA pursuant to the provisions of the Exchange Control Act 1972 and related regulations, for all issuances and transfers of securities of Bermuda companies, other than in cases where the BMA has granted a general permission. The BMA in its policy dated June 1, 2005 provides that where any equity securities, including our common shares, of a Bermuda company are listed on an appointed stock exchange, general permission is given for the issue and subsequent transfer of any securities of a company from and/or to a non-resident, for as long as any equity securities of such company remain so listed. The New York Stock Exchange is deemed to be an appointed stock exchange under Bermuda law. Notwithstanding the above general permission, the BMA has granted us permission to, subject to our common shares being listed on an appointed stock exchange, (a) issue and transfer our shares, up to the amount of our authorized capital from time to time, to persons resident and non-resident of Bermuda for exchange control purposes; (b) issue and transfer our options, warrants, depositary receipts, rights, and other securities; and (c) issue and transfer our loan notes and other debt instruments and options, warrants, receipts, rights over loan notes and other debt instruments to persons resident and non-resident of Bermuda for exchange control purposes.

In accordance with Bermuda law, share certificates are issued only in the names of corporations or individuals. In the case of an applicant acting in a special capacity, for example, as an executor or trustee, certificates may, at the request of the applicant, record the capacity in which the applicant is acting. Notwithstanding the recording of any such special capacity, we are not bound to investigate or incur any responsibility in respect of the proper administration of any such estate or trust. We will take no notice of any trust applicable to any of our common shares whether or not we have notice of such trust.

Under Bermuda law, exempted companies are companies formed for the purpose of conducting business outside Bermuda from a principal place in Bermuda. As exempted companies, we may not, without the express authorization of the Bermuda legislature or under a license granted by the Bermuda Minister of Finance, participate in various specified business transactions, including:

- the acquisition or holding of land in Bermuda, except land held by way of lease or tenancy agreement which is required for our business and held for a term not exceeding 50 years, or which is used to provide accommodation or recreational facilities for our officers and employees and held with the consent of the Bermuda Minister of Finance, for a term not exceeding 21 years;

- the taking of mortgages on land in Bermuda in excess of $50,000;

- the acquisition of any bonds or debentures secured by any land in Bermuda, other than certain types of Bermuda government or public authority securities; or

- subject to some exceptions, the carrying on of business of any kind in Bermuda for which we are not licensed in Bermuda.

Under Bermuda law, non-Bermudians (other than spouses of Bermudians) may not engage in any gainful occupation in Bermuda without an appropriate governmental work permit. Work permits may be granted or extended by the Bermuda government upon showing that, after proper public advertisement in most cases, no Bermudian (or spouse of a Bermudian) is available who meets the minimum standard requirements for the advertised position. The Bermuda government's policy limits the duration of work permits to six years, with certain exemptions for key employees. In addition, exempted companies, such as us, must comply with Bermuda resident representation provisions under the Companies Act which require that a minimum number of offices must be filled by persons who are ordinarily resident in Bermuda. We do not believe that such compliance will result in any material expense to us.

**Competition**

Property and casualty insurance is highly competitive. In specialty lines, we compete with numerous regional and national insurance companies, most notably The Chubb Corporation, American International Group, The Travelers Companies, Inc. and CNA Financial Corporation. In commercial and personal lines, we compete with numerous regional and national insurance companies, most notably The Travelers Companies, Inc., Zurich Financial Services Group, CNA Financial Corporation, Hartford Financial Services Group, Inc., The Hanover Insurance Group, Inc., W.R. Berkley Corporation, The Chubb Corporation, The Progressive Corporation, Allstate Insurance Company and Liberty Mutual Insurance Company. The more significant competitive factors for most insurance products we offer are price, product terms and claims service. Our underwriting principles and dedication to independent agency distribution are unlikely to make us the low-cost provider in most markets. However, while it is often difficult for insurance companies to differentiate their products to consumers, we believe that our dedication to providing superior product offerings, expertise and local talent, claims service and disciplined underwriting provide a competitive advantage over typical low-cost providers. However, as the emergence and growth of competitors that have lower cost structures, such as direct writers, continues, we will face greater pressure on our pricing which may impact our ability to compete.

**Ratings**

Insurance companies are evaluated by various rating agencies in order to measure each company's financial strength. Higher ratings generally indicate financial stability and a stronger ability to pay claims. We believe that strong ratings are an important factor in the marketing of insurance products to agents and consumers. These financial strength ratings do not refer to our ability to meet non-insurance obligations and are not a recommendation to purchase or discontinue any policy or contract issued by us or to buy, hold, or sell our securities.

The following table presents the financial strength ratings assigned to our principal insurance operating subsidiaries.

| | A.M. Best(1) | Standard & Poor's(2) | Moody's(3) | Fitch(4) |
|---|---|---|---|---|
| **Rating** | "A" (Excellent) | "A" (Strong) | "A2" (Good) | "A" (Strong) |
| **Outlook** | Stable | Stable | Stable | Stable |

(1) "A" is the third highest of fifteen financial strength ratings.

(2) "A" is the sixth highest of twenty-one financial strength ratings.

(3) "A2" is the sixth highest of twenty-one financial strength ratings.

(4) "A" is the sixth highest of twenty-one financial strength ratings.

**Employees**

As of December 31, 2007, we employed approximately 2,700 persons. We believe that we have satisfactory relations with our employees.

**AVAILABLE INFORMATION**

OneBeacon is subject to the informational reporting requirements of the Securities Exchange Act of 1934. In accordance therewith, the Company files reports, proxy statements and other information with the Securities and Exchange Commission (SEC). These documents are available free of charge at www.onebeacon.com as soon as reasonably practicable after such material is electronically filed with or furnished to the SEC. In addition, the Company's Code of Business Conduct as well as the charters of our Board Committees are available free of charge at www.onebeacon.com.

The Company will provide to any shareholder, upon request and without charge, copies of these documents (excluding any applicable exhibits unless specifically requested). Written or telephone requests should be directed to Investor Relations, OneBeacon Insurance Group, Ltd., 1 Beacon Lane, Canton, MA 02021, telephone number (877) 248-8765. Additionally, all such documents are physically available at the Company's registered office at Clarendon House, 2 Church Street, Hamilton, HM 11 Bermuda.

**ITEM 1A. RISK FACTORS**

The information contained in this report may contain "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. *See* **"FORWARD-LOOKING STATEMENTS"** (page 98) *for specific important factors that could cause actual results to differ materially from those contained in forward-looking statements.* The Company's actual future results and trends may differ materially depending on a variety of factors including, but not limited to, the risks and uncertainties discussed below.

**Risks Relating to Our Business**

***Our loss and loss adjustment expense reserves may be inadequate to cover our ultimate liability for losses and as a result any inadequacy could materially adversely affect our financial condition and results of operations.***

We are required to maintain adequate reserves to cover our estimated ultimate liabilities for loss and loss adjustment expenses, or LAE. Loss and LAE reserves are typically comprised of (1) case reserves for claims reported and (2) reserves for losses that have occurred but for which claims have not yet been reported, referred to as incurred but not reported, or IBNR, reserves, which include a provision for expected future development on case reserves. These reserves are estimates based on actuarial and statistical projections of what we believe the settlement and administration of claims will cost based on facts and circumstances then known to us. Because of the uncertainties that surround estimating loss and LAE reserves, we cannot be certain that our reserves are adequate and actual claims and claim expenses paid might exceed our reserves. For example, we have had a large number of construction defect claims arising from our general liability and multiple peril lines of business. Construction defect is a highly uncertain exposure due to issues concerning whether coverage exists, the definition of an occurrence, the determination of ultimate damages and the allocation of such damages to financially responsible parties.

We had established gross loss and LAE reserves of $4,480.3 million and $4,837.7 million as of December 31, 2007 and 2006, respectively. For the years ended December 31, 2007, 2006 and 2005, we recorded (favorable) or adverse development of $(48.3) million, $(11.3) million and $99.0 million, respectively, net of reinsurance, related to the re-estimation of previously established reserves.

If in the future we determine that our reserves are insufficient to cover our actual loss and LAE, we would have to strengthen our reserves, which could have a material adverse effect on our financial condition and results of operations.

For additional information relating to loss and LAE reserve requirements, see "Regulatory Matters." For additional information relating to how we estimate our loss and LAE reserves, including our asbestos and environmental reserves, see "Business  Loss and LAE Reserves" and "Management's Discussion and Analysis of Financial Condition and Results of Operations  Critical Accounting Estimates."

***Exposure to asbestos or environmental claims could materially adversely affect our financial condition and results of operations.***

Estimating our exposure to asbestos and environmental claims is subject to a particularly high degree of uncertainty. If we have not established adequate loss and LAE reserves to cover future claims, our financial condition and results of operations could be materially adversely affected.

In connection with the OneBeacon Acquisition, to help protect against potential asbestos and environmental claims relating to the pre-acquisition period, Aviva caused us to purchase a reinsurance contract from NICO, rated "AAA" by Standard & Poor's and "A++" by A.M. Best. We refer to this reinsurance contract as the NICO Cover. Under the NICO Cover we are entitled to recover up to $2.5 billion from NICO for (1) all asbestos claims arising from business written by us in 1992 and prior, (2) all environmental claims arising from business written by us in 1987 and prior, and (3) certain other latent exposures. As of December 31, 2007, we estimate that on an incurred basis we have ceded losses of approximately $2.1 billion to the NICO Cover, leaving remaining protection under the NICO Cover of $404.0 million. Net losses paid totaled $986.0 million as of December 31, 2007, with $139.0 million paid in 2007. Due to exclusions in policy language and changes in coverages provided, we do not believe that we have significant exposure to asbestos claims arising from business we wrote after 1992 or to environmental claims arising from business we wrote after 1987.

As of December 31, 2007, we had established gross loss and LAE reserves for asbestos claims of $1,155.9 million. Approximately 99% of these loss and LAE reserves are covered under reinsurance arrangements. Our net loss and LAE reserves for asbestos claims after giving effect to third party reinsurance other than the NICO Cover was $699.7 million at December 31, 2007. Our net loss and LAE reserves for asbestos claims after giving effect to both third party reinsurance and the NICO Cover was $7.2 million at December 31, 2007.

Estimating our future exposure to asbestos claims is subject to considerable uncertainty due to tort liability reform in various states, the difficulty of predicting jury awards in such matters and diverging legal interpretations and rules in different jurisdictions. These uncertainties also include, among other things:

- the extent of coverage under insurance policies;
- whether or not particular claims are subject to an aggregate limit;
- the number of occurrences involved in particular claims; and
- new theories of insured and insurer liability.

The ultimate liability for our asbestos claims remains uncertain and could exceed the coverage under our reinsurance arrangements and our net loss and LAE reserves.

Insurers, including us, experienced an increase in the number of new asbestos-related claims in recent years, in particular in 2002 and 2003. We experienced a 12% increase in the number of accounts with asbestos-related claims reported during 2002 as compared to 2001 and another 51% increase in the number reported in 2003 from the level reported in 2002. We believe this increase was attributable to, among other things, more intensive advertising by lawyers seeking asbestos claimants, the increasing focus by plaintiffs on new and previously peripheral defendants, an acceleration of claims prior to the potential enactment of Federal asbestos legislation, and an increase in the number of entities seeking bankruptcy protection as a result of asbestos-related liabilities. During 2004, we started to experience a decrease in the number of accounts with asbestos-related claims reported with a 37% decrease from the level reported in 2003; however, the number of accounts with asbestos-related claims reported in 2004 was still above levels reported in 1999, 2000 and 2001. During 2005, we experienced a 6% decrease in the number of accounts with asbestos-related claims reported when compared to the average of the prior three-year period. During 2006, we experienced a 13% decrease in the number of accounts with asbestos-related claims reported when compared to the average of the prior three-year period. During 2007, we experienced a 15% decrease in the number of accounts with asbestos-related claims reported when compared to the average of the prior three-year period. It is uncertain whether the number of new annual claims and filings will continue to decrease, remain stable or increase when compared to prior annual periods. Also, in addition to adding new claims, bankruptcy proceedings may have the effect of significantly accelerating and increasing loss payments by insurers, including us.

Increasingly, policyholders have been asserting that their claims for asbestos-related insurance are not subject to aggregate limits on coverage and that each individual bodily injury claim should be treated as a separate occurrence under a policy. Some policyholders who previously sought payment from us for asbestos claims under their products liability coverages, which were subject to aggregate limits, have increasingly sought payment from us for asbestos claims under the premises and operations coverages of their liability policies, which may not be subject to similar aggregate limits. We expect this trend to continue. To the extent either issue is resolved in favor of policyholders, our coverage obligations under the relevant policies would be materially increased and capped only by the applicable per occurrence limits and the number of asbestos bodily injury claims against the policyholders. Claims in these instances may vary significantly and policyholders may seek large amounts, although such claims frequently settle for a fraction of the initial alleged amount. Accordingly, it is difficult to predict the ultimate size of the claims for coverage not subject to aggregate limits.

From time to time in recent years, the United States Congress has given consideration to legislative proposals that would address various issues connected with asbestos liability. While it is unclear whether any such proposals will be passed into law at any time in the near future, if at all, we cannot predict what impact, if any, such adopted legislation would have on our ultimate asbestos liability or on the NICO Cover.

As of December 31, 2007, we had established gross loss and LAE reserves for environmental claims of $577.1 million. Approximately 99% of these loss and LAE reserves are covered under reinsurance arrangements. Our net reserves for environmental claims after giving effect to third party reinsurance, other than the NICO Cover was $342.5 million at December 31, 2007. Our net loss and LAE reserves for environmental claims after giving effect to both third party reinsurance and the NICO Cover aggregated $6.0 million as of December 31, 2007. Future exposure from environmental claims is uncertain, in part, for reasons similar to those described above for asbestos claims.

As a result of various state and Federal laws and regulations relating to environmental remediation, particularly the Comprehensive Environmental Response, Compensation, and Liability Act of 1980, which is commonly referred to as Superfund, and related damages claims, the insurance industry continues to be involved in litigation involving policy coverage and liability issues. In addition to regulatory pressures, the results of court decisions affecting the industry's coverage positions continue to be inconsistent and have expanded coverage beyond the industry's original expectations. Accordingly, the ultimate liability for environmental costs remain uncertain and could exceed the coverage of our reinsurance arrangements.

***We may not be able to successfully alleviate risk through reinsurance arrangements. Additionally, we may be unable to collect all amounts due from our reinsurers under our existing reinsurance arrangements.***

We attempt to limit our risk of loss through reinsurance arrangements. The availability and cost of reinsurance protection is subject to market conditions, which are outside of our control. In addition, the coverage under our reinsurance contracts may be inadequate to cover our future liabilities. As a result, we may not be able to successfully alleviate risk through these arrangements, which could have a material adverse effect on our financial condition and results of operations.

We are not relieved of our obligation to our policyholders by purchasing reinsurance. Accordingly, we are subject to credit risk with respect to our reinsurance in the event that a reinsurer is unable to pay amounts owed to us as a result of a deterioration in its financial condition or if it simply is unwilling to pay due to a dispute or other factors beyond our control. A number of reinsurers in the industry experienced such deterioration in the aftermath of the 2001 terrorist attacks and the active 2005 hurricane season. While several of our reinsurers were adversely affected by these events, and in some cases ceased writing new reinsurance coverages, the impact on our operations from these events has been negligible. In the future, it is possible that one or more of our reinsurers will be significantly adversely affected by significant loss events, causing them to be unable to pay amounts owed to us.

***Unpredictable catastrophic events could adversely affect our financial condition or results of operations.***

Our insurance operations expose us to claims arising out of unpredictable natural and other catastrophic events, such as hurricanes, windstorms, severe winter weather, earthquakes, floods, fires and explosions. In recent years, the frequency of major weather-related catastrophes has increased. Our exposure to catastrophic windstorm damage in the Northeastern United States is the largest single natural catastrophe risk to our business. Some extremely remote modeled catastrophic events, or series of events, could be of sufficient size to cause us to become insolvent.

The extent of losses from a catastrophe is a function of both the total amount of insured exposure in the area affected by the event and the severity of the event. Increases in the value and concentrations of insured property, the effects of inflation and changes in cyclical weather patterns may increase the severity of claims from catastrophic events in the future. Claims from catastrophic events could reduce our earnings and cause substantial volatility in our results of operations for any fiscal quarter or year and adversely affect our financial condition. Our ability to write new insurance policies could also be impacted as a result of corresponding reductions in our surplus levels.

We manage our exposure to catastrophic losses by limiting the aggregate insured value of policies in geographic areas with exposure to catastrophic events, by estimating a probable maximum loss, which we refer to as PML, for many different catastrophe scenarios and by buying reinsurance. To manage and analyze aggregate insured values and PML, we use a variety of tools, including catastrophe modeling software. Our estimates of PML are dependent on many variables, including assumptions about the demand surge and storm surge, loss adjustment expenses, insurance-to-value and storm intensity in the aftermath of weather-related catastrophes utilized to model the event and the relationship of the actual event to the modeled event. Accordingly, if our assumptions about these variables are incorrect, the losses we might incur from an actual catastrophe could be materially higher than our expectation of losses generated from modeled catastrophe scenarios, and our financial condition and results of operations could be materially adversely affected.

For example, in 2005, standard industry models for forecasting the losses resulting from hurricanes Katrina, Rita and Wilma proved to be inadequate. We had losses of $69.1 million in 2005 resulting from those hurricanes, which exceeded our internal expectations by approximately $24 million. The total industry loss from 2005 catastrophes was over $80 billion with approximately $58 billion related to hurricanes Katrina, Rita and Wilma, which materially exceeded industry models. During the year ended December 31, 2006, we increased our estimates of ultimate incurred loss and LAE relating to hurricanes Katrina, Rita and Wilma by $19.9 million.

***Future insurance and reinsurance coverage for terrorist acts is uncertain, and we may in the future have substantial exposure to such acts.***

We are unable to predict the extent to which our future insurance contracts will cover terrorist acts. We also are unsure how terrorist acts will be defined in our future contracts. The Terrorism Act, which has been extended through the end of 2014, requires primary commercial insurers to make terrorism coverage available and provides Federal protection for certain losses above both individual company retention and industry retention levels. While we know of no reason that the Terrorism Act will not be extended for an additional period of time, there is no assurance that it will be extended or of the terms of any such extension. The following types of coverage are excluded from the program: commercial automobile, burglary and theft, surety, farmowners, multi-peril and all professional liability coverages except directors and officers coverage. Our current property and casualty catastrophe reinsurance programs provide coverage for us for "non-certified" events as defined under the Terrorism Act, provided such losses are not the result of a nuclear, biological or chemical attack. Nonetheless, risks insured by us, including those covered by the Terrorism Act, remain exposed to terrorist attacks and the possibility remains that losses resulting from future terrorist attacks could prove to be material to our results of operations and financial condition.

***Our investment portfolio may suffer reduced returns or losses which could adversely affect our results of operations and financial condition. Any increase in interest rates or volatility in the equity and debt markets could result in significant losses in the fair value of our investment portfolio.***

Our investment portfolio consists of fixed maturity securities, short-term investments, common equity securities and other investments such as hedge funds, limited partnerships and private equity interests. Our investment selections are designed to maximize after-tax, total risk-adjusted return over the long term; however, investing entails substantial risks. We cannot assure you that we will achieve our investment objectives, and our investment performance may vary substantially over time.

Investment returns are an important part of our growth in book value, and fluctuations in the fixed income or equity markets could impair our results of operations or financial condition. A significant period of time normally elapses between the receipt of insurance premiums and the disbursement of insurance claims. During this time, we generate investment income, consisting primarily of interest earned on fixed maturity investments and dividends earned on equity securities, by investing our capital as well as insurance premiums allocated to support unpaid loss and LAE reserves. We also recognize unrealized investment gains and losses on the securities we hold in our investment portfolio and we generate investment gains and losses from sales of securities from our investment portfolio.

The investment income and fair market value of our investment portfolio are affected by general economic and market conditions, including fluctuations in interest rates and volatility in the stock market. Interest rates are highly sensitive to many factors, including governmental monetary policies, domestic and international economic and political conditions and other factors beyond our control. Although we attempt to manage the risks of investing in a changing interest rate environment, we may not be able to effectively mitigate interest rate sensitivity. In particular, a significant increase in interest rates could result in significant losses, realized or unrealized, in the fair value of our investment portfolio and, consequently, could have an adverse affect on our results of operations. In addition, we are exposed to changes in the level or volatility of equity prices that affect the value of securities or instruments that derive their value from a particular equity security, a basket of equity securities or a stock index. These conditions are outside of our control and could adversely affect the value of our investments and our results of operations and financial condition.

We are highly dependent on WM Advisors and Prospector in connection with the management of our investment portfolio. Subsequent to the initial public offering, under agreements dated November 14, 2006 and November 15, 2007, WM Advisors supervises and directs the fixed income and alternative investment portion of OneBeacon's investment portfolio. Under an agreement dated November 14, 2006, as amended October 22, 2007, Prospector supervises and directs the publicly-traded common equity and convertible securities portion of OneBeacon's investment portfolio. The agreements both provide for an initial fixed term of three years, which will be extendible by us for an additional year (a fourth year) at or prior to the end of the second year of the term, and if so extended, for a second additional year (a fifth year) at or prior to the end of the third year of the term. If we lose our investment relationship with WM Advisors or with Prospector, we may not be able to secure an investment advisor or advisors who will produce returns on our investments similar to these produced by WM Advisors and Prospector in the past, or any positive returns at all.

***We may not maintain favorable financial strength ratings, which could adversely affect our ability to conduct business.***

We may not maintain favorable financial strength ratings, which could adversely affect our ability to conduct business. Third party rating agencies assess and rate the financial strength, including claims-paying ability, of insurers and reinsurers. These ratings are based upon criteria established by the rating agencies and are subject to revision at any time at the sole discretion of the agencies. Some of the criteria relate to general economic conditions and other circumstances outside the rated company's control. These financial strength ratings are used by policyholders, agents and brokers as an important means of assessing the suitability of insurers as business counterparties and have become an increasingly important factor in establishing the competitive position of insurance companies. These financial strength ratings do not refer to our ability to meet non-insurance obligations and are not a recommendation to purchase or discontinue any policy or contract issued by us or to buy, hold or sell our securities. Our current financial strength ratings are "A" ("Excellent," third highest of 15 ratings) by A. M. Best Company, Inc., "A" ("Strong," sixth highest of 21 ratings) by Standard & Poor's Rating Service, "A2" ("Good," sixth highest of 21 ratings) by Moody's Investors Service, Inc. and "A" ("Strong," sixth highest of 21 ratings) by Fitch, Inc. Periodically, the rating agencies evaluate us to confirm that we continue to meet the criteria of the ratings previously assigned to us. A downgrade or withdrawal of our financial strength ratings could limit or prevent our insurance subsidiaries from writing new insurance policies or renewing existing insurance policies, which would have a material adverse affect on our financial condition and results of operations.

***Our debt, preferred stock and related service obligations could adverely affect our financial condition and results of operations.***

As of December 31, 2007, we had $758.8 million face value of indebtedness and $300.0 million face value of mandatorily redeemable preferred stock outstanding. We have established and funded trusts that are solely dedicated to the payment of dividends and redemption amounts of our outstanding mandatorily redeemable preferred stock with the deposit of U.S. government securities.

Our ability to meet our debt and related service obligations, as well as our ability to pay a dividend on our common shares, will depend on our future performance, which will be affected by financial, business, economic and other factors. We will not be able to control many of these factors, such as economic conditions and governmental regulation. We cannot be certain that our earnings will be sufficient to allow us to pay the principal and interest on our debt and meet our other obligations. If we do not have enough cash, we may be required to refinance all or part of our existing debt, sell assets, borrow more cash or sell equity. We cannot assure you that we will be able to accomplish any of these alternatives on terms acceptable to us, if at all.

We could incur additional indebtedness and issue additional preferred stock in the future. To the extent new debt, new preferred stock and other obligations are added to our and our subsidiaries' current debt and preferred stock levels, the risks described in the previous paragraph would increase.

***We are a holding company with no direct operations, and our insurance subsidiaries' ability to pay dividends to us is restricted by law.***

As a holding company with no direct operations and whose only significant assets are the capital stock of our subsidiaries, we rely on net investment income and dividends and other permitted payments from our subsidiaries to pay our expenses. Our subsidiaries may not be able to generate cash flow sufficient to pay a dividend or distribute funds to us. In addition, applicable state laws that regulate the payment of dividends by our insurance subsidiaries could prohibit such dividends or distributions. Under the insurance laws of the jurisdictions in which our insurance subsidiaries are domiciled, an insurer is restricted with respect to the timing or the amount of dividends it may pay without prior approval by regulatory authorities. Generally, our regulated operating subsidiaries have the ability to pay dividends during any 12-month period, without having to obtain the prior approval of regulatory authorities, in an amount equal to the greater of statutory net income for the preceding year or 10% of statutory surplus as of the end of the preceding year, subject to the availability of unassigned funds. As a result, based on 2007 statutory net income, our top tier regulated operating subsidiaries have the ability to pay an aggregate of approximately $346 million of dividends during 2008 without having to obtain prior approval of regulatory authorities, subject to the availability of unassigned funds. As of December 31, 2007, our top tier regulated operating subsidiaries had $1.5 billion of unassigned funds available for dividend distribution. Management believes that our cash balances, cash flows from operations and cash flows from investments are adequate to meet expected cash requirements for the foreseeable future on both a holding company and operating subsidiary level. However, if our insurance subsidiaries cannot pay dividends in future periods, beginning in 2009, we may have difficulty servicing our debt, paying dividends on our common shares and meeting our holding company expenses. For additional information relating to insurance regulations governing our operations, see "Regulatory Matters."

***The property and casualty insurance industry is highly competitive and we may not be able to compete effectively in the future.***

The property and casualty insurance industry is highly competitive and has, from time to time, experienced severe price competition. Competition in the personal auto insurance business line, for example, is intensifying and rate pressures in the auto industry are expected to continue. We compete with numerous regional and national insurance companies, including The Travelers Companies, Inc., Zurich Financial Services Group, CNA Financial Corporation, Hartford Financial Services Group, Inc., The Hanover Insurance Group, Inc., W.R. Berkley Corporation, The Chubb Corporation, The Progressive Corporation, Allstate Insurance Company, Liberty Mutual Insurance Company and American International Group, Inc. Many of these competitors have greater financial, marketing and management resources than we do and have established long-term and continuing business relationships throughout the insurance industry, which can be a significant competitive advantage for them.

In addition, the agents whom we rely upon compete with direct writers of insurance, who are often able to offer substantial discounts in pricing as compared to our insurance products. If our agents experience increased competition from direct writers of insurance, we in turn could be adversely affected if they are unable to maintain a competitive position in their respective markets. If we are unable to maintain our competitive position, our financial condition and results of operations may be adversely affected.

***We may suffer losses from unfavorable outcomes from litigation and other legal proceedings.***

In the ordinary course of business, we are subject to litigation and other legal proceedings as part of the claims process, the outcomes of which are uncertain. We maintain reserves for these legal proceedings as part of our loss and LAE reserves. We also maintain separate reserves for legal proceedings that are not related to the claims process. In the event of an unfavorable outcome in one or more legal matters, our ultimate liability may be in excess of amounts we have currently reserved for and such additional amounts may be material to our results of operations and financial condition. For a description of our material legal proceedings, see "Business  Legal Proceedings."

As industry practices and legal, judicial, social and other conditions change, unexpected and unintended issues related to claims and coverage may emerge. These issues may adversely affect our financial condition and results of operations by either extending coverage beyond our underwriting intent or by increasing the number and size of claims. In some instances, these changes may not become apparent until some time after we have issued insurance contracts that are affected by the changes.

***Our profitability may be adversely impacted by inflation and legislative actions and judicial decisions.***

The effects of inflation could cause claim costs to rise in the future. In addition, judicial decisions and legislative actions continue to broaden liability and policy definitions and to increase the severity of claim payments, such as described above with respect to asbestos and environmental claims. To the extent inflation and these legislative actions and judicial decisions cause claim costs to increase above reserves established for these claims, we will be required to increase our loss and LAE reserves with a corresponding reduction in our net income in the period in which the deficiency is identified.

***Regulation may restrict our ability to operate.***

The insurance industry is subject to extensive regulation under U.S. and state laws. Governmental agencies have broad administrative power to regulate many aspects of the insurance business, which include premium rates, marketing practices, advertising, policy forms and capital adequacy. These governmental agencies are concerned primarily with the protection of policyholders rather than shareholders. Insurance laws and regulations impose restrictions on the amount and type of investments, prescribe solvency standards that must be met and maintained and require the maintenance of reserves. Premium rate regulation is common across all of our lines of business and may make it difficult for us to increase premiums to adequately reflect the cost of providing insurance coverage to our policyholders. In our underwriting, we rely heavily upon information gathered from third parties such as credit report agencies and other data aggregators. The use of this information is also highly regulated and any changes to the current regulatory structure could materially affect how we underwrite and price premiums.

Changes in the laws and regulations may restrict our ability to operate and/or have an adverse effect upon the profitability of our business within a given jurisdiction. For example, legislation has been passed in Florida that significantly changes reinsurance protection provided by the Florida Hurricane Catastrophe fund to companies that write business in Florida. The legislation also contains a provision that will disallow insurers to write automobile insurance in Florida and write homeowners insurance elsewhere in the U.S. unless they begin to write homeowners insurance in Florida. We cannot determine what the impact of the new legislation will be upon our business in Florida, and the impact could be adverse, depending on how this provision is interpreted and how regulations are promulgated. In addition, state and Federal legislation has been proposed on catastrophe funds and underwriting in coastal areas which could impact our business.

***Government authorities are continuing to investigate the insurance industry, which may adversely affect our business.***

Recently, the insurance industry has been heavily scrutinized by various regulatory bodies, including State Attorneys General and state insurance departments, for alleged illegal conduct surrounding a number of topics, including producer compensation arrangements and the sale and use of finite reinsurance. For example, during 2004 and 2005, we received subpoenas from the Attorneys General of Massachusetts, New York and Connecticut requesting documents and seeking information relating to the conduct of business between us and insurance brokers. We have cooperated with all of these subpoenas and information requests. These investigations of the insurance industry, whether involving our company specifically or not, together with any legal or regulatory proceedings related settlement, or industry reforms, may materially adversely affect our business and future prospects.

***We may be unable to collect amounts utilized to capitalize reciprocals.***

Since 2002, we have capitalized three member-owned, not-for-profit insurance associations, which we refer to as reciprocals, by loaning money to them in exchange for surplus notes. As of December 31, 2007, we have loaned an aggregate of $125.9 million, including $0.2 million loaned in the form of a security deposit, to the three reciprocals, and accrued $41.1 million in interest. These three associations are currently consolidated in our consolidated financial statements. As a result, the surplus notes, the security deposit and accrued interest have been eliminated in consolidation. In the future, depending on their financial success, these associations could be deconsolidated. At such time, the surplus notes would be reflected as notes receivable on our balance sheet. Amounts utilized to capitalize reciprocals can be difficult to extract as repayment of principal and interest is subject to regulatory approval. If any reciprocal is unable to cover its ultimate liability for loss and LAE or is unable to obtain insurance regulatory approval to repay us, we would be unable to collect amounts owed under the related surplus note. In addition, while we have no legal obligation to loan further funds to these reciprocals, even in the event their capital becomes depleted, we may decide that it is in our best interest to provide the reciprocal with additional capital, thereby increasing our loss exposure.

***A failure to attract and retain key personnel could reduce our revenues and operational effectiveness.***

Our performance substantially depends on the efforts and abilities of our management team and other key employees. Furthermore, much of our competitive advantage is based on the expertise, experience and know-how of our key management personnel. We do not have fixed term employment agreements with any of these key employees nor key man life insurance and the loss of one or more of these key employees could adversely affect our business, results of operations and financial condition. Our success also depends on the ability to hire and retain additional key personnel such as experienced underwriters. Difficulty in hiring or retaining key personnel could adversely affect our results of operation and financial condition.

***We have limited experience operating as a stand-alone company and we may not be successful operating as a stand-alone company.***

We have benefited and continue to benefit from being a significant subsidiary of a well-financed, publicly-traded company. Following the initial public offering, we continue to be a significant subsidiary of White Mountains, however, we may gradually lose the benefit of being part of the White Mountains group, especially to the extent White Mountains elects to further sell down its position in our common shares. Accordingly, customers, agents, rating agencies and investors will continue to assess our strengths and weaknesses independently, and this may have a negative effect upon our ability to attract new business and raise additional capital.

***We will continue to incur increased costs as a result of being a public company.***

As a newly public company, we are and will continue to incur significant levels of legal, accounting and other expenses that we did not incur as a wholly-owned subsidiary of White Mountains. The U.S. Sarbanes-Oxley Act of 2002, particularly Section 404, and related rules of the U.S. Securities and Exchange Commission and the New York Stock Exchange, regulate corporate governance practices of public companies. We are experiencing and will continue to experience increased costs and time to remain in compliance with these public company requirements than we have in the past when we were wholly-owned by White Mountains. While we have spent considerable time and resources assisting our public parent in complying with public company regulations, we are and will continue to incur all expenses ourselves going forward. Furthermore, the cost of compliance, while not material to White Mountains on a consolidated basis, could be material to us because of our smaller size and scale of operations.

***Our written premiums are heavily concentrated in the Northeastern United States.***

Our revenues and profitability for the foreseeable future will be substantially impacted by prevailing regulatory, economic, demographic, competitive, weather and other conditions in the Northeastern United States. Changes in any of these conditions could make it more costly or more difficult to conduct our business. We are particularly exposed to Northeast windstorm risks. In 2007, 56% of our direct written premiums were derived from our Primary Insurance Operations in New York, Massachusetts, New Jersey, Maine and Connecticut.

***Mandated market mechanisms may require us to underwrite policies with a higher risk of loss and assessments and other surcharges for guaranty funds and second-injury funds may reduce our profitability.***

We are often required to participate directly or indirectly in mandatory shared market mechanisms as a condition of our licenses to do business in certain states. These markets, which are commonly referred to as "residual" or "involuntary" markets, generally consist of risks considered to be undesirable from a standard or routine underwriting perspective. In 2007, approximately 2% of our net written premiums related to our participation in mandatory shared market mechanisms. Underwriting performance related to assigned risk plans, a form of mandated market mechanism, is typically adverse and, as a result, we are required to underwrite some policies with a higher risk of loss than we would normally accept.

Each state dictates the level of insurance coverage that is mandatorily assigned to participating insurers within these markets. Our participation in mandatory shared market mechanisms is principally concentrated in the States of Massachusetts, New Jersey and New York. In certain states, such as New York, the amount of involuntary policies we are obligated to write in a given year is based on our historical market share of all voluntary policies written within that state. The share of involuntary written premium for policies assigned by the New York Automobile Insurance Plan, or NYAIP, a residual insurance plan that obtains personal automobile insurance for individuals who cannot otherwise obtain insurance in the voluntary insurance market, to a particular insurer in a given year is based on the proportion of the total voluntary writings in New York two years earlier. We estimate the cost of discharging our obligation for our NYAIP assignments as of December 31, 2007 to be $5.0 million and we have recorded this estimate as a liability in our consolidated financial statements. Our participation in assigned risk plans may result in greater liabilities than we anticipate and could materially adversely affect our financial condition and results of operations.

In addition, virtually all states require insurers licensed to do business in their state to bear a portion of the loss suffered by some insureds as the result of impaired or insolvent insurance companies. These guaranty funds are funded by assessments that are expected to increase in the future as a result of recent insolvencies. Many states also have laws that established second-injury funds to provide compensation to injured employees for aggravation of a prior condition or injury which are funded by either assessments based on paid losses or premium surcharge mechanisms. The effect of these assessments and surcharges or changes in them could reduce our profitability in any given period or limit our ability to grow our business.

***Cyclicality of the property and casualty insurance industry may cause fluctuations in our results of operations and financial condition.***

The property and casualty insurance business, especially the commercial lines business, has been historically characterized by periods of intense price competition, which could have an adverse effect on our results of operations and financial condition. Periods of intense price competition historically have alternated with periods when shortages of underwriting capacity have permitted attractive premium levels. Any significant decrease in the rates we can charge for property and casualty insurance would adversely affect our results. In the late 1990s, the property and casualty insurance industry experienced a prolonged period of downward pressure on prices caused by excess underwriting capacity and intense competition. Although premium rates we achieved during 2004 and 2005 were significantly improved over those achieved in prior years, an increase in competitive factors resulting from additional capital entering the property and casualty insurance market may cause current favorable pricing trends to reverse.

Our personal lines business is particularly affected by the cyclicality of loss cost trends. Factors that affect loss cost trends in automobile underwriting include inflation in the cost of automobile repairs, medical care, litigation of liability claims, improved automobile safety features, legislative changes and general economic conditions. Factors that affect loss cost trends in homeowners underwriting include inflation in the cost of building materials and labor costs and demand caused by weather-related catastrophes. Personal lines insurers, including us, are generally unable to increase premium rates until some time after the costs associated with the coverage have increased, primarily as a result of state insurance regulation laws. Therefore, in a period of increasing loss costs, profit margins decline.

We expect to continue to experience the effects of this cyclicality which, during down periods, could materially adversely affect our financial condition and results of operations.

***We may need additional capital in the future, which may not be available to us or available to us on favorable terms. Raising additional capital could dilute your ownership in our company and may cause the market price of our common shares to fall.***

We may need to raise additional funds through public or private debt or equity financings in order to:

- fund liquidity needs;
- replace capital lost in the event of a catastrophe or adverse reserve development;
- refinance $700 million aggregate principal amount of our senior notes;
- satisfy letter of credit or guarantee bond requirements that may be imposed by our clients or by regulators;
- acquire new businesses or invest in existing businesses;
- expand our business into new regions and countries; or
- otherwise respond to competitive pressures.

Any additional capital raised through the sale of equity will dilute your ownership percentage in our company and may decrease the market price of our common shares. Furthermore, the securities may have rights, preferences and privileges that are senior or otherwise superior to those of our common shares. Any additional financing we may need may not be available on terms favorable to us, or at all.

**Risks Relating to Our Relationship with White Mountains**

***Control of us by White Mountains and the holding of White Mountains shares by some of our directors and officers may result in conflicts of interest.***

White Mountains beneficially owns all of our Class B common shares, representing 96.4% of the voting power of our voting securities and 72.9% of our total equity. As long as White Mountains owns shares of our common shares representing more than 50% of the voting power of our outstanding voting securities, White Mountains will generally be able to determine the outcome of all corporate actions requiring shareholder approval, including the election of directors. Furthermore, we are relying on the "controlled company" exemption under the rules of the New York Stock Exchange, and are therefore not required to have a majority of independent directors on our Board. Of the eleven directors that we have on our Board, seven are current or former employees, directors or officers of White Mountains. White Mountains also has control over the adoption or amendment of provisions in our memorandum of association or bye-laws and the approval of amalgamations, mergers, and other significant corporate transactions. Furthermore, White Mountains will continue to be able to exercise this control as long as their economic equity ownership in us is at least 20%. These factors also may delay or prevent a change in the management or voting control of us.

Also, at some time in the future, White Mountains may sell all or a portion of its ownership interest in us or may make a tax-free distribution to its shareholders of all or a portion of that interest.

Questions relating to conflicts of interest may arise between us and White Mountains in a number of areas relating to our past and ongoing relationships. Certain of our directors and a number of our executive officers may own substantial amounts of White Mountains stock and may also be directors or officers of White Mountains from time to time. Their ownership of White Mountains stock and these other relationships could create, or appear to create, potential conflicts of interest when these individuals are faced with decisions that could have different implications for us and White Mountains.

These potential conflicts could arise, for example, over matters such as the desirability of an acquisition opportunity, employee retention or recruiting, or our dividend policy.

***White Mountains may compete with us and the involvement of those individuals who are directors and officers of White Mountains and directors of ours in resolving matters relating to such competition will not constitute a breach of fiduciary duty to us.***

Our bye-laws provide that White Mountains will have no obligation to refrain from:

- engaging in the same or similar business activities or lines of business as we do; or
- doing business with any of our clients or customers.

Because White Mountains may currently or in the future engage in the same activities in which we engage, we may be in direct competition with White Mountains. While White Mountains has indicated to us that its current expectation is to manage its activities such that opportunities to acquire specialty businesses will be pursued through OneBeacon, White Mountains is not legally obligated to do so and could in the future manage its activities in a different way. Due to the resources of White Mountains, including financial resources, name recognition and knowledge of our strengths, weaknesses and business practices, White Mountains could have a competitive advantage over us should it decide to engage in the type of business we conduct, which may have a material adverse effect on our operations and financial condition. The corporate opportunity policy included in our bye-laws addresses potential conflicts of interest between us, on the one hand, and White Mountains and its officers and directors who are also our directors, on the other hand. These provisions are designed to resolve conflicts between us and White Mountains. Under our bye-laws, it is not a breach of fiduciary duty on the part of any of our officers and directors by reason of their participation in any of the above described activities.

***Transitional and other arrangements with White Mountains may not be on arm's length terms.***

In connection with the initial public offering, we entered into certain contractual arrangements with White Mountains and its affiliates. These agreements were made in the context of a parent-subsidiary relationship. For example, some of our investments are managed pursuant to an investment management agreement on a discretionary basis by a registered investment adviser which is owned by White Mountains. We have a multi-year investment management contract with this adviser. While we are satisfied with the terms of such arrangement, we cannot confirm that such terms are as favorable to us as they might have been had we contracted with an independent advisor. On the other hand, after the expiration of this agreement, we may not be able to replace these investment services in a timely manner or on terms and conditions, including cost, that are comparable to those we receive from White Mountains, and we may have to pay higher prices for similar services from unaffiliated third parties. For more information on these and other arrangements with White Mountains, see Note 18 "Related Party Disclosures" of the accompanying consolidated financial statements.

***Refinancing of our senior notes may occur on unfavorable terms.***

In connection with the initial public offering, we entered into an agreement with White Mountains pursuant to which White Mountains guarantees the senior notes of our subsidiary, Fund American, for a specified fee in the amount of 25 basis points per annum on the outstanding principal amount of the senior notes. We further agreed that if White Mountains' voting interest in our common shares ceases to represent more than 50% of all our voting securities, we will seek to redeem, exchange or otherwise modify the senior notes in order to fully and permanently eliminate White Mountains' obligations under its guarantee. White Mountains and its subsidiaries beneficially own all of our outstanding Class B common shares, representing 96.4% of the voting power of our voting securities. If we have not successfully eliminated the guarantee within 180 days upon notice of the triggering of the voting interest condition, the guarantee fee will increase by 200 basis points. The guarantee fee will further increase by 100 basis points for each subsequent 90 day period thereafter, up to a maximum guarantee fee of 425 basis points, until White Mountains' obligations under its guarantee have been extinguished. This arrangement could require us to devote significant time and expense trying to refinance the senior notes and we may not be able to do so on commercially reasonable terms or at all. For more information on these and other arrangements with White Mountains, see Note 18 "Related Party Disclosures" of the accompanying consolidated financial statements.

**Risks That Relate to Taxes**

***We may become subject to taxes in Bermuda after 2016.***

We may become subject to taxes in Bermuda after 2016. We have received a standard assurance from the Bermuda Minister of Finance, under Bermuda's Exempted Undertakings Tax Protection Act 1966, that if any legislation is enacted in Bermuda that would impose tax computed on profits or income, or computed on any capital asset, gain or appreciation, or any tax in the nature of estate duty or inheritance tax, then the imposition of any such tax will not be applicable to us or to any of our operations or our shares, debentures or other obligations until March 28, 2016. Given the limited duration of the Minister of Finance's assurance, we cannot be certain that we will not be subject to any Bermuda tax after March 28, 2016. In the event that we become subject to any Bermuda tax after such date, it would have a material adverse effect on our financial condition and results of operations.

***Changes in tax laws or tax treaties may cause more of the income of certain non-U.S. companies in our group to become subject to taxes in the United States.***

The taxable income of our U.S. subsidiaries is subject to U.S. Federal, state and local income tax and other taxes. The income of the non-U.S. companies in our group is generally not subject to tax in the United States other than withholding taxes on interest and dividends. Certain of our non-U.S. companies are eligible for the benefits of tax treaties between the United States and other countries. We believe our non-U.S. companies will continue to be eligible for treaty benefits. However, it is possible that factual changes or changes to U.S. tax laws or changes to tax treaties that presently apply to our non-U.S. companies could impact income subject to tax in the United States. Similarly, changes to the applicable tax laws, treaties or regulations of other countries could subject the income of members of our group to higher rates of tax outside the United States.

## ITEM 1B. UNRESOLVED STAFF COMMENTS

As of the date of this report, we had no unresolved written comments from the Commission staff regarding its periodic or current reports under the Exchange Act.

## ITEM 2. PROPERTIES

Our headquarters are located at the Bank of Butterfield Building, 42 Reid Street, 6th Floor, Hamilton HM 12, Bermuda. Our U.S. headquarters are located at 1 Beacon Lane, Canton, Massachusetts 02021, our principal executive office is located at 601 Carlson Parkway, Minnetonka, Minnesota 55305 and our registered office is located at Clarendon House, 2 Church Street, Hamilton HM 11, Bermuda. We also maintain branch offices in various cities throughout the United States. Our U.S. headquarters is owned by us. Our headquarters, principal executive office and our branch offices are leased. Management considers our office facilities suitable and adequate for our current level of operations.

## ITEM 3. LEGAL PROCEEDINGS

OneBeacon, and the insurance industry in general, is subject to litigation and arbitration in the normal course of business. Other than those items listed below, we are not a party to any material litigation or arbitration other than as routinely encountered in claims activity, none of which is expected by management to have a material adverse effect on our financial condition and/or cash flows.

In August 2004, OneBeacon asserted claims against Liberty Mutual in the Court of Common Pleas in Philadelphia, Pennsylvania (the Court) for breach of contract and negligence with respect to agreements with Liberty Mutual (the Liberty Agreements). The portion of the contract claim relating to OneBeacon Insurance Company (OBIC) was submitted to arbitration and the Court stayed the remaining claims, including OneBeacon's claims on behalf of its other insurance subsidiaries that were signatories to the Liberty Agreements, pending resolution of the arbitration. In August 2007, the arbitration panel issued an award in favor of OneBeacon on the portion of the breach of contract claim submitted to it finding that Liberty Mutual breached the Liberty Agreements. The panel awarded OneBeacon $4.5 million plus interest.

Subsequent to the award, in September 2007, Liberty Mutual filed petitions in the U.S. District Court for the District of Massachusetts (USDC) and the Court to vacate the arbitral award and dismiss or arbitrate the remaining Court claims. In October 2007, OneBeacon (on behalf of its other insurance subsidiaries that were signatories to the Liberty Agreements) filed suit against Liberty Mutual in Suffolk County Superior Court in Massachusetts to recover damages caused by Liberty Mutual's claims conduct. Concurrently, a demand for arbitration was served on Liberty Mutual to preserve the rights and interests of OneBeacon (on behalf of the same subsidiaries). In December 2007, the Court confirmed the arbitral award. Liberty Mutual has appealed the Court's confirmation of the award to the Pennsylvania Superior Court. Liberty Mutual's motion to vacate the award is still pending in USDC. Resolution of the outstanding motions is expected in the near future.

In January 2005 Liberty Mutual initiated arbitration against OneBeacon (the ULAE Arbitration) seeking payment of approximately $67 million relating to claims-related services under the Liberty Agreements. In September 2006, OneBeacon initiated an arbitration against Liberty Mutual (the Reinsurance Arbitration) seeking payment of approximately $57 million relating to reinsurance arrangements under the Liberty Agreements. In January 2007, the Reinsurance Arbitration was consolidated into the ULAE Arbitration. In July 2007, the reinsurance payment issues in the Reinsurance Arbitration were favorably resolved. Arbitration hearings regarding ULAE issues and damages related thereto are scheduled to occur in the second quarter and third quarters of 2008, respectively.

As of December 31, 2007, OneBeacon believes its loss and LAE reserves are sufficient to cover reasonably anticipated outcomes of all disputes with Liberty Mutual.

## ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

There were no matters submitted to a vote of the Company's shareholders during the fourth quarter of 2007.

**Executive Officers of the Registrant and its Subsidiaries as of February 28, 2008:**

| Name | Age | Position(s) |
|---|---|---|
| T. Michael Miller | 49 | Director, President and Chief Executive Officer |
| Paul H. McDonough | 43 | Vice President and Chief Financial Officer |
| Ann Marie Andrews | 35 | Chief Accounting Officer |
| Alexander C. Archimedes | 56 | Senior Vice President, OneBeacon Insurance Company |
| Andrew C. Carnase | 43 | Senior Vice President, OneBeacon Insurance Company |
| Jane E. Freedman | 39 | Secretary |
| Kevin J. Rehnberg | 44 | Senior Vice President, OneBeacon Insurance Company |
| Bradford W. Rich | 60 | Senior Vice President & General Counsel |

Set forth below is information concerning our directors and executive officers as of the date of this filing:

T. Michael Miller became a director and President and CEO of OneBeacon in August 2006 and was elected President and CEO of OneBeacon Insurance Group LLC, or OB LLC, in July 2005 and joined OB LLC as its Chief Operating Officer in April 2005. Prior to joining OneBeacon, Mr. Miller spent 10 years at St. Paul Travelers, most recently as Co-Chief Operating Officer. Prior to joining St. Paul Travelers, Mr. Miller spent 14 years with The Chubb Corporation.

Paul H. McDonough was elected CFO of OneBeacon in August 2006 and was elected CFO of OB LLC in December 2005. Mr. McDonough previously served as Executive Vice President and CFO for BJ's Wholesale Club in 2005, and served as Treasurer for St. Paul Travelers, where he worked from 1999-2004. Prior to joining St. Paul Travelers, Mr. McDonough served in finance roles with Sears and with Chevron.

Ann Marie Andrews became Chief Accounting Officer of OneBeacon in October 2006. Prior thereto, Ms. Andrews served in various financial roles of increasing responsibility at OneBeacon, most recently as controller of OB LLC. Prior to joining OneBeacon in July 2002, she was with Arthur Andersen LLP.

Alexander C. Archimedes became Senior Vice President of OBIC in September 2002 after joining OneBeacon Insurance Company in January 2002. Mr. Archimedes was previously employed by Fireman's Fund Insurance Company for 16 years and most recently served as President and CEO of Parkway Insurance Company (a Fireman's Fund subsidiary) from 1993 to 2001. Prior to joining Fireman's Fund, Mr. Archimedes spent 9 years at Colonial Penn Insurance Company in various field and operational roles.

Andrew C. Carnase became Senior Vice President of OBIC in 2002. Mr. Carnase previously served as Senior Vice President at The Chubb Corporation where he worked in various underwriting management positions from 1987 to 2002.

Jane E. Freedman became Secretary of OneBeacon in November 2007. She joined OneBeacon in November 2006 as Associate General Counsel. Prior to joining OneBeacon, she served as Senior Counsel at Raytheon Company for 5 years. Prior to joining Raytheon, she was in private practice at Hinckley, Allen & Snyder LLP.

Kevin J. Rehnberg became Senior Vice President of OBIC in 2005. Mr. Rehnberg previously served as Senior Vice President, Specialty Commercial at St. Paul Travelers where he worked from 1997-2005. Prior to joining The St. Paul Companies Mr. Rehnberg served in underwriting management roles for 2 years with Liberty Mutual Insurance Company and for 9 years with The Chubb Corporation.

Bradford W. Rich became Senior Vice President and General Counsel of OneBeacon in September 2007. Mr. Rich previously served as General Counsel of USAA and ACE Ltd. He began his legal career as an assistant staff judge advocate in the United States Air Force, after serving as a staff assistant to the President of the United States.

**PART II**

**ITEM 5. MARKET FOR THE COMPANY'S COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

The common shares of OneBeacon are listed and traded on the New York Stock Exchange (Symbol: OB). Our Class A common shares began trading on November 9, 2006. Prior to such date, there was no established public trading market for our common shares. We also have Class B common shares that are not listed for trading, all of which are held by White Mountains. There is no public market for this class of securities. The closing price per share of the Class A common shares on the New York Stock Exchange on February 27, 2008 was $21.73. As of February 27, 2008, the 25,719,656 outstanding Class A common shares were held by 12 holders of record. During 2007, we paid a quarterly dividend of $0.21 per common share, or $83.7 million total. On February 4, 2008, the Board declared a $2.03 per common share special dividend, payable on March 26, 2008 to shareholders of record on March 17, 2008. On February 27, 2008, the Board declared a dividend of $0.21 per common share, payable on March 26, 2008 to shareholders of record on March 17, 2008. See "Management's Discussion and Analysis of Financial Condition and Results of Operations Dividend Capacity". Subject to the approval of the Board, the Company anticipates paying a quarterly dividend of $0.21 per common share.

The following table presents the range of share prices for our Class A common shares for the periods indicated, and the quarterly dividends declared per share:

| | Three months ended, | | | |
|---|---|---|---|---|
| | **March 31,** | **June 30,** | **September 30,** | **December 31,** |
| **2007** | | | | |
| Common share price: | | | | |
| High | $ 28.24 | $ 26.46 | $ 25.50 | $ 22.20 |
| Low | $ 24.70 | $ 23.71 | $ 20.15 | $ 20.22 |
| Dividends declared | $ 0.21 | $ 0.21 | $ 0.21 | $ 0.21 |
| | | | | |
| **2006(1)** | | | | |
| Common share price: | | | | |
| High | $ | $ | $ | $ 28.15 |
| Low | $ | $ | $ | $ 26.01 |
| Dividends declared | $ | $ | $ | $ |

(1) The 2006 period only includes the range of share prices for our Class A common shares for the period from November 9, 2006, the date our Class A common shares commenced trading on the New York Stock Exchange, through December 31, 2006.

OneBeacon was acquired by White Mountains from Aviva in 2001. White Mountains is a holding company whose businesses provide property and casualty insurance, reinsurance and certain other products. During the fourth quarter of 2006, White Mountains sold 27.6 million or 27.6% of the Company's Class A common shares in an initial public offering. Prior to the initial public offering, OneBeacon was a wholly-owned subsidiary of White Mountains. As of December 31, 2007, White Mountains owned 72.9% of our common shares.

For information on securities authorized for issuance under the Company's equity compensation plans, see "Item 12 Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters."

**Purchases of Equity Securities by the Issuer**

On August 22, 2007, the Company's Board authorized us to repurchase up to $200.0 million of our Class A common shares from time to time, subject to market conditions. Shares may be repurchased on the open market or through privately negotiated transactions. This program does not have a stated expiration date. As of December 31, 2007, 1.6 million Class A common shares were repurchased for $33.0 million and retired.

The following table includes information regarding repurchases by us of our Class A common shares during the periods indicated. All repurchased shares were retired.

| | Total Number of Shares Repurchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plan | Approximate Dollar Value of Shares That May Yet Be Purchased Under the Plan |
|---|---|---|---|---|
| September 1 30, 2007 | 274,244 | $ 20.76 | 274,244 | $ 194,307,548 |
| October 1 31, 2007 | 247,304 | $ 21.09 | 247,304 | $ 189,090,868 |
| November 1 30, 2007 | 605,563 | $ 21.50 | 605,563 | $ 176,072,329 |
| December 1 31, 2007 | 429,860 | $ 21.22 | 429,860 | $ 166,950,875 |
| Total | 1,556,971 | $ 21.23 | 1,556,971 | $ 166,950,875 |

**Stock Performance Graph**

The following chart compares the total return on a cumulative basis of $100 invested in our Class A common shares on November 9, 2006, the date our shares commenced trading on the New York Stock Exchange, to the Standard & Poor's 500 Stock Index and the Standard & Poor's Property and Casualty Insurance Index.

**ITEM 6. SELECTED FINANCIAL DATA**

The following tables set forth our selected consolidated financial information for the dates indicated. We have derived the selected consolidated financial information presented below as of and for the years ended December 31, 2007, 2006, 2005, 2004 and 2003 from our consolidated financial statements, which have been prepared in accordance with GAAP. The consolidated financial statements as of December 31, 2007 and 2006 and for the years ended December 31, 2007, 2006, 2005 and 2004 have been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm. The consolidated financial statements as of December 31, 2003 are unaudited.

| | Year ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2007 | 2006 | 2005 | 2004 | 2003 |
| | (in millions, except per share amounts) | | | | |
| **Summary Income Statement Data:** | | | | | |
| Net written premiums | $ 1,864.4 | $ 2,007.0 | $ 2,095.6 | $ 2,164.7 | $ 1,803.5 |
| **Revenues** | | | | | |
| Earned premiums | $ 1,873.6 | $ 2,075.9 | $ 2,012.7 | $ 2,087.1 | $ 1,992.4 |
| Net investment income | 208.5 | 191.8 | 236.8 | 209.6 | 210.9 |
| Net realized investment gains | 173.7 | 163.6 | 123.2 | 128.8 | 115.9 |
| Net other revenues | 17.2 | 38.8 | 24.1 | 59.5 | 98.7 |
| Total revenues | 2,273.0 | 2,470.1 | 2,396.8 | 2,485.0 | 2,417.9 |
| **Expenses** | | | | | |
| Loss and LAE | 1,089.8 | 1,283.6 | 1,390.4 | 1,385.4 | 1,364.2 |
| Policy acquisition expenses and other underwriting expenses | 648.3 | 740.0 | 612.7 | 709.8 | 596.8 |
| General and administrative expenses | 9.8 | 15.3 | 8.4 | 81.9 | 37.7 |
| Accretion of fair value adjustment to loss and LAE reserves(1) | 16.0 | 23.0 | 26.0 | 33.2 | 48.6 |
| Interest expense(2) | 110.6 | 104.1 | 96.5 | 92.6 | 68.9 |
| Total expenses | 1,874.5 | 2,166.0 | 2,134.0 | 2,302.9 | 2,116.2 |
| **Pre-tax earnings from continuing operations** | 398.5 | 304.1 | 262.8 | 182.1 | 301.7 |
| Income tax provision | (147.9) | (68.9) | (82.1) | (49.4) | (103.3) |
| **Net income from continuing operations before equity in earnings of unconsolidated affiliate** | 250.6 | 235.2 | 180.7 | 132.7 | 198.4 |
| Dividends and accretion on subsidiary preferred stock to face value(2) | | | | | (21.5) |
| Equity in earnings of unconsolidated affiliate | | 10.3 | 5.6 | 27.4 | 57.5 |
| **Net income from continuing operations** | 250.6 | 245.5 | 186.3 | 160.1 | 234.4 |
| Net income (loss) from discontinued operations | | 1.2 | 25.2 | (24.1) | 19.2 |
| Gain from sale of discontinued operations, net of tax | | | 21.1 | | |
| **Net income** | 250.6 | 246.7 | 232.6 | 136.0 | 253.6 |
| Other comprehensive (loss) income | (5.8) | 29.0 | (144.8) | 84.3 | 73.6 |
| **Comprehensive net income** | $ 244.8 | $ 275.7 | $ 87.8 | $ 220.3 | $ 327.2 |

| | Year ended December 31, | | | | |
|---|---|---|---|---|---|
| Earnings per share: | | | | | |
| Net income from continuing operations | | | | | |
| Basic | $ 2.51 | $ 2.46 | $ 1.86 | $ 1.60 | $ 2.34 |
| Diluted | $ 2.51 | $ 2.46 | $ 1.86 | $ 1.60 | $ 2.32 |
| Net income | | | | | |
| Basic | $ 2.51 | $ 2.47 | $ 2.33 | $ 1.36 | $ 2.54 |
| Diluted | $ 2.51 | $ 2.47 | $ 2.33 | $ 1.36 | $ 2.51 |
| Weighted average number of shares outstanding | 99.8 45 | 100.0 | 100.0 | 100.0 | 100.0 |

| | Year ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2007 | 2006 | 2005 | 2004 | 2003 |
| | (in millions) | | | | |
| **Selected Ratios (Based on GAAP Income Statement Data):** | | | | | |
| ***Consolidated*** | | | | | |
| Loss and LAE ratio(3) | 58.2% | 61.8% | 69.1% | 66.4% | 68.5% |
| Expense ratio(4) | 34.6 | 35.6 | 30.4 | 34.0 | 30.0 |
| Combined ratio(5) | 92.8% | 97.4% | 99.5% | 100.4% | 98.5% |
| ***Primary Insurance Operations*** | | | | | |
| Loss and LAE ratio(3) | 58.2% | 60.7% | 67.2% | 65.7% | 68.5% |
| Expense ratio(4) | 34.6 | 35.6 | 31.4 | 34.2 | 30.0 |
| Combined ratio(6) | 92.8% | 96.3% | 98.6% | 99.9% | 98.5% |
| **Summary Balance Sheet Data:** | | | | | |
| Total cash and investments | $ 5,218.9 | $ 5,254.2 | $ 4,808.6 | $ 5,209.6 | $ 5,395.5 |
| Total assets | 9,541.5 | 9,869.4 | 10,252.7 | 9,954.0 | 15,233.9 |
| Loss and LAE reserves | 4,480.3 | 4,837.7 | 5,354.3 | 4,922.2 | 5,695.9 |
| Unearned premiums | 1,005.9 | 985.2 | 1,042.8 | 1,001.4 | 941.0 |
| Debt | 757.7 | 759.5 | 744.9 | 726.3 | 706.1 |
| Intercompany debt payable | | | | 1,000.0(7) | |
| Preferred stock subject to mandatory redemption | 278.4 | 262.3 | 234.0 | 211.9 | 194.5 |
| Common shareholders' equity | 1,906.5 | 1,777.2 | 1,560.0(7) | 417.5(7) | 2,804.1(7) |

(1) In connection with purchase accounting for our acquisition by White Mountains, which we refer to as the OneBeacon Acquisition, we were required to adjust to fair value our loss and LAE reserves and the related reinsurance recoverables by $646.9 million and $346.9 million, respectively, on our balance sheet as of June 1, 2001. This net charge to loss and LAE reserves of $300.0 million is being accreted through an income statement charge ratably with and over the period the claims are settled.

(2) In accordance with our adoption of Statement of Financial Accounting Standards (SFAS) No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity" or SFAS 150, beginning in the third quarter of 2003, we began presenting all accretion and dividends on preferred stock subject to mandatory redemption as interest expense.

(3) The loss and LAE ratio is calculated by dividing loss and LAE, which includes long-term compensation expense, by earned premiums.

(4) The expense ratio is calculated by dividing policy acquisition expenses and other underwriting expenses, which includes long-term compensation expense, by earned premiums.

(5) The combined ratio is the sum of the loss and LAE ratio and the expense ratio, including long-term incentive compensation expense. Long-term incentive compensation expense increased our consolidated combined ratio by 1.6 points, 2.1 points, 1.8 points, 5.3 points and 4.2 points for the years ended December 31, 2007, 2006, 2005, 2004 and 2003, respectively.

(6) Includes our long-term incentive compensation expense. Long-term incentive compensation expense increased our combined ratio for the Primary Insurance Operations by 1.6 points, 2.3 points, 1.8 points, 5.0 points and 4.2 points for the years ended December 31, 2007, 2006, 2005, 2004 and 2003, respectively.

(7)

As part of a corporate reorganization at White Mountains during 2004, we distributed our interest in several wholly-owned subsidiaries to White Mountains. The distribution of Folksamerica Holdings, Inc. and its subsidiaries, as well as $270.0 million in intercompany notes receivable from another affiliate of White Mountains, resulted in a $1.3 billion reduction in common shareholders' equity. In addition, the distribution of WM Asset Management (Barbados) Ltd., which held, among other things, $1.0 billion of notes receivable from OneBeacon, resulted in a $1.1 billion reduction in shareholders' equity in December 2004. During the first quarter of 2005, White Mountains contributed the $1.0 billion of intercompany notes receivable back to OneBeacon, resulting in a $1.0 billion increase to common shareholders' equity in 2005.

## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

*The following discussion contains "forward-looking statements." Statements that are not historical in nature are forward-looking statements. OneBeacon cannot promise that our expectations in such forward-looking statements will turn out to be correct. OneBeacon's actual results could be materially different from and worse than our expectations. See "Forward-Looking Statements" on page 98 for specific important factors that could cause actual results to differ materially from those contained in forward-looking statements.*

*The following discussion also includes five non-GAAP financial measures, adjusted book value per common share, adjusted book value per common share, including dividends, adjusted common shareholders' equity, adjusted common shareholders' equity, including dividends and loss and loss adjustment expenses ratio prior to reserve reallocation and total combined ratio prior to reserve reallocation that have been reconciled to their most comparable GAAP financial measures (see below and pages 59 and 70). OneBeacon believes these measures to be useful supplements to the comparable GAAP measures in evaluating OneBeacon's financial performance.*

**Adjusted Book Value Per Common Share for the Year Ended December 31, 2007**

We ended the full year 2007 with an adjusted book value per share of $19.14 reflecting a 16.2% increase for the full year 2007, including dividends. The following table presents our adjusted book value per common share and adjusted book value per common share, including dividends, and reconciles these non-GAAP financial measures to their most comparable GAAP measure.

| | As of December 31, | | |
|---|---|---|---|
| | **2007** | **2006** | **2005** |
| **Numerator** | | | |
| Common shareholders' equity | **$ 1,906.5** | $ 1,777.2 | $ 1,560.0 |
| Remaining adjustment of subsidiary preferred stock to face value | **(21.6)** | (57.7) | (86.0) |
| Adjusted common shareholders' equity(1) | **$ 1,884.9** | $ 1,719.5 | $ 1,474.0 |
| Dividends(2) | **83.7** | 0.0 | 0.0 |
| Adjusted common shareholders' equity, including dividends(1)(2) | **$ 1,968.6** | $ 1,719.5 | $ 1,474.0 |
| **Denominator** | | | |
| Common shares outstanding(3)(4) | **98.5** | 100.0 | 100.0 |
| **Book value per common share** | **$ 19.36** | $ 17.77 | $ 15.60 |
| **Adjusted book value per common share(1)** | **$ 19.14** | $ 17.20 | $ 14.74 |
| **Adjusted book value per common share, including dividends(1)(2)** | **$ 19.99** | $ 17.20 | $ 14.74 |

(1) Represents a non-GAAP financial measure.

(2) Includes dividends of $0.21 per common share paid quarterly beginning in March 2007.

(3) On October 18, 2006, the Company executed a stock split and recapitalization that increased the common shares outstanding from 12,000 to 100 million and reduced the par value from $1.00 to $0.01. The stock split and recapitalization have been reflected retroactively in these financial statements for the 2005 period presented.

(4)

Includes the impact of repurchases of Class A common shares made through the Company's share repurchase program which commenced in the third quarter of 2007.

**Overview**

OneBeacon is a property and casualty insurance writer that provides a range of specialty insurance products as well as a variety of segmented commercial and personal insurance products. With roots dating back to 1831, we have been operating for more than 175 years and have many long-standing relationships with independent agencies, which constitute our primary distribution channel. We consist of a group of operating companies which are U.S.-based property and casualty insurance writers, substantially all of which operate in a multi-company pool. Pooling arrangements permit the participating companies to rely on the capacity of the entire pool's capital and surplus rather than just on its own capital and surplus. Under such arrangements, the members share substantially all insurance business that is written, and allocate the combined premiums, losses and expenses. In 2007, our net written premiums totaled $1.9 billion and we had total assets of $9.5 billion and total common shareholders' equity of $1.9 billion at December 31, 2007.

***Our Historical Consolidated Financial Information***

Prior to our initial public offering, we consolidated certain other businesses for GAAP financial reporting and U.S. tax purposes that are no longer held by us (the Internal Reorganization). These other businesses are therefore reflected in our historical consolidated financial statements in this report as discontinued operations. Furthermore, on August 24, 2006, we exchanged our investment in the common shares of Montpelier Re Holdings, Ltd. (Montpelier), for an agreed-upon portfolio of common equity and fixed maturity securities of equal value owned by White Mountains. (See "Management's Discussion and Analysis of Financial Condition and Results of Operations Montpelier Investment.") In the fourth quarter of 2006, we commuted our two quota share reinsurance arrangements with other subsidiaries of White Mountains.

***Our Segments***

OneBeacon's reportable segments are Primary Insurance Operations, Affiliate Quota Shares and Other Operations.

*Primary Insurance Operations.* Our Primary Insurance Operations segment includes the results of substantially all of our insurance operations, with the exception of certain quota share arrangements with affiliates of White Mountains as described below. Our Primary Insurance Operations segment also includes run-off business which primarily consists of national accounts, certain specialty programs and regional agency business transferred to Liberty Mutual effective November 1, 2001. See "Business Run-off".

In the fourth quarter of 2006, we began to include OBSP within commercial lines and AutoOne within personal lines. Both OBSP and AutoOne were formerly reported in specialty lines. The reporting change was undertaken to better align the reported results of our underwriting units with their product and management structure. Prior periods have been reclassified to conform to the current presentation.

*Affiliate Quota Shares.* During 2004 and 2005, we entered into two quota share reinsurance arrangements with other subsidiaries of White Mountains, primarily for White Mountains' capital management purposes. Under the Sirius Quota Share, we ceded between 6% and 12% of business written, effective April 1, 2004, to Sirius. Under the Esurance Quota Share, which was effective on January 1, 2005, we assumed approximately 85% of business written by Esurance, which includes business written by its wholly-owned subsidiary. These agreements were commuted in the fourth quarter of 2006 in connection with our initial public offering.

*Other Operations.* Our Other Operations segment consists of the activities of our top holding company, OneBeacon Insurance Group, Ltd. and our intermediate holding and finance companies.

***Revenues***

We account for insurance policies that we write in accordance with SFAS No. 60, "Accounting and Reporting by Insurance Enterprises," or SFAS 60. Premiums written are recognized as revenues and are earned ratably over the term of the related policy. Unearned premiums represent the portion of premiums written that are applicable to future insurance coverage provided by policies. AutoOne, one of our subsidiaries, which acts as a LAD servicing carrier, enters into contractual arrangements with insurance companies to assume private passenger and commercial automobile assigned risk exposures in 22 states. AutoOne receives LAD and CLAD servicing fees from these other companies for assuming these risks. In addition, AutoOne chooses to write certain policies voluntarily by taking risks out of the NYAIP. These policies generate takeout credits which can be sold for fees, which we refer to as take-out fees, to other carriers. These other carriers in turn can use such credits to reduce their obligations to write assigned risk business. AutoOne's LAD and CLAD servicing and take-out fees are recorded as written premium when billed and are earned ratably over the term of the related policy to which the fee relates.

***Deferred Acquisition Costs***

Deferred acquisition costs represent commissions, premium taxes, brokerage expenses and other costs that are directly attributable to and vary with the production of new business. These costs are deferred and amortized over the applicable premium recognition period. Deferred acquisition costs are limited to the amount expected to be recovered from future earned premiums and anticipated investment income.

***Loss and Loss Adjustment Expenses***

Loss and loss adjustment expenses, or LAE, are charged against income as incurred. Unpaid loss and LAE reserves are based on estimates (generally determined by claims adjusters, legal counsel and actuarial staff) of the ultimate costs of settling claims, including the effects of inflation and other societal and economic factors. Unpaid loss and LAE reserves represent management's best estimate of ultimate loss and LAE, net of estimated salvage and subrogation recoveries, if applicable. Such estimates are reviewed and updated on a quarterly basis and any adjustments resulting therefrom are reflected in current operations. The process of estimating loss and LAE involves a considerable degree of judgment by management and the ultimate amount of expense to be incurred could be considerably greater than or less than the amounts currently reflected in the consolidated financial statements.

***Reinsurance***

Our insurance subsidiaries enter into ceded reinsurance contracts from time to time to protect their businesses from losses due to concentration of risk and to limit losses arising from catastrophic events. The majority of such reinsurance contracts are executed through excess-of-loss treaties and catastrophe contracts under which a third party reinsurer indemnifies our insurance subsidiaries for a specified part or all of certain types of losses over stipulated amounts arising from any one occurrence or event. We also have entered into quota share treaties with reinsurers under which all risks meeting prescribed criteria are ceded to third party reinsurers on a pro rata basis. The amount of each risk ceded by us is subject to maximum limits that vary by line of business and type of coverage. Amounts related to reinsurance contracts are recorded in our consolidated financial statements in accordance with SFAS No. 113, "Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts," or SFAS 113, and Emerging Issues Task Force Topic No. D-54, as applicable.

Amounts recoverable from reinsurers are estimated in a manner consistent with the claim liability associated with the reinsured policies. Our ability to collect our reinsurance recoverables is subject to the solvency of the reinsurers with whom we have entered into reinsurance contracts. We are selective in regard to our reinsurers, principally placing reinsurance with those reinsurers with strong financial condition, industry ratings and underwriting ability. Management monitors the financial condition and ratings of our reinsurers on an ongoing basis.

Reinsurance premiums, commissions, expense reimbursements and reserves related to reinsured business are accounted for on a basis consistent with those used in accounting for the original policies issued and the terms of the reinsurance contracts. Premiums ceded to other companies are reported as a reduction of premiums written. Expense allowances received in connection with reinsurance ceded have been accounted for as a reduction of the related policy acquisition costs.

***Mandatorily Redeemable Preferred Stock***

OneBeacon has two classes of mandatorily redeemable preferred stock of subsidiaries. These instruments are classified as liabilities and are carried at their historical carrying values. All dividends and accretion on OneBeacon's mandatorily redeemable preferred stock have been recorded as interest expense. See Note 11 "Mandatorily Redeemable Preferred Stock of Subsidiaries" of the accompanying consolidated financial statements.

***Share-Based Compensation***

*Compensation Philosophy*

Our executive compensation policies are designed with one goal in mind, namely, the maximization of shareholder value over long periods of time. We believe that this goal is best pursued by utilizing a pay-for-performance program that serves to attract and retain superior executive talent and provide management with performance-based incentives to maximize shareholder value. Through this compensation program, we seek to maximize shareholder value by aligning closely the financial interests of management with those of our shareholders. The cost of all incentive compensation is fully accrued and expensed.

Compensation of our senior management team, including our named executive officers, consists primarily of three components: base salary, annual bonus and long-term incentive awards. Base salaries have been capped at $400,000. Annual bonus targets for all senior executives are 50% of base salary with their payout potential ranging from 0% to 200% of target depending on performance against established goals. Long-term incentives for senior executives have in the past been comprised of performance shares and/or performance units. Under these instruments, payouts are explicitly tied to White Mountains' or OneBeacon's performance over a three-year period and are highly variable (the actual number of shares/units paid out at the end of the cycle will range from 0% to 200% of target depending on performance against established goals). See Note 10 "Employee Share-Based Incentive Compensation Plans" of the accompanying consolidated financial statements.

*Share-Based Compensation Primary Insurance Operations*

**2002-2004 performance cycle**

For this cycle, the long-term incentives for employees of our Primary Insurance Operations segment were comprised solely of White Mountains performance shares, with performance objectives tied to both White Mountains and OneBeacon financial results. Accordingly, incentive compensation expense in 2004 for these operations was heavily dependent on the market price of White Mountains common shares, which rose by 41% in 2004. In the 2002-2004 performance cycle, a total of 246,325 White Mountains performance shares were earned by employees of our Primary Insurance Operations segment based on payout levels ranging from 113% to 200% of target.

**2003-2005 through 2006-2008 performance cycles**

For these cycles, OneBeacon revised the design of its long-term incentive plans principally to use OneBeacon performance units instead of White Mountains performance shares, with performance targets primarily tied to OneBeacon's adjusted combined ratio. Each unit is initially valued at $100 and compounds in value over the performance period by the underwriting return on capital achieved by OneBeacon. In the case of certain senior officers of our Primary Insurance Operations segment, a portion of their long-term incentive compensation in these periods has been denominated in White Mountains performance shares. As a result of the shift from White Mountains performance shares to OneBeacon performance units, OneBeacon's incentive compensation expense associated with these performance cycles is no longer significantly impacted by changes in the market price of White Mountains common shares. Prior to February 2007, the value of OneBeacon's performance shares was based upon the market price of an underlying White Mountains common share (WTM Performance Shares). In February 2007, all of OneBeacon's WTM Performance Shares outstanding were replaced with performance shares whose value is based upon the market price of an underlying OneBeacon common share (OB Performance Shares). As of December 31, 2007, 117,363 and 141,522 performance shares were outstanding for employees of our Primary Insurance Operations segment with respect to the 2005-2007 and 2006-2008 performance cycles, respectively.

**2007-2009 performance cycle**

In February 2007, the OneBeacon Compensation Committee of the Board approved the principal performance share goal of the Incentive Plan to be the after tax corporate return on equity as measured by growth in its intrinsic business value per share (ROE). In determining the intrinsic business value per share, the Compensation Committee has considered the growth in the adjusted book value per share and underwriting return on equity with some attention to growth in the market value per share. This proprietary measure is viewed by OneBeacon's management as being an objective and conservative measure of the value of OneBeacon's stock and includes the cost of all outstanding compensation awards. As of December 31, 2007, 826,395 performance shares were outstanding for employees of our Primary Insurance Operations segment with respect to the 2007-2009 performance cycle.

*Compensation Other Operations*

In connection with the Internal Reorganization, on August 3, 2006, all employees of our Other Operations segment became employees of White Mountains. Therefore, we will no longer incur significant compensation expense in our Other Operations segment.

*Share-Based Compensation Recognition*

Our share-based compensation plans consist of performance shares which are typically settled in cash and stock options which were granted in connection with our initial public offering. Effective January 1, 2006, we account for these share-based compensation plans in accordance with SFAS No. 123 R, "Share-Based Payment" or SFAS 123R. Compensation cost is measured and recognized based on the current market price of the underlying common shares and on the number of shares that are expected to vest. Prior to adoption of SFAS 123R, we accounted for these plans in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," or APB 25, whereby we recognized compensation cost based on the current market price of the underlying common shares and on the assumption that all shares awarded would vest. Compensation cost gave effect only to actual rather than assumed forfeitures prior to adoption of SFAS 123R.

***Purchase Accounting***

In connection with purchase accounting for the OneBeacon Acquisition, we were required to adjust to fair value our loss and LAE reserves and the related reinsurance recoverables by $646.9 million and $346.9 million, respectively, on our balance sheet as of June 1, 2001. This net change to loss and LAE reserves of $300.0 million is being accreted through an income statement charge ratably with and over the period the claims are settled. Accordingly, we recognized $16.0 million, $23.0 million and $26.0 million of such charges, recorded as loss and LAE, during 2007, 2006 and 2005, respectively. As of December 31, 2007, the outstanding pre-tax unaccreted adjustment was $17.4 million.

***Income taxes***

The income tax provision related to pre-tax earnings from continuing operations for 2007, 2006 and 2005 represented an effective tax rate of 37.1%, 22.7% and 31.2%, respectively. Our effective tax rate for 2007 was higher than the U.S. statutory rate of 35% primarily due to income generated in jurisdictions other than the United States at lower tax rates, offset by withholding taxes payable on dividends paid from income generated in the United States, and non-deductible dividends and accretion on the Berkshire Preferred Stock and Zenith Preferred Stock. Our effective tax rates for 2006 and 2005 were lower than the U.S. statutory rate of 35% primarily due to income generated in jurisdictions other than the United States, partially offset by non-deductible dividends and accretion on preferred stock subject to mandatory redemption. In addition, our effective tax rate for 2006 was lower than the U.S. statutory rate of 35% due to the settlement of the Federal income tax audits related to tax years prior to 2003 and tax benefits recognized on the exchange of our investment in MSA. Due to the redemption of the Zenith Preferred Stock in June 2007 and the redemption of the Berkshire Preferred Stock in May 2008, the impact to the effective tax rate for these items will be reduced in 2008 and will be eliminated in 2009 and subsequent years.

**Discontinued Operations**

In 2006, we sold certain consolidated subsidiaries to White Mountains at GAAP book value. We did not recognize a gain or a loss on these sales. These subsidiaries are included in discontinued operations and comprise the following entities:

***Sold in 2006:***

As part of the Internal Reorganization, we sold certain other consolidated subsidiaries to White Mountains on August 3, 2006 as follows:

White Mountains Advisors, LLC (WM Advisors) an investment management subsidiary;

White Mountains Management Company, Inc. and White Mountains Capital, Inc. both service companies;

White Mountains Services Holdings, Inc. and White Mountains Services, LLC these companies contain the remainder of mortgage banking run-off assets following the sale of substantially all the mortgage banking assets of White Mountains Services Corporation (formerly Source One Mortgage Services Corporation) to Citibank Mortgage, Inc. in 1999;

Tuckerman Capital, L.P. and Tuckerman Capital II, L.P. both private equity fund investments; and

International American Group primarily consists of American Centennial Insurance Company and British Insurance Company of Cayman, two run-off insurance companies.

On September 30, 2005, we sold NFU to QBE Insurance Group, Ltd., or QBE, for $138.3 million in cash. NFU is included in discontinued operations for all periods presented through the date of its sale. We recognized a gain of $26.2 million ($21.1 million after-tax) on the sale which is included in gain on sale of discontinued operations and is presented net of tax in the statements of consolidated income and comprehensive income.

Our income from continuing operations excludes the results of operations for the above entities for all periods presented. Net income from discontinued operations has been presented separately and is shown net of related income taxes.

Cash flows associated with the operating and investing activities of discontinued operations are aggregated and presented under separate captions in our consolidated statements of cash flows. There were no cash flows associated with financing activities for the discontinued operations.

**Other Acquisitions and Dispositions**

During the third quarter of 2007, we sold one of our inactive licensed subsidiaries, American Employers' Insurance Company (AEIC) to Sparta Insurance Holdings, Inc. (Sparta) for $47.7 million in cash, gross of sales costs, and recorded a pre-tax gain of $11.3 million through net other revenues.

During the third quarter of 2006, we sold one of our inactive licensed subsidiaries, Homeland Central Insurance Company (HCIC), to a subsidiary of White Mountains. In connection with the sale of HCIC, we recorded a $6.0 million gain as additional paid in capital.

On October 31, 2006, we restructured our investment in MSA. We received a $70 million cash dividend from MSA following which we sold our 50% common stock investment in MSA to Main Street America Group, Inc. (the MSA Group) for (i) $70.0 million in 9.0% non-voting cumulative perpetual preferred stock of the MSA Group and (ii) 4.9% of the common stock of the MSA Group. (See Note 3 "Acquisitions and Dispositions" of the accompanying consolidated financial statements.) Effective October 31, 2006, we account for our remaining investment in the MSA Group in accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities." Prior to the sale, we owned 50% of the total common shares outstanding of MSA and accounted for this investment using the equity method of accounting. These transactions resulted in a net after-tax realized gain of $8.5 million.

On September 29, 2006, we sold certain assets and the right to renew existing policies of Agri, a division of OneBeacon that provided commercial farm and ranch and commercial agricultural insurance products, for $32.0 million in cash to QBE Insurance Group, Ltd. (QBE) and recorded a pre-tax gain of $30.4 million through net other revenues in 2006. In connection with this sale, we entered into agreements under which, at the option of QBE, we will write the policies of Agri on a direct basis and cede 100% of this business to QBE.

On August 2, 2005, we sold one of our inactive licensed subsidiaries, Traders and Pacific Insurance Company (TPIC), to Endurance Reinsurance for $23.4 million in cash and recognized a gain of $8.0 million ($5.2 million after-tax) on the sale through net other revenues in 2005.

**Results of Operations**

*Review of Consolidated Results*

A summary of our consolidated financial results for the years ended December 31, 2007, 2006 and 2005 is as follows:

| | Year ended December 31, | | |
|---|---|---|---|
| | 2007 | 2006 | 2005 |
| | | ($ in millions) | |
| Net written premiums | $ 1,864.4 | $ 2,007.0 | $ 2,095.6 |
| **Revenues** | | | |
| Earned premiums | $ 1,873.6 | $ 2,075.9 | $ 2,012.7 |
| Net investment income | 208.5 | 191.8 | 236.8 |
| Net realized investment gains | 173.7 | 163.6 | 123.2 |
| Net other revenues | 17.2 | 38.8 | 24.1 |
| Total revenues | 2,273.0 | 2,470.1 | 2,396.8 |
| **Expenses** | | | |
| Loss and LAE | 1,089.8 | 1,283.6 | 1,390.4 |
| Policy acquisition expenses | 318.9 | 379.9 | 349.3 |
| Other underwriting expenses | 329.4 | 360.1 | 263.4 |
| General and administrative expenses | 9.8 | 15.3 | 8.4 |
| Accretion of fair value adjustment to loss and LAE reserves | 16.0 | 23.0 | 26.0 |
| Interest expense on debt | 45.2 | 45.5 | 44.1 |
| Interest expense dividends and accretion on preferred stock subject to mandatory redemption | 65.4 | 58.6 | 52.4 |
| Total expenses | 1,874.5 | 2,166.0 | 2,134.0 |
| **Pre-tax earnings from continuing operations** | 398.5 | 304.1 | 262.8 |
| Income tax provision | (147.9) | (68.9) | (82.1) |
| **Net income from continuing operations before equity in earnings of unconsolidated affiliate** | 250.6 | 235.2 | 180.7 |
| Equity in earnings of unconsolidated affiliate | | 10.3 | 5.6 |
| **Net income from continuing operations** | 250.6 | 245.5 | 186.3 |
| Net income from discontinued operations | | 1.2 | 25.2 |
| Gain from sale of discontinued operations | | | 21.1 |
| **Net income** | 250.6 | 246.7 | 232.6 |
| Other comprehensive (loss) income | (5.8) | 29.0 | (144.8) |
| **Comprehensive net income** | $ 244.8 | $ 275.7 | $ 87.8 |

**Consolidated Results Year ended December 31, 2007 versus year ended December 31, 2006**

Our pre-tax income from continuing operations for 2007 was $398.5 million, compared to pre-tax income from continuing operations of $304.1 million for 2006 and our GAAP combined ratio was 92.8% for 2007, compared to 97.4% for 2006.

The decrease to our GAAP combined ratio was due to decreases in both our loss and LAE ratio and expense ratio. Our 2007 results included $48.3 million or 2.6 points of favorable development on prior accident year losses due to lower than expected frequency for professional liability in specialty lines and lower than expected severity for automobile liability in personal lines partially offset by unfavorable development for multiple peril and workers compensation primarily for accident years

2001 and prior. The prior year period included $11.3 million or 0.5 points of adverse development on prior accident year losses mainly due to adverse development on catastrophe losses, primarily related to hurricanes Katrina and Wilma and two 2004 catastrophes, partially offset by favorable development on prior accident year non-catastrophe losses in specialty lines and commercial lines. Our expense ratio for 2007 decreased due to the benefit of one-time, non-recurring items including the partial settlement of our qualified pension plan liabilities and the benefit of a state premium tax refund which reduced our expense ratio by 1.0 point and 0.4 points, respectively, partially offset by 0.7 point of office consolidation costs. Our 2006 results included 3.9 points related to incentive compensation expense which was 1.0 point higher than in 2007 and 1.0 point of office consolidation costs.

Our total revenues decreased 8.0% in 2007 to $2,273.0 million, compared to $2,470.1 million in 2006, due principally to a 9.7% decrease in earned premiums in 2007. 2006 included $309.9 million of business assumed from the affiliate quota share agreement with Esurance, which was commuted in the fourth quarter of 2006, in connection with our initial public offering. Net realized investment gains increased to $173.7 million in 2007, compared with $163.6 million in 2006.

Net other revenues decreased 55.7% in 2007 to $17.2 million, compared to $38.8 million in 2006. The 2006 period included $30.4 million gain on the sale of renewal rights of Agri to QBE. Partially offsetting the Agri gain was a $12.6 million pre-tax loss on the sale of our investment in MSA. This pre-tax loss was offset by tax benefits recognized on the exchange of our investment in MSA described above. Our 2007 net other revenues included an $11.3 million gain from the sale of one of our inactive licensed insurance subsidiaries, AEIC, to Sparta.

During 2007, we reallocated reserves of our primary insurance operations from ongoing lines of business to run-off claims, particularly reserves for construction defect and workers compensation related to accident years 2001 and prior. The reallocation shifted $116.7 million of our reserves from specialty lines ($87.4 million), commercial lines ($6.0 million) and personal lines ($23.3 million) to run-off claims. This adjustment had no impact on our total 2007 combined ratio.

The income tax provision related to pre-tax income from continuing operations for the years ended December 31, 2007 and 2006 represented effective tax rates of 37.1% and 22.7%, respectively, which were higher and lower than the U.S. statutory rate of 35%, respectively. Our effective tax rate for 2007 was higher than the U.S. statutory rate of 35% primarily due to withholding taxes payable on dividends paid from income generated in the United States and non-deductible dividends and accretion on the Berkshire Preferred Stock and Zenith Preferred Stock, partially offset by income generated in jurisdictions other than the United States at lower tax rates. Our effective tax rate for 2006 was lower than the U.S. statutory rate of 35% primarily due to income generated in jurisdictions other than the United States, the settlement of Federal income tax audits related to tax years prior to 2003 and tax benefits recognized on the exchange of our investment in MSA. This was partially offset by non-deductible dividends and accretion on the Berkshire Preferred Stock and Zenith Preferred Stock.

**Consolidated Results Year ended December 31, 2006 versus year ended December 31, 2005**

Our pre-tax income from continuing operations for 2006 was $304.1 million, compared to pre-tax income from continuing operations of $262.8 million for 2005 and our GAAP combined ratio was 97.4% for 2006, compared to 99.5% for 2005.

Our 2006 results included $29.1 million in current accident year catastrophe losses, which impacted the combined ratio by 1.4 points, a decrease of $52.1 million from 2005, which included $69.1 million in current accident year catastrophe losses related to Hurricanes Katrina, Rita and Wilma. Adverse development on prior accident years was $11.3 million in 2006, which impacted the combined ratio by 0.5 points, a decrease of $87.7 million, compared with 2005, which included $99.0 million in adverse development primarily relating to 2002 and prior accident years. Offsetting these decreases was $81.8 million of incentive compensation expense, which impacted the combined ratio by 3.9 points, an increase of $17.7 million, compared to 2005 and $19.5 million of expenses associated with actions taken to optimize long-term occupancy costs, including our move to our new U.S. headquarters in Canton, Massachusetts, which added 1.0 point to the combined ratio. In addition, 2005 included a $53.6 million gain from the settlement of our retiree medical plan, which reduced the 2005 combined ratio by a total of 2.7 points. The retiree medical plan, which had been frozen in 2002, was terminated and an independent trust was established and funded to provide benefits to covered participants. These actions relieved us of our future retiree medical obligations and triggered recognition of the gain. The majority of the gain was recorded as a reduction of other underwriting expenses with a portion of the gain reflected in the loss and LAE as a portion of the expense of the retiree medical program was allocated to the claims department. In addition, during 2005, we recorded a $23.9 million reclassification between liability accounts which resulted in a decrease in other underwriting expenses and a corresponding increase in loss and LAE. This reclassification decreased the 2005 expense ratio by 1.2 points and increased the loss and LAE ratio by 1.2 points.

Our total revenues increased 3.1% in 2006 to $2,470.1 million, compared to $2,396.8 million in 2005, due principally to a 3.1% increase in earned premiums in 2006. The increase in earned premiums was due to an increase in business assumed from the affiliate quota share agreement with Esurance, prior to the commutation of the quota share agreement in the fourth quarter of 2006. Net realized investment gains increased to $163.6 million in 2006, compared with $123.2 million in 2005. The 2005 period included a realized loss of $54.6 million due to an other-than-temporary impairment with respect to our investment in Montpelier common shares. During 2005, the market value of Montpelier common shares decreased from $38.45 per share to $18.90 per share. Our original cost of this investment in 2001 was $105.0 million, which was subsequently increased by $65.3 million in equity in earnings recorded from 2001 to March 2004, the period in which we accounted for the investment under the equity method of accounting. The impairment charge represented the difference between our GAAP cost of $170.3 million and the investment's fair value of $115.7 million at December 31, 2005. Partially offsetting the increase in net realized investment gains was a $45.0 million decrease in net investment income primarily due to a $34.7 million special dividend on Montpelier common stock in the first quarter of 2005.

Net other revenues increased 61.0% in 2006 to $38.8 million, compared to $24.1 million in 2005, primarily due to the sale of our renewal rights to the Agri business which resulted in a pre-tax gain of $30.4 million. Partially offsetting the Agri gain was a $12.6 million pre-tax loss on the sale of our investment in MSA. This pre-tax loss was offset by tax benefits recognized on the exchange of our investment in MSA described above. In addition, net other revenues in 2005 included an $8.0 million gain from the sale of TPIC.

During 2005, as a result of an actuarial review completed in the fourth quarter, we reallocated a portion of our IBNR reserves in our primary insurance operations from some of our ongoing lines of business to run-off. This shifted $34.4 million of our IBNR reserves from specialty lines ($10.9 million), commercial lines ($11.5 million) and personal lines ($12.0 million) to our run-off. This adjustment had no impact on our 2005 combined ratio.

The income tax provision related to pre-tax income from continuing operations for the years ended December 31, 2006 and 2005 represented effective tax rates of 22.7% and 31.2%, respectively, which were lower than the U.S. statutory rate of 35%. The effective tax rate is lower for each of the years ended December 31, 2006 and 2005 due to income generated in jurisdictions other than the United States, partially offset by non-deductible dividends and accretion on the Berkshire Preferred Stock and Zenith Preferred Stock. Also contributing to the lower effective tax rate in 2006 was a $26.3 million tax benefit recognized in the second quarter of 2006 related to settlements of U.S. Federal income tax audits for the years prior to 2003 as well as tax benefits recognized on the exchange of our investment in MSA which yielded a tax benefit of $16.7 million.

***Summary of Operations By Segment***

Our segments consist of the following: (1) Primary Insurance Operations, (2) Affiliate Quota Shares and (3) Other Operations. In the fourth quarter of 2006, within our Primary Insurance Operations segment, we began to include OBSP within commercial lines and AutoOne within personal lines. Both OBSP and AutoOne were formerly reported in specialty lines. The reporting change was undertaken to better align the reported results of our underwriting units with their product and management structure. Prior periods have been reclassified to conform to the current presentation. The affiliate quota share agreements were commuted in the fourth quarter of 2006 in connection with our initial public offering. All of our investments are managed by our affiliate, WM Advisors, and by Prospector. A discussion of our consolidated investment operations is included after the discussion of operations by segment. Our segment information is presented in Note 14 "Segment Information" of the accompanying consolidated financial statements.

*Primary Insurance Operations*

Financial results for our Primary Insurance Operations segment for the years ended December 31, 2007, 2006 and 2005, were as follows:

| | Year ended December 31, | | |
|---|---|---|---|
| | **2007** | **2006** | **2005** |
| | | **($ in millions)** | |
| Net written premiums | $ 1,864.4 | $ 1,957.6 | $ 1,988.6 |
| Earned premiums | 1,873.6 | 1,944.0 | 1,988.2 |
| Net investment income | 184.5 | 182.3 | 232.5 |
| Net realized investment gains | 174.5 | 165.3 | 124.2 |
| Net other revenues | 19.2 | 21.8 | 14.7 |
| Total revenues | 2,251.8 | 2,313.4 | 2,359.6 |
| Loss and LAE | 1,089.8 | 1,180.3 | 1,335.6 |
| Policy acquisition expenses | 318.9 | 332.3 | 360.5 |
| Other underwriting expenses | 329.4 | 360.1 | 263.4 |
| General and administrative expenses | 2.9 | 3.3 | 1.1 |
| Interest expense on debt | 3.2 | 2.9 | 1.4 |
| Total expenses | 1,744.2 | 1,878.9 | 1,962.0 |
| Pre-tax income | $ 507.6 | $ 434.5 | $ 397.6 |

The following tables provide ratios, net written premiums and earned premiums by underwriting units for the years ended December 31, 2007, 2006 and 2005:

| | Year ended December 31, 2007 | | | |
|---|---|---|---|---|
| | Specialty | Commercial | Personal | Total(2) |
| | ($ in millions) | | | |
| *Ratios: (1)(3)(4)(5)* | | | | |
| Loss and LAE prior to reserve reallocation(6) | 57.7% | 51.3% | 60.4% | 58.2% |
| Impact of reserve reallocation(6) | (20.0) | (0.8) | (3.2) | |
| Loss and LAE | 37.7 | 50.5 | 57.2 | 58.2 |
| Expense | 30.8 | 37.1 | 33.6 | 34.6 |
| Total GAAP combined | 68.5% | 87.6% | 90.8% | 92.8% |
| Total combined prior to reserve reallocation(6) | 88.5% | 88.4% | 94.0% | 92.8% |
| Net written premiums | $ 446.2 | $ 727.7 | $ 690.4 | $ 1,864.4 |
| Earned premiums | 436.4 | 712.0 | 725.0 | 1,873.6 |

| | Year ended December 31, 2006 | | | |
|---|---|---|---|---|
| | Specialty | Commercial | Personal | Total(2) |
| | ($ in millions) | | | |
| *Ratios: (1)(3)(4)(5)* | | | | |
| Loss and LAE | 54.7% | 56.0% | 63.5% | 60.7% |
| Expense | 34.3 | 39.0 | 32.4 | 35.6 |
| Total GAAP combined | 89.0% | 95.0% | 95.9% | 96.3% |
| Net written premiums | $ 437.6 | $ 718.3 | $ 800.6 | $ 1,957.6 |
| Earned premiums | 432.3 | 689.3 | 822.3 | 1,944.0 |

| | Year ended December 31, 2005 | | | |
|---|---|---|---|---|
| | Specialty | Commercial | Personal | Total(2) |
| | ($ in millions) | | | |
| *Ratios: (1)(3)(4)(5)* | | | | |
| Loss and LAE prior to reserve reallocation(6) | 57.9% | 60.7% | 63.3% | 67.2% |
| Impact of reserve reallocation(6) | (2.8) | (1.8) | (1.3) | |
| Loss and LAE | 55.1 | 58.9 | 62.0 | 67.2 |
| Expense | 29.8 | 38.4 | 28.8 | 31.4 |
| Total GAAP combined | 84.9% | 97.3% | 90.8% | 98.6% |
| Total combined prior to reserve reallocation(6) | 87.7% | 99.1% | 92.1% | 98.6% |

| | Year ended December 31, 2005 | | | |
|---|---|---|---|---|
| Net written premiums | $ 416.3 | $ 654.4 | $ 910.2 | $ 1,988.6 |
| Earned premiums | 391.7 | 654.7 | 933.7 | 1,988.2 |

(1) In the fourth quarter of 2006, we began to include OBSP within commercial lines and AutoOne within personal lines. Both OBSP and AutoOne were formerly reported in specialty lines. The reporting change was undertaken to better align the reported results of our underwriting units with their product and management structure. Prior periods have been reclassified to conform to the current presentation.

(2) Includes results from run-off. For the years ended December 31, 2007, 2006 and 2005, includes net written premiums of $0.1 million, $1.1 million and $7.7 million, respectively, from run-off and earned premiums of $0.2 million, $0.1 million and $8.1 million, respectively, from run-off.

(3)

Includes our long-term incentive compensation expense. For the years ended December 31, 2007, 2006 and 2005, long-term incentive compensation expense increased our total GAAP combined ratio by 1.6 points, 2.3 points and 1.8 points, respectively.

(4)

Includes loss and LAE relating to catastrophes. For the years ended December 31, 2007, 2006 and 2005, total calendar year incurred loss and LAE relating to catastrophes increased our loss and LAE and total combined ratios by 0.8 points, 2.8 points and 4.2 points, respectively, including development on prior accident year catastrophes which (decreased) increased our loss and LAE and total combined ratios by (0.1) point, 1.3 points and 0.1 point, respectively.

(5)

Prior accident year development, including development on catastrophes, for the years ended December 31, 2007, 2006 and 2005 (decreased) increased our loss and LAE and total combined ratios by (2.6) points, 1.2 points and 5.3 points, respectively.

(6)

Represents a non-GAAP financial measure. During 2007 and 2005, we reallocated reserves from our ongoing lines of business to run-off which had the effect of lowering the loss and LAE ratios and combined ratios of our ongoing businesses. The reallocation had no impact on total primary insurance operations. For further discussion, see "Consolidated Results Year ended December 31, 2007 versus year ended December 31, 2006" and "Consolidated Results Year ended December 31, 2006 versus year ended December 31, 2005." The tables above for the years ended December 31, 2007 and 2005 reflect our loss and LAE ratios and total combined ratios prior to the reserve reallocation and reconciles these non-GAAP financial measures to their most comparable GAAP measures.

**Primary Insurance Operations Year ended December 31, 2007 versus year ended December 31, 2006**

*Specialty lines.* Net written premiums for specialty lines increased by 2.0% to $446.2 million in 2007 as compared to $437.6 million in 2006. Excluding the Agri business, to which the renewal rights were sold in the third quarter of 2006, net written premiums increased by 19.6%, compared to 2006 due to a $34.6 million increase in net written premiums in specialty liability products at OBPP, an $18.7 million increase in net written premiums at IMU and $14.9 million in net written premiums in the Accident and Health business which commenced operations in 2007.

The specialty lines combined ratio for 2007 decreased to 88.5% from 89.0% in 2006 due to a decreased expense ratio. The expense ratio for 2007 decreased 3.5 points to 30.8%, compared to 34.3% in the prior year period, primarily due to a 3.3 point reduction of commission expense from fees received from fronting services in 2007 from QBE on renewals of Agri business, as well as a 0.6 point favorable impact from the partial settlement of our qualified pension plan liabilities, partially offset by 0.3 points of office consolidation costs. The loss and LAE ratio increased 3.0 points to 57.7% primarily due to unfavorable large non-catastrophe current accident year losses in the Agri run-off business.

*Commercial lines.* Net written premiums for commercial lines increased by 1.3% to $727.7 million in 2007, compared to $718.3 million in 2006, due a $35.6 million increase in net written premiums in the small business division, principally driven by our small business package products. Partially offsetting this increase was a $26.2 million decrease in the middle market division primarily due to lower premiums at OBSP as a result of our strategy to manage our exposure to potential catastrophe losses.

The commercial lines combined ratio for 2007 decreased to 88.4% from 95.0% in 2006 due to decreases in both the loss and LAE ratio and the expense ratio. The 2007 loss and LAE ratio decreased to 51.3%, compared to 56.0% in 2006, driven by 3.1 points of favorable development on prior accident year losses in 2007 primarily related to property and general liability claims. The 2006 loss and LAE ratio included 2.3 points of adverse development on prior accident years driven by 3.8 points of net unfavorable development on prior accident year catastrophe losses primarily at OBSP, related to hurricanes Katrina and Wilma and two 2004 catastrophes. The decrease in the loss and LAE ratio was partially offset by a 0.8 point increase in the current accident year loss ratio in 2007, compared to 2006, driven in part by the pricing environment and in part by the low impact of large losses in the prior year. The expense ratio decreased to 37.1% from 39.0% in 2006 primarily due to lower policy acquisition expenses as a result of an increase to the deferral rate of commercial lines' policy acquisition costs related to the expansion into new states, as well as a 0.8 point favorable impact from the partial settlement of our qualified pension plan liabilities. Partially offsetting the impact of these favorable items was 0.9 points of office consolidation costs in 2007, compared to 1.3 points in the prior year.

*Personal lines.* Net written premiums for personal lines decreased by 13.8% to $690.4 million in 2007, compared to $800.6 million in 2006. The decrease was primarily attributable to reduced writings at AutoOne due to significant declines in New York's assigned risk pool. Market trends indicate that assigned risk volumes are expected to decline to approximately $137 million in 2008, down from $170 million in 2007, $253 million in 2006, and $383 million in 2005. Assigned risk volumes in New Jersey are also expected to decline in 2008. Market trends indicate that the assigned risk pool in New Jersey is expected to decline to approximately $61 million in 2008, down from $77 million in 2007, $141 million in 2006, and $247 million in 2005. The Company expects a reduction in AutoOne's premium volume reflective of these trends. In traditional personal lines, premium decreased due to an increasingly competitive auto market and also Massachusetts state-mandated rate decreases. In September 2007 we notified agents that we plan to seek regulatory approval of a withdrawal plan to cease writing business in Houston General Insurance Exchange and also took actions to better align personal lines staffing with our business needs. Net written premiums for Houston General Insurance Exchange were $15.1 million in 2007, compared to $3.8 million in 2006.

The personal lines combined ratio for 2007 decreased to 94.0% from 95.9% in 2006 due to a decrease in the loss and LAE ratio. The loss and LAE ratio decreased 3.1 points to 60.4% primarily due to 3.2 points of favorable development on prior accident years in automobile liability in traditional personal lines and at AutoOne, compared to 0.7 points of adverse development on prior accident years in 2006. Partially offsetting this decrease was higher than average large loss activity experienced in the first half of 2007. The expense ratio increased by 1.2 points to 33.6% from 32.4% in 2006 primarily due to the adverse effect of a lower earned premium base compared to the prior year period. The expense ratio in 2007 included the impact of non-recurring favorable items, including 1.0 point from a state premium tax refund and 0.9 points related to the partial settlement of our qualified pension plan liabilities, partially offset by 0.8 points of office consolidation costs. In addition, the expense ratio for 2007 included 0.5 points of expense incurred in connection with the decision to cease writing business in Houston General Insurance Exchange and actions taken to better align personal lines staffing with our business needs.

*Run-off.* For 2007, run-off generated an underwriting loss of $155.6 million ($38.9 million excluding a $116.7 million increase to loss and LAE reserves resulting from the reserve reallocation), compared to an underwriting loss of $44.1 million in 2006. Results for 2007 (excluding the reserve reallocation) and 2006 include $9.3 million and $9.0 million in adverse development, respectively.

**Primary Insurance Operations Year ended December 31, 2006 versus year ended December 31, 2005**

*Specialty lines.* Net written premiums for specialty lines increased by 5.1% to $437.6 million in 2006 as compared to $416.3 million in 2005. The increase was mainly due to a $29.8 million increase in net written premiums in specialty liability products at OBPP to $179.3 million principally driven by our long-term care and lawyers professional liability products. During the third quarter of 2006, we sold the renewal rights to the Agri business. Excluding the Agri business, net written premiums increased by 12%, compared to 2005.

The specialty lines combined ratio for 2006 was 89.0%, compared to 84.9% for 2005 due primarily to increases in the expense ratio. The expense ratio increased 4.5 points in 2006 to 34.3%, compared with 29.8% in 2005 primarily due to a 1.1 point increase in incentive compensation expense in 2006. In addition, 2005 included the favorable impact of the settlement of the retiree medical plan which lowered the expense ratio by 1.5 points. The loss and LAE ratio for 2006 was essentially flat when compared to 2005. Excluding the favorable impact of the reallocation of some IBNR reserves to run-off in 2005 (2.8 points), the loss and LAE ratio improved in 2006.

*Commercial lines.* Net written premiums for commercial lines increased by 9.8% to $718.3 million in 2006, compared to $654.4 million in 2005 with increases in both the middle market and the small business divisions. The increase in net written premiums in the middle market division were in our property and inland marine products as well as at OBSP. The increase in small business was in our small business package products.

The commercial lines combined ratio for 2006 was 95.0%, compared to 97.3% for 2005 due to a decreased loss and LAE ratio. The 2006 loss and LAE ratio decreased to 56.0% compared to 58.9% in 2005, primarily due to lower catastrophe losses in 2006 (4.4 points) as compared to 2005 (9.7 points). Included in 2005 was $56.1 million, or 8.6 points, in losses incurred from Hurricanes Katrina, Rita and Wilma. Partially offsetting the impact of this decrease was the favorable impact of 1.1 points related to the settlement of the retiree medical plan in 2005 and 1.8 points related to the reallocation of some IBNR reserves to run-off. The expense ratio for 2006 increased slightly to 39.0%, compared to 38.4% in 2005. Included in 2006 were 1.3 points related to actions taken to optimize long-term occupancy costs and a 1.0 point increase in incentive compensation expense compared to 2005. The 2005 expense ratio included a 1.7 point decrease from the settlement of the retiree medical plan.

*Personal lines.* Net written premiums for personal lines decreased by 12.0% to $800.6 million in 2006, compared to $910.2 million in 2005. The decrease was primarily attributable to reduced writings at AutoOne due to significant declines in New York's assigned risk pool. Assigned risk volumes declined in New York to $253 million in 2006 down from $383 million in 2005 and $629 million in 2004. Assigned risk volumes in New Jersey declined to $141 million in 2006 down from $247 million in 2005 and $375 million in 2004. The Company expects a reduction in AutoOne's premium volume reflective of these trends. In traditional personal lines, premium decreased due to an increasingly competitive auto market and also Massachusetts state-mandated rate decreases.

The personal lines combined ratio for 2006 was 95.9%, compared to 90.8% for 2005. The decrease in the combined ratio was primarily due to increases in both the loss and LAE ratio and the expense ratio. The loss and LAE ratio increased to 63.5%, compared to 62.0% in 2005, primarily due to one-time favorable items in 2005 including the settlement of the retiree medical plan (1.0 points) and the favorable impact of the reallocation of IBNR reserves to run-off (1.3 points). The expense ratio increased to 32.4%, compared with 28.8% in the prior year. The increase in the expense ratio in 2006 was mainly due to other underwriting expenses, including 1.0 point related to actions taken to optimize long-term occupancy costs and 0.6 points of increased incentive compensation expense in 2006 and the inclusion of the settlement of the retiree medical plan in 2005, which decreased the 2005 expense ratio by 1.5 points. In addition, the 2006 expense ratio was higher than the 2005 expense ratio as expense reductions were not proportional to reductions in earned premiums.

*Run-off.* For 2006, run-off generated an underwriting loss of $44.1 million, compared to an underwriting loss of $133.4 million in 2005. The variance was primarily due to higher loss and LAE in the 2005 period. 2005 included $106.7 million in adverse development, mainly from 2002 and prior accident years, which was primarily due to higher than anticipated defense costs and higher damages from liability assessments in general liability and multiple peril lines. As described above, 2005 also included a reallocation of $34.4 million of IBNR reserves from some of our ongoing lines of business to run-off. In addition, during 2005, we recorded a $23.9 million reclassification between liability accounts which resulted in a decrease in other underwriting expenses and a corresponding increase in loss and LAE. This reclassification decreased the primary insurance operations' 2005 expense ratio by 1.2 points and increased the loss and LAE ratio by 1.2 points. Excluding the impact of the IBNR reserves reallocated to run-off and the reclassification between liability accounts, incurred loss and LAE in 2006 was $60.8 million lower than in the 2005 period.

*Affiliate Quota Shares*

During 2004 and 2005, we entered into two quota share reinsurance arrangements with other subsidiaries of White Mountains. Under the Esurance Quota Share, which was effective on January 1, 2005, we assumed approximately 85% of business written by Esurance, which includes business written by its wholly-owned subsidiary. Under the Sirius Quota Share, we ceded between 6% and 12% of business written, effective April 1, 2004, to Sirius.

The affiliate quota shares were entered into primarily for White Mountains' capital management purposes and were therefore excluded from the information used by White Mountains' Board of Directors to measure our financial performance. The affiliate quota share agreements were commuted in the fourth quarter of 2006 in connection with our initial public offering.

A summary of results from our Affiliate Quota Shares segment for the years ended December 31, 2006 and 2005 is as follows:

| | Year ended December 31, | | | |
|---|---|---|---|---|
| | 2006 | | 2005 | |
| | Esurance Quota Share | Sirius Quota Share | Esurance Quota Share | Sirius Quota Share |
| | ($ in millions) | | | |
| Net written premiums | $ 227.4 | $ (178.0) | $ 336.9 | $ (229.9) |
| Earned premiums | 309.9 | (178.0) | 254.4 | (229.9) |
| Total revenues | 309.9 | (178.0) | 254.4 | (229.9) |
| Loss and LAE | 195.5 | (92.2) | 177.1 | (122.3) |
| Policy acquisition expenses | 114.4 | (66.8) | 75.0 | (86.2) |
| Total expenses | 309.9 | (159.0) | 252.1 | (208.5) |
| Pre-tax income (loss) | $ | $ (19.0) | $ 2.3 | $ (21.4) |

*Other Operations*

Our Other Operations segment consists of OneBeacon Insurance Group, Ltd. and our intermediate subsidiary holding companies. Our Other Operations segment primarily consists of financing activities, purchase accounting adjustments relating to our acquisition by White Mountains in 2001 and other assets and general and administrative expenses incurred at the holding company level. This segment also includes entities that prior to the initial public offering employed persons associated with White Mountains' holding company operations. Accordingly, in 2006 and 2005, Other Operations