IROBOT CORP
Form PRE 14A
April 02, 2009

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of the
Securities Exchange Act of 1934 (Amendment No.)

Filed by the Registrant þ

Filed by a Party other than the Registrant o

Check the appropriate box:

þ Preliminary Proxy Statement
o **Confidential, For Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
o Definitive Proxy Statement
o Definitive Additional Materials
o Soliciting Material Pursuant to §240.14a-12

iRobot Corporation
(Name of Registrant as Specified in Its Charter)
(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

þ No fee required.

o Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

1) Title of each class of securities to which transaction applies:

2) Aggregate number of securities to which transaction applies:

3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

4) Proposed maximum aggregate value of transaction:

5) Total fee paid:

o Fee paid previously with preliminary materials.

o Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

1) Amount previously paid:

2) Form, Schedule or Registration Statement No.:

3) Filing Party:

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Dear Stockholder: April , 2009

You are cordially invited to attend the annual meeting of stockholders of iRobot Corporation to be held at 2:00 p.m., local time, on Thursday, May 28, 2009 at iRobot Corporation headquarters located at 8 Crosby Drive, Bedford, Massachusetts 01730.

At this annual meeting, you will be asked to elect three class I directors for three-year terms, to ratify the appointment of our independent registered public accountants, and to approve an amendment to the 2005 Stock Option and Incentive Plan and a stock option exchange program for eligible iRobot Corporation employees, excluding, among others, our executive officers. The board of directors unanimously recommends that you vote FOR election of the director nominees, FOR ratification of appointment of our independent registered public accountants, and FOR the amendment to the 2005 Stock Option and Incentive Plan and a stock option exchange program for eligible employees, excluding, among others, our executive officers.

Details regarding the matters to be acted upon at this annual meeting appear in the accompanying proxy statement. Please give this material your careful attention.

Whether or not you plan to attend the annual meeting, we urge you to sign and return the enclosed proxy so that your shares will be represented at the annual meeting. If you attend the annual meeting, you may vote in person even if you have previously returned your proxy card. Your prompt cooperation will be greatly appreciated.

Very truly yours,

COLIN M. ANGLE
Chief Executive Officer & Chairman of the Board

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iROBOT CORPORATION
8 Crosby Drive
Bedford, Massachusetts 01730
(781) 430-3000

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS
To Be Held on May 28, 2009

To the Stockholders of iRobot Corporation:

The annual meeting of stockholders of iRobot Corporation, a Delaware corporation (the Company), will be held on Thursday, May 28, 2009, at 2:00 p.m., local time, at iRobot Corporation headquarters located at 8 Crosby Drive, Bedford, Massachusetts 01730, for the following purposes:

1. To elect three (3) class I directors, nominated by the Board of Directors, each to serve for a three-year term and until his successor has been duly elected and qualified or until his earlier resignation or removal;

2. To ratify the appointment of the accounting firm of PricewaterhouseCoopers LLP as the Company s independent registered public accountants for the current fiscal year;

3. To approve an amendment to the 2005 Stock Option and Incentive Plan and a stock option exchange program for eligible iRobot Corporation employees, excluding, among others, our executive officers, which would enable them to exchange certain out-of-the-money stock options issued under the Company s equity plans, for new stock options exercisable for fewer shares of common stock with lower exercise prices and extended vesting terms, and:

4. To transact such other business as may properly come before the annual meeting and any adjournments or postponements thereof.

Proposal 1 relates solely to the election of three (3) class I directors nominated by the board of directors and does not include any other matters relating to the election of directors, including without limitation, the election of directors nominated by any stockholder of the Company.

Only stockholders of record at the close of business on April 9, 2009, are entitled to notice of and to vote at the annual meeting and at any adjournment or postponement thereof.

All stockholders are cordially invited to attend the annual meeting in person. However, to assure your representation at the annual meeting, we urge you, whether or not you plan to attend the annual meeting, to sign and return the enclosed proxy so that your shares will be represented at the annual meeting. If you attend the annual meeting, you may vote in person even if you have previously returned your proxy card.

By Order of the Board of Directors,

GLEN D. WEINSTEIN
Senior Vice President,
General Counsel and Secretary

Bedford, Massachusetts

April , 2009

IMPORTANT NOTICE REGARDING THE AVAILABILITY OF PROXY MATERIALS FOR THE SHAREHOLDER MEETING TO BE HELD ON MAY 28, 2009. THE PROXY STATEMENT AND ANNUAL REPORT TO SHAREHOLDERS ARE AVAILABLE AT http://materials.proxyvote.com/462726

WHETHER OR NOT YOU EXPECT TO ATTEND THE ANNUAL MEETING, PLEASE COMPLETE, DATE AND SIGN THE ENCLOSED PROXY CARD AND MAIL IT PROMPTLY IN THE ENCLOSED ENVELOPE IN ORDER TO ASSURE REPRESENTATION OF YOUR SHARES. NO POSTAGE NEED BE AFFIXED IF THE PROXY CARD IS MAILED IN THE UNITED STATES.

IN ACCORDANCE WITH OUR SECURITY PROCEDURES, ALL PERSONS ATTENDING THE ANNUAL MEETING WILL BE REQUIRED TO PRESENT PICTURE IDENTIFICATION.

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iROBOT CORPORATION
8 Crosby Drive
Bedford, Massachusetts 01730

PROXY STATEMENT
For the Annual Meeting of Stockholders
To Be Held on May 28, 2009

April , 2009

This proxy statement is furnished in connection with the solicitation of proxies by the board of directors of iRobot Corporation, a Delaware corporation (the Company), for use at the annual meeting of stockholders to be held on Thursday, May 28, 2009, at 2:00 p.m., local time, at iRobot Corporation headquarters located at 8 Crosby Drive, Bedford, Massachusetts 01730, and any adjournments or postponements thereof. An annual report to stockholders, containing financial statements for the fiscal year ended December 27, 2008, is being mailed together with this proxy statement to all stockholders entitled to vote at the annual meeting. This proxy statement and the form of proxy are expected to be first mailed to stockholders on or about April 21, 2009.

The purposes of the annual meeting are to elect three class I directors for three-year terms, to ratify the appointment of the Company s independent registered public accountants, and to approve an amendment to the 2005 Stock Option and Incentive Plan (the 2005 Plan) and a stock option exchange program for eligible employees, excluding, among others, our executive officers. Only stockholders of record at the close of business on April 9, 2009 will be entitled to receive notice of and to vote at the annual meeting. As of March 27, 2009, 24,941,889 shares of common stock, $.01 par value per share, of the Company were issued and outstanding. The holders of common stock are entitled to one vote per share on any proposal presented at the annual meeting.

Stockholders may vote in person or by proxy. If you attend the annual meeting, you may vote in person even if you have previously returned your proxy card. Any proxy given pursuant to this solicitation may be revoked by the person giving it at any time before it is voted. Proxies may be revoked by (i) filing with the Secretary of the Company, before the taking of the vote at the annual meeting, a written notice of revocation bearing a later date than the proxy, (ii) duly completing a later-dated proxy relating to the same shares and delivering it to the Secretary of the Company before the taking of the vote at the annual meeting, or (iii) attending the annual meeting and voting in person (although attendance at the annual meeting will not in and of itself constitute a revocation of a proxy). Any written notice of revocation or subsequent proxy should be sent so as to be delivered to iRobot Corporation, 8 Crosby Drive, Bedford, Massachusetts 01730, Attention: Secretary, before the taking of the vote at the annual meeting.

The representation in person or by proxy of at least a majority of the outstanding shares of common stock entitled to vote at the annual meeting is necessary to constitute a quorum for the transaction of business. Votes withheld from any nominee, abstentions and broker non-votes are counted as present or represented for purposes of determining the presence or absence of a quorum for the annual meeting. A non-vote occurs when a nominee holding shares for a beneficial owner votes on one proposal but does not vote on another proposal because, with respect to such other proposal, the nominee does not have discretionary voting power and has not received instructions from the beneficial owner.

For Proposal 1, the election of class I directors, the nominees receiving the highest number of affirmative votes of the shares present or represented and entitled to vote at the annual meeting shall be elected as directors. For Proposal 2, the ratification of the appointment of PricewaterhouseCoopers LLP as the Company s independent registered public accountants for the current fiscal year, and for Proposal 3, the approval of an amendment to the 2005 Plan and a stock

option exchange program for eligible employees, excluding, among others, our executive officers, an affirmative vote of a majority of the shares present, in person or represented by proxy, and voting on each such matter is required for approval. Abstentions are included in the number of shares present or represented and voting on each matter. Broker non-votes are not considered voted for the particular matter and have the effect of reducing the number of affirmative votes required to achieve a majority for such matter by reducing the total number of shares from which the majority is calculated.

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The person named as attorney-in-fact in the proxies, Glen D. Weinstein, was selected by the board of directors and is an officer of the Company. All properly executed proxies returned in time to be counted at the annual meeting will be voted by such person at the annual meeting. Where a choice has been specified on the proxy with respect to the foregoing matters, the shares represented by the proxy will be voted in accordance with the specifications. If no such specifications are indicated, such proxies will be voted FOR election of the director nominees, FOR ratification of the appointment of our independent registered public accountants and FOR the approval of an amendment to the 2005 Plan and a stock option exchange program for eligible employees, excluding, among others, our executive officers.

Aside from the election of directors, ratification of the appointment of the independent registered public accountants, and approval of an amendment to the 2005 Plan and a stock option exchange program for eligible employees, the board of directors knows of no other matters to be presented at the annual meeting. If any other matter should be presented at the annual meeting upon which a vote properly may be taken, shares represented by all proxies received by the board of directors will be voted with respect thereto in accordance with the judgment of the person named as attorney-in-fact in the proxies.

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth certain information regarding beneficial ownership of the Company s common stock as of March 27, 2009: (i) by each person who is known by the Company to beneficially own more than 5% of the outstanding shares of common stock; (ii) by each director or nominee of the Company; (iii) by each named executive officer of the Company; and (iv) by all directors and executive officers of the Company as a group. Unless otherwise noted below, the address of each person listed on the table is c/o iRobot Corporation, 8 Crosby Drive, Bedford, Massachusetts 01730.

Name of Beneficial Owner	Shares Beneficially Owned(1)	Percentage of Shares Beneficially Owned(2)
OppenheimerFunds, Inc.(3) 2 World Financial Center 225 Liberty Street New York, NY 10281-1008	2,571,257	10.3%
BlackRock, Inc.(4) 40 East 52nd Street New York, NY 10022	1,399,950	5.6%
Morgan Stanley(5) 1585 Broadway New York, NY 10036	1,242,630	5.0%
Colin M. Angle(6)	1,906,292	7.6%
John J. Leahy	0	*
Joseph W. Dyer(7)	247,267	1.0%
Glen D. Weinstein(8)	113,636	*
Alison Dean(9)	30,724	*
Rodney A. Brooks, Ph.D.(10)	1,266,939	5.1%
Ronald Chwang(11)	754,681	3.0%

Jacques S. Gansler(12)	61,401	*
Andrea Geisser(13)	50,775	*
Helen Greiner(14)	1,530,178	6.1%
George C. McNamee(15)	107,128	*
Peter T. Meekin(16)	48,000	*
Paul J. Kern(17)	34,001	*
Geoffrey P. Clear(18)	182,140	*
All executive officers, directors and nominees as a group (19) (13 persons)	6,151,022	24.7%

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* Represents less than 1% of the outstanding common stock.

(1) Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission and includes voting and investment power with respect to shares. Unless otherwise indicated below, to the knowledge of the Company, all persons listed below have sole voting and investment power with respect to their shares of common stock, except to the extent authority is shared by spouses under applicable law. Pursuant to the rules of the Securities and Exchange Commission, the number of shares of common stock deemed outstanding includes (i) shares issuable pursuant to options held by the respective person or group that are currently exercisable or may be exercised within 60 days of March 27, 2009 and (ii) shares issuable pursuant to restricted stock units held by the respective person or group that vest within 60 days of March 27, 2009.

(2) Applicable percentage of ownership as of March 27, 2009 is based upon 24,941,889 shares of common stock outstanding.

(3) OppenheimerFunds, Inc. has shared voting power and shared dispositive power with respect to all of these shares. This information has been obtained from a Schedule 13G/A filed by OppenheimerFunds, Inc. with the Securities and Exchange Commission on January 26, 2009, and includes 2,500,000 shares over which Oppenheimer Global Opportunity Fund has shared voting and shared dispositive power. The address of Oppenheimer Global Opportunity Fund is 6803 S. Tucson Way, Centennial, CO 80112.

(4) BlackRock, Inc. has shared voting power and shared dispositive power with respect to all of these shares. This information has been obtained from a Schedule 13G filed by BlackRock, Inc. with the Securities and Exchange Commission on February 10, 2009.

(5) Morgan Stanley has sole voting power with respect to 1,143,868 of these shares and sole dispositive power with respect to all of these shares. This information has been obtained from a Schedule 13G filed by Morgan Stanley with the Securities and Exchange Commission on February 17, 2009.

(6) Includes 17,167 shares issuable to Mr. Angle upon exercise of stock options, 4,075 shares issuable to Mr. Angle upon vesting of restricted stock units and 190,549 shares held in a trust for the benefit of certain of his family members.

(7) Includes 200,416 shares issuable to Mr. Dyer upon exercise of stock options and 2,875 shares issuable to Mr. Dyer upon vesting of restricted stock units.

(8) Includes 104,202 shares issuable to Mr. Weinstein upon exercise of stock options and 1,838 shares issuable to Mr. Weinstein upon vesting of restricted stock units.

(9) Includes 28,567 shares issuable to Ms. Dean upon exercise of stock options.

(10) Includes 4,667 shares issuable to Dr. Brooks upon exercise of stock options.

(11) Includes an aggregate of 526,970 shares held by iD5 Fund, L.P. Dr. Chwang is a general partner of the management company for iD5 Fund, L.P. and may be deemed to share voting and investment power with respect to all shares held by iD5 Fund, L.P. Dr. Chwang disclaims beneficial ownership of such shares except to the extent of his pecuniary interest, if any. Also includes 34,001 shares issuable to Dr. Chwang upon exercise of stock options and 193,710 shares held in a trust for the benefit of certain of his family members.

(12) Includes 60,001 shares issuable to Dr. Gansler upon exercise of stock options.

(13) Includes 34,001 shares issuable to Mr. Geisser upon exercise of stock options and 3,868 shares issuable to Mr. Geisser upon vesting of phantom stock.

(14) Includes 10,667 shares issuable to Ms. Greiner upon exercise of stock options and 2,200 shares issuable to Ms. Greiner upon vesting of restricted stock units.

(15) Includes 34,001 shares issuable to Mr. McNamee upon exercise of stock options and 3,487 shares issuable to Mr. McNamee upon vesting of phantom stock.

(16) Includes 34,001 shares issuable to Mr. Meekin upon exercise of stock options and 3,481 shares issuable to Mr. Meekin upon vesting of phantom stock.

(17) Consists of 34,001 shares issuable to Mr. Kern upon exercise of stock options.

(18) Includes 123,350 shares held by Geoffrey P. Clear and Marjorle P. Clear (JTWROS), over which Mr. Clear and Mrs. Clear share voting power and investment power.

(19) Includes an aggregate of 595,692 shares issuable upon exercise of stock options held by twelve (12) executive officers and directors, an aggregate of 10,988 shares issuable pursuant to restricted stock units held by four (4) executive officers and directors, and an aggregate of 10,836 shares issuable upon vesting of phantom stock to three (3) directors. Excludes securities beneficially owned by Mr. Clear, who is no longer employed by the Company, and Jeffrey A. Beck, who was appointed President, Home Robots as of April 1, 2009.

PROPOSAL 1

ELECTION OF DIRECTORS

Nominees

Our board of directors currently consists of nine members. Our amended and restated certificate of incorporation divides the board of directors into three classes. One class is elected each year for a term of three years. The board of directors, upon the recommendation of the nominating and corporate governance committee, has nominated Colin M. Angle, Ronald Chwang, Ph.D., and Paul J. Kern, Gen. U.S. Army (ret.) and recommended that each be elected to the board of directors as a class I director, each to hold office until the annual meeting of stockholders to be held in the year 2012 and until his successor has been duly elected and qualified or until his earlier death, resignation or removal. Messrs. Angle and Kern and Dr. Chwang are class I directors whose terms expire at this annual meeting. Mr. Angle serves as our chairman of the board and chief executive officer. The board of directors is also composed of (i) three class II directors (Helen Greiner, George C. McNamee and Peter T. Meekin), whose terms expire upon the election and qualification of directors at the annual meeting of stockholders to be held in 2010 and (ii) three class III Directors (Rodney A. Brooks, Ph.D., Andrea Geisser, and Jacques S. Gansler, Ph.D.) whose terms expire upon the election and qualification of directors at the annual meeting of stockholders to be held in 2011.

The board of directors knows of no reason why any of the nominees would be unable or unwilling to serve, but if any nominee should for any reason be unable or unwilling to serve, the proxies will be voted for the election of such other person for the office of director as the board of directors may recommend in the place of such nominee. Unless otherwise instructed, the proxy holders will vote the proxies received by them for the nominees named below.

Recommendation of the Board

THE BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS THAT YOU VOTE *FOR* THE NOMINEES LISTED BELOW.

The following table sets forth the nominees to be elected at the annual meeting and continuing directors, the year each such nominee or director was first elected a director, the positions with us currently held by each nominee and director, the year each nominee s or director s current term will expire and each nominee s and director s current class:

Nominee s or Director s Name and Year First Became a Director	Position(s) with the Company	Year Current Term Will Expire	Current Class of Director
Nominees for Class I Directors:			
Colin M. Angle 1992	Chairman of the Board, Chief Executive Officer and Director	2009	I
Ronald Chwang, Ph.D. 1998	Director	2009	I
Paul J. Kern, Gen. U.S. Army (ret.) 2006	Director	2009	I
Continuing Directors:			
Helen Greiner 1994	Director	2010	II

George C. McNamee			
1999	Director	2010	II
Peter T. Meekin			
2003	Director	2010	II
Rodney A. Brooks, Ph.D.			
1990	Director	2011	III
Andrea Geisser			
2004	Director	2011	III
Jacques S. Gansler, Ph.D.			
2003	Director	2011	III

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DIRECTORS AND EXECUTIVE OFFICERS

The following table sets forth the director nominees to be elected at the annual meeting, the directors and the executive officers of the Company, their ages immediately prior to the annual meeting, and the positions currently held by each such person with the Company.

Name	Age	Position
Colin M. Angle	41	Chairman of the Board, Chief Executive Officer and Director
John J. Leahy	50	Executive Vice President, Chief Financial Officer and Treasurer
Jeffrey A. Beck	46	President, Home Robots
Joseph W. Dyer	62	President, Government & Industrial
Glen D. Weinstein	38	Senior Vice President, General Counsel and Secretary
Alison Dean	44	Vice President, Financial Controls & Analysis
Rodney A. Brooks, Ph.D.	54	Director
Ronald Chwang, Ph.D.(1)	61	Director
Jacques S. Gansler, Ph.D.(2)	74	Director
Andrea Geisser(3)	66	Director
Helen Greiner	41	Director
George C. McNamee(1)(2)(3)	62	Director
Peter T. Meekin(2)(3)	59	Director
Paul J. Kern, Gen. U.S. Army (ret)(1)	63	Director

(1) Member of compensation committee

(2) Member of nominating and corporate governance committee

(3) Member of audit committee

Colin M. Angle, a co-founder of iRobot, has served as chairman of the board since October 2008, as chief executive officer since June 1997, and prior to that, as our president since November 1992. Mr. Angle has also served as a director since October 1992. Mr. Angle also worked at the National Aeronautical and Space Administration s Jet Propulsion Laboratory where he participated in the design of the behavior-controlled rovers that led to Sojourner exploring Mars in 1997. Mr. Angle holds a B.S. in Electrical Engineering and an M.S. in Computer Science, both from MIT.

John J. Leahy has served as our executive vice president, chief financial officer and treasurer since June 2008. From August 2007 to September 2007, Mr. Leahy, served as executive vice president, chief financial officer, principal financial/accounting officer and assistant treasurer of The Hanover Insurance Group, Inc. From 1999 to 2007, Mr. Leahy served as executive vice president and chief financial officer of Keane, Inc., and served as interim president and chief executive officer from May 2006 to January 2007. Mr. Leahy received a B.S. in Finance from Merrimack College and an M.B.A. from Boston College.

Jeffrey A. Beck has served as the president of our home robots division since April 2009. Prior to joining iRobot, Mr. Beck served at AMETEK Corporation as senior vice president and general manager, Aerospace & Defense from 2008 to 2009 and as vice president & general manager, Power Systems and Instruments Division from 2004 to 2008. From 1996 to 2004, Mr. Beck served in a number of positions at Danaher Corporation, including president, Danaher Precision Systems Division and vice president of sales, Kollmorgen I&C Division. Mr. Beck holds a B.S. in Mechanical Engineering from the New Jersey Institute of Technology and an M.B.A. from Boston University.

Joseph W. Dyer has served as the president of our government and industrial robots division since July 2006. Mr. Dyer served as executive vice president and general manager of our government and industrial robots division from September 2003 until July 2006. Prior to joining iRobot, Mr. Dyer served for 32 years in the U.S. Navy. From July 2000 until July 2003, he served as Vice Admiral commanding the Naval Air Systems Command at which he was responsible for research and development, procurement and in-service

support for naval aircraft, weapons and sensors. He is an elected fellow in the Society of Experimental Test Pilots and the National Academy of Public Administration. He also chairs NASA s Aerospace Safety Advisory Panel. Mr. Dyer holds a B.S. in Chemical Engineering from North Carolina State University and an M.S. in Finance from the Naval Postgraduate School, Monterey, California.

Glen D. Weinstein has served as our general counsel since July 2000. Since February 2005, Mr. Weinstein has also served as a senior vice president, and he served as a vice president from February 2002 to January 2005. Since March 2004, he has also served as our secretary. Prior to joining iRobot, Mr. Weinstein was with Covington & Burling, a law firm in Washington, D.C. Mr. Weinstein holds a B.S. in Mechanical Engineering from MIT and a J.D. from the University of Virginia School of Law.

Alison Dean has served as our vice president, financial controls & analysis and principal accounting officer since March 2007. Ms. Dean served as our vice president, financial planning & analysis from August 2005 until March 2007. From 1995 to August 2005, Ms. Dean served in a number of positions at 3Com Corporation, including vice president and corporate controller from 2004 to 2005 and vice president of finance worldwide sales from 2003 to 2004. Ms. Dean holds a B.A. in Business Economics from Brown University and an M.B.A. from Boston University.

Rodney A. Brooks, Ph.D., a co-founder of iRobot, has served as a director since our inception in August 1990, and from inception until February 2004, as the chairman of the board of directors. Dr. Brooks held various positions at iRobot since our inception, including chief technology officer from June 1997 until September 2008, and prior to that, treasurer and president. In September 2008, Dr. Brooks co-founded Heartland Robotics to develop low-cost industrial robots that will empower workers and serves as its chairman and chief technology officer. Dr. Brooks has taken a leave from his position as Panasonic Professor of Robotics at MIT. From August 1997 until June 2003, he was the director of the MIT Artificial Intelligence Laboratory. Dr. Brooks is a member of the National Academy of Engineering. Dr. Brooks holds a degree in pure mathematics from the Flinders University of South Australia and a Ph.D. in Computer Science from Stanford University.

Ronald Chwang, Ph.D, has served as a director since November 1998. Dr. Chwang is the chairman and president of iD Ventures America, LLC (formerly known as Acer Technology Ventures) under the iD SoftCapital Group, a venture investment and management consulting service group formed in January 2005. From August 1998 until December 2004, Dr. Chwang was the chairman and president of Acer Technology Ventures, LLC, managing high-tech venture investment activities in North America. Dr. Chwang also serves on the board of directors of Silicon Storage Technology, Inc. and a number of other private high tech companies. Dr. Chwang holds a B.Eng. (with honors) in Electrical Engineering from McGill University and a Ph.D. in Electrical Engineering from the University of Southern California.

Jacques S. Gansler, Ph.D. has served as a director since July 2004. Dr. Gansler has been a professor at the University of Maryland, where he leads the school s Center for Public Policy and Private Enterprise, since January 2001. From November 1997 until January 2001, Dr. Gansler served as the Under Secretary of Defense for Acquisition, Technology and Logistics for the U.S. federal government. Dr. Gansler holds a B.E. in electrical engineering from Yale University, an M.S. in Electrical Engineering from Northeastern University, an M.A. in Political Economy from New School for Social Research, and a Ph.D. in Economics from American University.

Andrea Geisser has served as a director since March 2004. Mr. Geisser is currently a senior advisor to Fenway Partners Resources, a private equity firm, and senior advisor to Zephyr Management Inc., a global private equity firm. From 1995 to 2005, Mr. Geisser was a managing director of Fenway Partners. Prior to founding Fenway Partners, Mr. Geisser was a managing director of Butler Capital Corporation. Prior to that, he was a managing director of Onex Investment Corporation, a Canadian management buyout company. From 1974 to 1986, he was a senior officer of Exor America. Mr. Geisser has been a board member and audit committee member of several private companies.

Mr. Geisser holds a bachelor s degree from Bocconi University in Milan, Italy and a P.M.D. from Harvard Business School.

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Helen Greiner, a co-founder of iRobot, has served as a director since July 1994. Ms. Greiner also served as president of iRobot from June 1997 until February 2004 and as chairman of the board from February 2004 until October 2008. In October 2008, Ms. Greiner resigned as an employee of iRobot and as chairman of the board to become chairman, president & CEO of The Droid Works. Prior to joining iRobot, Ms. Greiner founded California Cybernetics, a company commercializing Jet Propulsion Laboratory technology. She has been honored by Technology Review Magazine as an Innovator for the Next Century. Ms. Greiner holds a B.S. in Mechanical Engineering and an M.S. in Computer Science, both from MIT.

George C. McNamee has served as a director since August 1999. Mr. McNamee is a managing partner of FA Technology Ventures, an information and energy technology venture capital firm. From 1984 to 2007, Mr. McNamee served as chairman of First Albany Companies Inc., a specialty investment banking firm. Mr. McNamee serves as chairman of the board of directors of Plug Power Inc. and is a director of Broadpoint Securities Group, Inc. and several private companies. He is a Trustee of the American Friends of Eton College and the Albany Academies. Mr. McNamee holds a B.A. from Yale University.

Peter T. Meekin has served as a director since February 2003. Mr. Meekin has been a managing director of Trident Capital, a venture capital firm, since 1998. Prior to joining Trident Capital, he was vice president of venture development at Enterprise Associates, LLC, the venture capital division of IMS Health. Mr. Meekin holds a B.S. in Mathematics from the State University of New York at New Paltz.

Paul J. Kern, Gen. U.S. Army (ret.) has served as a director since May 2006. Gen. Kern has served as president and chief operating officer of AM General LLC since 2008, and as a senior counselor to The Cohen Group, an international strategic business consulting firm, from January 2005 until 2008. From 1963 to 2004, Gen. Kern served in the U.S. Army and, from October 2001 to November 2004, as Commanding General of the U.S. Army Materiel Command. Prior to his command in the U.S. Army Materiel Command, he served as the military deputy to the Assistant Secretary of the Army for Acquisition, Logistics and Technology. Gen. Kern also serves on the board of directors of ITT Corporation. He holds a B.S. from the United States Military Academy at West Point, an M.S. in Civil Engineering from the University of Michigan and an M.S. in Mechanical Engineering from the University of Michigan.

Our executive officers are elected by the board of directors on an annual basis and serve until their successors have been duly elected and qualified or until their earlier death, resignation or removal.

CORPORATE GOVERNANCE AND BOARD MATTERS

Independence of Members of the Board of Directors

The board of directors has determined that Drs. Chwang and Gansler and Messrs. Geisser, McNamee, Meekin and Kern are independent within the meaning of the director independence standards of The NASDAQ Stock Market, Inc., or NASDAQ, and the Securities and Exchange Commission, including Rule 10A-3(b)(1) under the Securities Exchange Act of 1934, as amended, or the Exchange Act. Furthermore, the board of directors has determined that each member of each of the committees of the board of directors is independent within the meaning of the director independence standards of NASDAQ and the Securities and Exchange Commission.

Executive Sessions of Independent Directors

Executive sessions of the independent directors are held prior to each regularly scheduled in-person meeting of the board of directors. Executive sessions do not include any of our non-independent directors and are chaired by a lead independent director who is appointed annually by the board of directors from our independent directors.

Mr. McNamee currently serves as the lead independent director. In this role, Mr. McNamee serves as chairperson of the independent director sessions and assists the board in assuring effective corporate governance. The independent directors of the board of directors met in executive session four (4) times in 2008.

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Policies Governing Director Nominations

Director Qualifications

The nominating and corporate governance committee of the board of directors is responsible for reviewing with the board of directors from time to time the appropriate qualities, skills and characteristics desired of members of the board of directors in the context of the needs of the business and current make-up of the board of directors. This assessment includes consideration of the following minimum qualifications that the nominating and corporate governance committee believes must be met by all directors:

- nominees must have experience at a strategic or policy making level in a business, government, non-profit or academic organization of high standing;
- nominees must be highly accomplished in his or her respective field, with superior credentials and recognition;
- nominees must be well regarded in the community and shall have a long-term reputation for the highest ethical and moral standards;
- nominees must have sufficient time and availability to devote to the affairs of the Company, particularly in light of the number of boards on which the nominee may serve;
- nominees must be free of conflicts of interest and potential conflicts of interest, in particular with relationships with other boards; and
- nominees must, to the extent such nominee serves or has previously served on other boards, demonstrate a history of actively contributing at board meetings.

The board of directors seeks members from diverse professional backgrounds who combine a broad spectrum of relevant industry and strategic experience and expertise that, in concert, offer us and our stockholders diversity of opinion and insight in the areas most important us and our corporate mission. In addition, nominees for director are selected to have complementary, rather than overlapping, skill sets. All candidates for director nominee must have time available to devote to the activities of the board of directors. The nominating and corporate governance committee also considers the independence of candidates for director nominee, including the appearance of any conflict in serving as a director. Candidates for director nominee who do not meet all of these criteria may still be considered for nomination to the board of directors, if the nominating and corporate governance committee believes that the candidate will make an exceptional contribution to us and our stockholders.

Process for Identifying and Evaluating Director Nominees

The board of directors is responsible for selecting its own members. The board of directors delegates the selection and nomination process to the nominating and corporate governance committee, with the expectation that other members of the board of directors, and of management, will be requested to take part in the process as appropriate.

Generally, the nominating and corporate governance committee identifies candidates for director nominee in consultation with management, through the use of search firms or other advisors, through the recommendations submitted by stockholders or through such other methods as the nominating and corporate governance committee deems to be helpful to identify candidates. Once candidates have been identified, the nominating and corporate governance committee confirms that the candidates meet all of the minimum qualifications for director nominees

established by the nominating and corporate governance committee. The nominating and corporate governance committee may gather information about the candidates through interviews, detailed questionnaires, comprehensive background checks or any other means that the nominating and corporate governance committee deems to be helpful in the evaluation process. The nominating and corporate governance committee then meets as a group to discuss and evaluate the qualities and skills of each candidate, both on an individual basis and taking into account the overall composition and needs of the board of directors. Based on the results of the evaluation process, the nominating and corporate governance committee recommends candidates for the board of directors approval as director nominees for election to the board of directors. The nominating and corporate governance committee also recommends candidates to the board of directors for appointment to the committees of the board of directors.

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Procedures for Recommendation of Director Nominees by Stockholders

The nominating and corporate governance committee will consider director nominee candidates who are recommended by our stockholders. Stockholders, in submitting recommendations to the nominating and corporate governance committee for director nominee candidates, shall follow the following procedures:

The nominating and corporate governance committee must receive any such recommendation for nomination not later than the close of business on the 120th day nor earlier than the close of business on the 150th day prior to the first anniversary of the date of the proxy statement delivered to stockholders in connection with the preceding year s annual meeting.

All recommendations for nomination must be in writing and include the following:

Name and address of the stockholder making the recommendation, as they appear on our books and records, and of such record holder s beneficial owner;

Number of shares of our capital stock that are owned beneficially and held of record by such stockholder and such beneficial owner;

Name, age, business and residential address, educational background, current principal occupation or employment, and principal occupation or employment for the preceding five full fiscal years of the individual recommended for consideration as a director nominee;

All other information relating to the recommended candidate that would be required to be disclosed in solicitations of proxies for the election of directors or is otherwise required, in each case pursuant to Regulation 14A under the Exchange Act, including the recommended candidate s written consent to being named in the proxy statement as a nominee and to serving as a director if approved by the board of directors and elected; and

A written statement from the stockholder making the recommendation stating why such recommended candidate meets our criteria and would be able to fulfill the duties of a director.

Nominations must be sent to the attention of our secretary by U.S. mail (including courier or expedited delivery service) to:

iRobot Corporation
8 Crosby Drive
Bedford, Massachusetts 01730
Attn: Secretary of iRobot Corporation

Our secretary will promptly forward any such nominations to the nominating and corporate governance committee. Once the nominating and corporate governance committee receives the nomination of a candidate and the candidate has complied with the minimum procedural requirements above, such candidacy will be evaluated and a recommendation with respect to such candidate will be delivered to the board of directors.

Policy Governing Security Holder Communications with the Board of Directors

The board of directors provides to every security holder the ability to communicate with the board of directors as a whole and with individual directors on the board of directors through an established process for security holder communication as follows:

For communications directed to the board of directors as a whole, security holders may send such communications to the attention of the chairman of the board of directors by U.S. mail (including courier or expedited delivery service) to:

iRobot Corporation
8 Crosby Drive
Bedford, Massachusetts 01730
Attn: Chairman of the Board, c/o Secretary

For security holder communications directed to an individual director in his or her capacity as a member of the board of directors, security holders may send such communications to the attention of the individual director by U.S. mail (including courier or expedited delivery service) to:

iRobot Corporation
8 Crosby Drive
Bedford, Massachusetts 01730
Attn: [Name of the director], c/o Secretary

We will forward any such security holder communication to the chairman of the board, as a representative of the board of directors, or to the director to whom the communication is addressed, on a periodic basis. We will forward such communications by certified U.S. mail to an address specified by each director and the chairman of the board for such purposes or by secure electronic transmission.

Policy Governing Director Attendance at Annual Meetings of Stockholders

Our policy is to schedule a regular meeting of the board of directors on the same date as our annual meeting of stockholders and, accordingly, directors are encouraged to be present at our stockholder meetings. All nine (9) board members attended the annual meeting of stockholders held in 2008.

Board of Directors Evaluation Program

The board of directors performs annual self-evaluations of its composition and performance, including evaluations of its standing committees and individual evaluations for each director. In addition, each of the standing committees of the board of directors conducts it own self-evaluation, which is reported to the board of directors. The board of directors retains the authority to engage its own advisors and consultants.

For more corporate governance information, you are invited to access the Corporate Governance section of our website available at http://www.irobot.com.

Code of Ethics

We have adopted a code of ethics, as defined by regulations promulgated under the Securities Act of 1933, as amended, and the Exchange Act, that applies to all of our directors and employees worldwide, including our principal executive officer, principal financial officer, principal accounting officer and controller, or persons performing similar functions. A current copy of the Code of Business Conduct and Ethics is available at the Corporate Governance section of our website at http://www.irobot.com. A copy of the Code of Business Conduct and Ethics may also be obtained, free of charge, from us upon a request directed to: iRobot Corporation, 8 Crosby Drive, Bedford, Massachusetts 01730, Attention: Investor Relations. We intend to disclose any amendment to or waiver of a provision of the Code of Business Conduct and Ethics that applies to our principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions, by posting such information on its website available at http://www.irobot.com and/or in our public filings with the Securities and Exchange Commission.

For more corporate governance information, you are invited to access the Corporate Governance section of our website available at http://www.irobot.com.

THE BOARD OF DIRECTORS AND ITS COMMITTEES

Board of Directors

The board of directors met nine (9) times during the fiscal year ended December 27, 2008, and took action by unanimous written consent two (2) times. Each of the directors attended at least 75% of the aggregate of the total number of meetings of the board of directors and the total number of meetings of all committees of the board of directors on which they served during fiscal 2008. The board of directors has the following standing committees: audit committee; compensation committee; and nominating and corporate

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governance committee, each of which operates pursuant to a separate charter that has been approved by the board of directors. A current copy of each charter is available at http://www.irobot.com. Each committee reviews the appropriateness of its charter at least annually. Each committee retains the authority to engage its own advisors and consultants. The composition and responsibilities of each committee are summarized below.

Audit Committee

The audit committee of the board of directors currently consists of Messrs. Geisser, McNamee and Meekin, each of whom is an independent director within the meaning of the director independence standards of NASDAQ and the Securities and Exchange Commission, or SEC, including Rule 10A-3(b)(1) under the Securities Exchange Act of 1934, as amended, or the Exchange Act. Mr. Geisser serves as the chairman of the audit committee. In addition, the board of directors has determined that Mr. Geisser is financially literate and that Mr. Geisser qualifies as an audit committee financial expert under the rules of the SEC. Stockholders should understand that this designation is a disclosure requirement of the SEC related to Mr. Geisser s experience and understanding with respect to certain accounting and auditing matters. The designation does not impose upon Mr. Geisser any duties, obligations or liability that are greater than are generally imposed on him as a member of the audit committee and the board of directors, and his designation as an audit committee financial expert pursuant to this SEC requirement does not affect the duties, obligations or liability of any other member of the audit committee or the board of directors.

The audit committee met seven (7) times during the fiscal year ended December 27, 2008. The audit committee operates under a written charter adopted by the board of directors, a current copy of which is available at the Corporate Governance section of our website at http://www.irobot.com.

As described more fully in its charter, the audit committee oversees our accounting and financial reporting processes, internal controls and audit functions. In fulfilling its role, the audit committee responsibilities include:

- appointing, approving the compensation of, and assessing the independence of our independent registered public accounting firm;
- pre-approving auditing and permissible non-audit services, and the terms of such services, to be provided by our independent registered public accounting firm;
- reviewing and discussing with management and the independent registered public accounting firm our annual and quarterly financial statements and related disclosures;
- coordinating the oversight and reviewing the adequacy of our internal control over financial reporting;
- establishing policies and procedures for the receipt and retention of accounting related complaints and concerns; and
- preparing the audit committee report required by SEC rules to be included in our annual proxy statement.

Compensation Committee

The compensation committee of the board of directors currently consists of Mr. McNamee, Gen. Kern, and Dr. Chwang, each of whom is an independent director within the meaning of the director independence standards of NASDAQ, a non-employee director as defined in Rule 16b-3 of the Exchange Act, and an outside director pursuant to Rule 162(m) of the Internal Revenue Code. Mr. McNamee serves as the chairman of the compensation committee. The compensation committee s responsibilities include:

annually reviewing and approving corporate goals and objectives relevant to compensation of our chief executive officer;

evaluating the performance of our chief executive officer in light of such corporate goals and objectives and determining the compensation of our chief executive officer;

- overseeing and administering our compensation, welfare, benefit and pension plans and similar plans; and
- reviewing and making recommendations to the board with respect to director compensation.

The compensation committee met six (6) times and took action by unanimous written consent fourteen (14) times during the fiscal year ended December 27, 2008. The compensation committee operates under a written charter adopted by the board of directors, a current copy of which is available at the Corporate Governance section of our website at http://www.irobot.com.

Nominating and Corporate Governance Committee

The nominating and corporate governance committee of the board of directors currently consists of Dr. Gansler, and Messrs. Meekin and McNamee, each of whom is an independent director within the meaning of the director independence standards of NASDAQ and applicable rules of the SEC. Dr. Gansler serves as the chairman of the nominating and corporate governance committee. The nominating and corporate governance committee s responsibilities include:

- developing and recommending to the board criteria for board and committee membership;
- establishing procedures for identifying and evaluating director candidates including nominees recommended by stockholders;
- identifying individuals qualified to become board members;
- recommending to the board the persons to be nominated for election as directors and to each of the board s committees;
- developing and recommending to the board a code of business conduct and ethics and a set of corporate governance guidelines; and
- overseeing the evaluation of the board and management.

The nominating and corporate governance committee met five (5) times during the fiscal year ended December 27, 2008. The nominating and corporate governance committee operates under a written charter adopted by the board of directors, a current copy of which is available at the Corporate Governance section of our website at http://www.irobot.com.

Compensation Committee Interlocks and Insider Participation

During 2008, Dr. Chwang, Gen. Kern and Mr. McNamee served as members of the compensation committee. No member of the compensation committee was an employee or former employee of us or any of our subsidiaries, or had any relationship with us requiring disclosure herein.

During the last year, no executive officer of the Company served as: (i) a member of the compensation committee (or other committee of the board of directors performing equivalent functions or, in the absence of any such committee, the entire board of directors) of another entity, one of whose executive officers served on our compensation committee; (ii) a director of another entity, one of whose executive officers served on our compensation committee; or (iii) a member of the compensation committee (or other committee of the board of directors performing equivalent

functions or, in the absence of any such committee, the entire board of directors) of another entity, one of whose executive officers served as a director of the Company.

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REPORT OF THE AUDIT COMMITTEE OF THE BOARD OF DIRECTORS

No portion of this audit committee report shall be deemed to be incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, through any general statement incorporating by reference in its entirety the proxy statement in which this report appears, except to the extent that the Company specifically incorporates this report or a portion of it by reference. In addition, this report shall not be deemed filed under either the Securities Act or the Exchange Act.

This report is submitted by the audit committee of the board of directors. The audit committee currently consists of Messrs. Geisser (chairman), McNamee and Meekin. None of the members of the audit committee is an officer or employee of the Company, and the board of directors has determined that each member of the audit committee meets the independence requirements promulgated by NASDAQ and the Securities and Exchange Commission, including Rule 10A-3(b)(1) under the Exchange Act. Mr. Geisser is an audit committee financial expert as is currently defined under SEC rules. The audit committee operates under a written charter adopted by the board of directors.

The audit committee oversees the Company s accounting and financial reporting processes on behalf of the board of directors. The Company s management has the primary responsibility for the financial statements, for maintaining effective internal control over financial reporting, and for assessing the effectiveness of internal control over financial reporting. In fulfilling its oversight responsibilities, the audit committee has reviewed and discussed with management the Company s consolidated financial statements for the fiscal year ended December 27, 2008, including a discussion of, among other things, the quality of the Company s accounting principles, the reasonableness of significant estimates and judgments, and the clarity of disclosures in the Company s financial statements.

The audit committee also reviewed with PricewaterhouseCoopers LLP, the Company s independent registered public accounting firm, the results of their audit and discussed matters required to be discussed by the Statement on Auditing Standards No. 61 (*Communication with Audit Committees*), as currently in effect, other standards of the Public Company Accounting Oversight Board, rules of the Securities and Exchange Commission and other applicable regulations. The audit committee has reviewed permitted services under rules of the Securities and Exchange Commission as currently in effect and discussed with PricewaterhouseCoopers LLP their independence from management and the Company, including the matters in the written disclosures and the letter from the independent registered public accounting firm required by applicable requirements of the Public Company Accounting Oversight Board regarding the independent accountant s communications with the audit committee concerning independence, and has considered and discussed the compatibility of non-audit services provided by PricewaterhouseCoopers LLP with that firm s independence.

The audit committee meets with the independent registered public accounting firm, with and without management present, to discuss the results of their examinations; their evaluations of the Company s internal control, including internal control over financial reporting; and the overall quality of the Company s financial reporting.

Based on its review of the financial statements and the aforementioned discussions, the audit committee concluded that it would be reasonable to recommend, and on that basis did recommend, to the board of directors that the audited financial statements be included in the Company s Annual Report on Form 10-K for the year ended December 27, 2008.

The audit committee has also evaluated the performance of PricewaterhouseCoopers LLP, including, among other things, the amount of fees paid to PricewaterhouseCoopers LLP for audit and non-audit services in 2008. Information about PricewaterhouseCoopers LLP s fees for 2008 is discussed below in this proxy statement under Proposal 2 *Ratification of Appointment of Independent Registered Public Accountants.* Based on its evaluation, the audit

committee has recommended that the Company retain PricewaterhouseCoopers LLP to serve as the Company s independent registered public accounting firm for the 2009 fiscal year.

Respectfully submitted by the Audit Committee,

Andrea Geisser (chairman)
George C. McNamee
Peter T. Meekin

REPORT OF THE COMPENSATION COMMITTEE OF THE BOARD OF DIRECTORS

No portion of this compensation committee report shall be deemed to be incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, through any general statement incorporating by reference in its entirety the proxy statement in which this report appears, except to the extent that the Company specifically incorporates this report or a portion of it by reference. In addition, this report shall not be deemed filed under either the Securities Act or the Exchange Act.

The compensation committee of the board of directors, which is comprised solely of independent directors within the meaning of applicable rules of The NASDAQ Stock Market, Inc., outside directors within the meaning of Section 162 of the Internal Revenue Code of 1986, as amended, and non-employee directors within the meaning of Rule 16b-3 under the Securities Exchange Act of 1934, as amended, is responsible for developing executive compensation policies and advising the board of directors with respect to such policies and administering the Company s cash incentive, stock option and employee stock purchase plans. The compensation committee sets performance goals and objectives for the chief executive officer and the other executive officers, evaluates their performance with respect to those goals and sets their compensation based upon the evaluation of their performance. In evaluating executive officer pay, the compensation committee may retain the services of a compensation consultant and consider recommendations from the chief executive officer with respect to goals and compensation of the other executive officers. The compensation committee assesses the information it receives in accordance with its business judgment. The compensation committee also periodically reviews director compensation. All decisions with respect to executive and director compensation are approved by the compensation committee and recommended to the full board for ratification. George McNamee, Paul Kern and Ronald Chwang are the current members of the compensation committee.

The compensation committee has reviewed and discussed the Compensation Discussion and Analysis (the CD&A) for the year ended December 27, 2008 with management. In reliance on the reviews and discussions referred to above, the compensation committee recommended to the board of directors, and the board of directors has approved, that the CD&A be included in the proxy statement for the year ended December 27, 2008 for filing with the SEC.

Respectfully submitted by the
Compensation Committee,

George C. McNamee (chairman)
Paul J. Kern
Ronald Chwang

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COMPENSATION AND OTHER INFORMATION CONCERNING DIRECTORS AND OFFICERS

Compensation Discussion & Analysis

Overview

Our compensation philosophy is based on a desire to balance retention of executive talent with pay for performance-based incentive compensation, which is designed to reward our named executive officers for continued service and our sustained financial and operating performance. We believe that the compensation of our named executive officers should align our executives interests with those of our stockholders and focus executive behavior on the achievement of both near-term corporate targets as well as long-term business objectives and strategies. It is the responsibility of the compensation committee of our board of directors to administer our compensation practices to ensure that they are competitive and include incentives that are designed to appropriately drive our performance, including our revenue and earnings growth. Our compensation committee reviews and approves all of our executive compensation policies, including executive officer salaries, bonuses and equity awards.

Objectives of Our Compensation Programs

Our compensation programs for our executive officers are designed to achieve the following objectives:

- to provide competitive compensation that attracts, motivates and retains the best talent and the highest caliber executives to serve us and help us to achieve our strategic objectives;

- to align management s interest with our success;

- to connect a significant portion of the total potential cash compensation paid to executives to our annual financial performance or the division, region or segment of our business for which an executive has management responsibility by basing cash incentive compensation on corresponding financial targets;

- to align management s interest with the interests of stockholders through long-term equity incentives; and

- to provide management with performance goals that are directly linked to our annual plan for growth and profit.

We believe that the compensation of our named executive officers should reflect their success as a management team, rather than as individuals, in attaining key operating objectives, such as revenue growth and gross profit improvement, as well as longer-term strategic objectives, such as invention and product development.

We also believe that their compensation should not be based on the short-term performance of our stock, whether favorable or unfavorable, but rather that the price of our stock will, in the long-term, reflect our operating performance, and ultimately, the management of the company by our named executive officers. We seek to have the long-term performance of our stock reflected in executive compensation through our stock option and other equity incentive programs.

Methodologies for Establishing Executive Compensation

The compensation committee, which is comprised entirely of independent directors, reviews the compensation packages for our named executive officers, including an analysis of all elements of compensation separately and in the aggregate. In determining the appropriate compensation levels for our chief executive officer, the compensation committee meets outside the presence of all our executive officers. With respect to the compensation levels of all other named executive officers, the compensation committee meets outside the presence of all executive officers except our chief executive officer and, in 2008, our former chairman of the board. Mr. Angle, our chief executive officer, annually reviews each other named executive officer s performance with the compensation committee.

With the input of our human resources department and compensation consultants, the chief executive officer makes recommendations to the compensation committee regarding base salary levels, target incentive awards, performance goals for incentive compensation and equity awards for named executive officers, other than Mr. Angle. In conjunction with the annual performance review of each named executive officer in January of each year, the compensation committee carefully considers the recommendations of the chief executive officer when setting base salary, bonus payments under the prior year s incentive compensation plan, target amounts and performance goals for the current year s incentive compensation plan, and any other special adjustments or bonuses. In addition, the compensation committee similarly determines equity incentive awards, if any, for each named executive officer.

Our compensation plans are developed, in part, by utilizing publicly available compensation data and subscription compensation survey data for national and regional companies in the technology, defense, household durables and robotics industries. We believe that the practices of this group of companies provide us with appropriate compensation benchmarks, because these companies have similar organizational structures and tend to compete with us to attract executives and other employees. For benchmarking executive compensation, we typically review the compensation data we have collected from the complete group of companies, as well as a subset of the data from companies with revenues, numbers of employees and market capitalizations similar to our profile.

With respect to 2008 base salary, cash incentive compensation, and long-term incentives, we reviewed companies with similar-sized revenues of greater than $160 million and less than $630 million and market capitalizations of between $275 million to $1.1 billion, in particular: Aerovironment, Inc., Argon ST, Inc., Audiovox Corp., Axsys Technologies, Inc., Ducommun Incorporated, Force Protection Inc., Gencorp Inc., Genesis Microchip Inc., Heico Corp., LoJack Corporation, National Presto Industries Inc., Plantronics Inc., Raven Industires Inc., Syntax-Brillian Corp., Tivo, Inc. and Universal Electronics Inc.

The compensation committee also engaged a consultant, DolmatConnell & Partners, to help evaluate peer companies for cash compensation and long-term incentive purposes, analyze applicable compensation data and determine appropriate compensation levels for our named executive officers.

We will annually reassess the relevance of our peer group and make changes when judged appropriate. We believe that the use of benchmarking is an important factor in remaining competitive with our peers and furthering our objective of attracting, motivating and retaining highly qualified personnel.

The compensation committee reviews all components of compensation for named executive officers. In accordance with its charter, the compensation committee also, among other responsibilities, administers our incentive compensation plan, and reviews and makes recommendations to management on company-wide compensation programs and practices. In setting compensation levels for our executive officers in fiscal 2008, the compensation committee considered many factors in addition to benchmarking described above, including, but not limited to:

- the scope and strategic impact of the executive officer s responsibilities,
- our past business and segment performance and future expectations,
- our long-term goals and strategies,
- the performance and experience of each individual,
- past salary levels of each individual and of the named executive officers as a group,
- relative levels of pay among the executive officers,

the amount of base salary in the context of the executive officer s total compensation and other benefits,

for each named executive officer, other than the chief executive officer, the evaluations and recommendations of the chief executive officer, and

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the competitiveness of the compensation packages relative to the selected benchmarks as highlighted by the independent compensation consultant s analysis.

The compensation committee determines compensation for our chief executive officer using the same factors it uses for other executive officers, placing relatively less emphasis on base salary, and instead, creating greater performance-based opportunities through long-term equity and short term cash incentive compensation, which we believe better aligns our chief executive officer s interests with our success and the interests of our stockholders. In assessing the compensation paid to our chief executive officer, the compensation committee relies on both information from our selected benchmarks and its judgment with respect to the factors described above.

Elements of Compensation

Our executive compensation program consists of three primary elements: salary, long-term equity interest, primarily in the form of stock options and restricted stock awards, and an annual cash incentive program based on both corporate and, if appropriate, divisional performance. All of our executive officers also are eligible for certain benefits offered to employees generally, including life, health, disability and dental insurance, as well as to participate in our 401(k) plan. We also enter into executive agreements with our executive officers that provide for certain severance benefits upon termination of employment following a change in control of the Company.

Annual Cash Compensation

Base Salary. The compensation committee believes that our executive officers, including our chief executive officer, are paid salaries in line with their qualifications, experience and responsibilities. Salaries are structured so that they are at least comparable with salaries paid by the peer companies reviewed by the compensation committee in the technology and robotics industry. We target base salaries for each of our executives at the market median (50th percentile) in the technology and robotics industry and also take into consideration many additional factors which we believe enable us to attract, motivate and retain our leadership team in an extremely competitive environment. Salaries are reviewed generally on an annual basis.

Fiscal year 2007 demonstrated our ability to sustain growth while laying a strong foundation for continued expansion. Under Mr. Angle s leadership, we improved our results of operations, achieved record revenues and gained momentum in areas of critical importance such as international market expansion and key military programs. As a result, in 2008, Mr. Angle received salary compensation of $372,288. The increase in Mr. Angle s annual salary from $330,625 in 2007 to $378,769 was based on the compensation committee s consideration of the factors described above. Additionally, the decision to increase Mr. Angle s base salary was based on the compensation committee s assessment that Mr. Angle s 2007 salary was below the market median salary for chief executive officers whose companies were included in the selected benchmarks and that it would be appropriate to move towards more closely aligning Mr. Angle s salary with the 50th percentile of such benchmarks.

Fiscal year 2008 base salaries for our executive officers, other than Mr. Angle, were determined by the compensation committee after considering the base salary level of the executive officers in prior years and taking into account for each executive officer the amount of base salary as a component of total compensation. Base salary levels for each of our executive officers, other than our chief executive officer, were also based upon evaluations and recommendations made by our chief executive officer. These recommendations include an assessment of the individual s responsibilities, experience, individual performance and contribution to our performance, and also generally take into account the competitive environment for attracting and retaining executives consistent with our business needs.

In light of the considerations discussed above, for fiscal year 2008, the annual base salaries of our chief executive officer, chief financial officer, president, government & industrial robots, senior vice president and general counsel and vice president, financial controls and analysis were $378,769, $350,012, $325,000, $284,875 and $230,000, respectively. In addition, the annual base salaries of our former officers including our former chairman of the board and former chief financial officer were $330,625 and $278,200, respectively. We

believe that the base salaries paid to our executive officers during our fiscal year 2008 achieve our executive compensation objectives, compare favorably to our peer group and, in light of our overall compensation program, are within our target of providing total compensation at the market median.

Cash Incentive Compensation. The compensation committee believes that some portion of overall cash compensation for executive officers should be at risk, *i.e.*, contingent upon successful implementation of our strategy. For our named executive officers, including our chief executive officer, the granting of cash incentive payments is based on an evaluation of achievement against predetermined financial and operational metrics in accordance with our Senior Executive Incentive Compensation Plan that was adopted by the compensation committee. Target cash incentives for named executive officers are generally targeted at the 50th percentile of similar cash incentives provided to officers in peer companies reviewed by the compensation committee in the technology and robotics industries. The amount of cash incentives paid to the named executive officers, however, is subject to the discretion of the compensation committee based on its assessment of our performance in general or the achievement of specific goals.

For fiscal 2008, the target bonus awards under our Senior Executive Incentive Compensation Plan for each of our named executive officers, as a percentage of base salary, were 85% for our chief executive officer, 65% for our chief financial officer, 65% for the president of our Government & Industrial Robots division, 50% for our senior vice president and general counsel, and 25% for our vice president, financial controls and analysis. In addition, the target cash incentive awards under our Senior Executive Incentive Compensation Plan for our now departed officers, as a percentage of base salary, were 80% for our chairman and 40% for our former chief financial officer. This target payout amount was set at levels the compensation committee determined were appropriate in order to achieve our objective of retaining those executives who perform at or above the levels necessary for us to achieve our business plan, which, among other things, involved growing our company in a cost-effective way.

We designed our Senior Executive Incentive Compensation Plan to focus our executives on achieving key corporate financial objectives and strategic milestones, and to reward substantial achievement of these company financial objectives and strategic milestones. The performance goals and cash incentive payment criteria established by the compensation committee under our 2008 Senior Executive Incentive Compensation Plan were designed to require significant effort and operational success on the part of us and our named executive officers for achievement. While the Senior Executive Incentive Compensation Plan is designed to provide cash incentive payments based upon objectively determinable formulas that tie cash incentive payments to specific financial goals and strategic milestones, the compensation committee retains the discretion to adjust cash incentive payments under the Senior Executive Incentive Compensation Plan based upon additional factors.

For each executive officer, except Mr. Leahy, 100% of his or her target cash incentive compensation in 2008 was tied to a company-wide revenue threshold. We had to achieve minimum revenue of approximately $300 million for any portion of the cash incentive compensation to be accrued, with accrual increasing ratably until we achieve revenue of approximately $311 million, at which 100% of the target cash incentive compensation would have been accrued; provided, however, that the payment of such cash incentive compensation was conditioned on our pre-tax net income as a percentage of revenue for fiscal 2008 remaining above a pre-determined threshold of 2%. The compensation committee chose revenue achievement as a primary determinant of cash incentive compensation because it believed that, as a growth company, we should reward meaningful revenue growth. The compensation committee conditioned the payment of cash incentive compensation on the achievement of a minimum level of pre-tax net income as a percentage of revenue because it believed that we must balance our growth with a disciplined increase in profitability designed to allow us to achieve our more long-term financial goals.

We achieved our revenue threshold for 2008, but because we did not achieve the minimum level of pre-tax net income, the executive officers, except Mr. Leahy, did not meet performance thresholds under the formula driven portion of the 2008 Senior Executive Incentive Compensation Plan. Nevertheless, based upon its discretion under the

2008 Senior Executive Incentive Compensation Plan, the compensation committee determined that cash incentive compensation should be paid based upon a number of factors including the

substantial achievement of the fundamental revenue target, the company s strengthened balance sheet and overall organizational improvements,the extraordinary global economic conditions, the lack of any cash incentive compensation paid pursuant to the 2007 Senior Executive Incentive Compensation Plan, and the comparable cash incentive compensation of companies within our peer group. Based on these factors, the compensation committee determined that our chief executive officer, chief financial officer, president, government & industrial robots, senior vice president and general counsel and vice president, financial controls and analysis should receive $105,714, $122,504, $153,380, $88,954 and $39,928, respectively, which corresponds to 33.5%, 100.0%, 73.4%, 63.0% and 69.9%, respectively, of each executive s total target cash incentive compensation amount.

Because Mr. Leahy joined us in June 2008, after a substantial portion of the year had passed, and in accordance with the terms of his employment offer letter, the compensation committee provided that his cash incentive compensation would be paid at 100% of his threshold bonus amount.

In addition, pursuant to Ms. Greiner s Employment Separation Agreement, a bonus payment of $102,913 was authorized by the compensation committee. Similarly, pursuant to Mr. Clear s Transitional Services and Departure Agreement, a bonus payment of $27,791 was approved for Mr. Clear.

Long-Term Incentives

Executive officers (and other employees) are eligible to receive restricted stock, stock option grants and other stock awards that are intended to promote success by aligning employee financial interests with long-term shareholder value. These stock-based incentives are based on various factors primarily relating to the responsibilities of the individual officer or employee, their past performance, anticipated future contributions and prior option grants. In general, our compensation committee bases its decisions to grant stock-based incentives on recommendations of management and the compensation committee s analysis of peer group compensation information, with the intention of keeping the executives overall compensation, including the equity component of that compensation, at a competitive level with the comparator companies reviewed by the compensation committee in the technology and robotics industries. Our compensation committee also considers the number of shares of common stock outstanding, the number of shares of common stock authorized for issuance under its equity compensation plans, the number of options and shares held by the executive officer for whom an award is being considered and the other elements of the officer s compensation, as well as our compensation objectives and policies described above. During fiscal year 2008, stock options and deferred stock awards were granted to our named executive officers. As with the determination of base salaries and short term incentive payments, the compensation committee exercises subjective judgment and discretion in view of the above criteria.

Other Compensation

We also have various broad-based employee benefit plans. Our executive officers participate in these plans on the same terms as other eligible employees, subject to any legal limits on the amounts that may be contributed or paid to executive officers under these plans. We offer a 401(k) plan, which allows our employees to invest in a wide array of funds on a pre-tax basis. We do not provide pension arrangements or post-retirement health coverage for our named executive officers or other employees. We also maintain insurance and other benefit plans for our employees. Executive officers receive higher life, accidental death and dismemberment and disability insurance benefits than other employees. In addition, one executive officer receives amounts allocable to use of our corporate apartment. We also enter into executive agreements with our executive officers providing for certain severance benefits which may be triggered as a result of the termination of such officer s employment under certain circumstances. We offer no perquisites, other than the use of our corporate apartment, that are not otherwise available to all of our employees.

Executive Agreements

We entered into executive agreements with each of our executive officers. The executive agreements provide for severance payments equal to 50% of such officer s annual base salary, as well as certain continued health benefits, in the event that we terminate his or her employment other than for cause. In addition, these

executive agreements provide that if we experience a change in control and the employment of such officer is terminated without cause, or if such officer terminates his or her employment for certain reasons including a substantial reduction in salary or bonus or geographic movement during the one-year period following the change in control, then all unvested stock options held by such officer become fully-vested and immediately exercisable and such officer is entitled to severance payments equal to 100% of his or her annual base salary and 50% of such officer s annual bonus, as well as certain continued health benefits. The agreements also provide that all options granted to each officer will have their vesting accelerated by 25% upon a change in control. It was the belief of the compensation committee that these provisions were consistent with executive severance arrangements that are customary for public companies at our stage of development and were necessary in order to hire and/or retain the executives.

From time to time, the Company s executive officers enter into stock restriction agreements upon the exercise of their option grants.

We entered into indemnification agreements with each of our executive officers and directors, providing for indemnification against expenses and liabilities reasonably incurred in connection with their service for us on our behalf.

On December 30, 2002, we entered into an independent contractor agreement with Dr. Rodney Brooks. On August 8, 2008, we amended and restated this independent contractor agreement. Our independent contractor agreement with Dr. Brooks shall continue until terminated by either party upon 60 days written notice.

Tax Deductibility of Executive Compensation

In general, under Section 162(m) of the Internal Revenue Code of 1986, as amended, or the Code, we cannot deduct, for federal income tax purposes, compensation in excess of $1,000,000 paid to certain executive officers. This deduction limitation does not apply, however, to compensation that constitutes qualified performance-based compensation within the meaning of Section 162(m) of the Code and the regulations promulgated thereunder. We have considered the limitations on deductions imposed by Section 162(m) of the Code and it is our present intention, for so long as it is consistent with our overall compensation objective, to structure executive compensation to minimize application of the deduction limitations of Section 162(m) of the Code.

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Executive Compensation Summary

The following table sets forth summary compensation information for the Company s chief executive officer, chief financial officer and the three other most highly compensated executive officers:

SUMMARY COMPENSATION TABLE

Name and Principal Position	Year	Salary ($)	Stock Awards ($)(1)	Option Awards ($)(1)	Non-Equity Incentive Plan Compensation ($)	All Other Compensation ($)(2)(3)	Total ($)
Colin M. Angle	2008	372,288	73,664	84,191	105,714	6,900	642,757
Chairman, Chief Executive	2007	324,820	30,691	25,944	0	6,750	388,205
Officer and Director	2006	281,731	17,935		105,081	6,600	411,347
John J. Leahy(4)	2008	195,199	105,591	173,423	122,504	5,654	602,371
Executive Vice President, Chief Financial Officer and Treasurer							
Joseph W. Dyer	2008	322,074	50,256	49,082	153,380	6,900	581,692
President and General	2007	300,240	18,285	16,215	0	6,750	341,490
Manager Government & Industrial	2006	277,600	10,313		155,142	6,600	449,655
Glen D. Weinstein	2008	282,704	47,575	99,841	88,954	6,900	525,974
Senior Vice President, General Counsel and Secretary							
Alison Dean	2008	228,654	21,028	219,421	39,928	6,854	515,885
Vice President, Financial Controls & Analysis, Principal Accounting Officer							
Helen Greiner(5)	2008	273,402	223,476	147,927	102,913	337,525(6)	1,085,243
	2007	324,820	30,691	25,944	0	6,750	388,205
	2006	282,749	17,935		105,081	6,600	412,365
Geoffrey P. Clear(7)	2008	201,860	(6,636)	98,300	27,791	83,460(8)	404,775
	2007	265,144	13,218	20,089	0	6,750	305,201
	2006	248,461	6,042	5,136	42,999	6,600	309,238

(1) Represents the dollar amount recognized for financial statement reporting purposes for the fiscal years ended December 27, 2008, December 29, 2007 and December 30, 2006, as appropriate, in accordance with SFAS No. 123(R) and, accordingly, includes amounts from options granted prior to 2008. See the information appearing in note 2 to our consolidated financial statements included as part of our Annual Report on Form 10-K for the fiscal year ended December 27, 2008 for certain assumptions made in the valuation of stock and option awards.

(2) Excludes medical, group life insurance and certain other benefits received by the named executive officers that are available generally to all of our salaried employees and certain prerequisites and other personal benefits received by the named executive officers which do not exceed $10,000.

(3) Represents 401(k) matching contributions.

(4) Mr. Leahy joined as Executive Vice President, Chief Financial Officer and Treasurer, iRobot Corporation, on June 9, 2008.

(5) Ms. Greiner resigned as an employee and as Chairman of the Board, effective October 24, 2008.

(6) Includes severance payments of $330,625 and payment in lieu of 401(k) matching contribution of $6,900 pursuant to an Employment Separation Agreement dated October 22, 2008.

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(7) Mr. Clear resigned as Senior Vice President, Chief Financial Officer and Treasurer of the Company effective June 9, 2008, and served as Senior Finance Advisor to the Chief Executive Officer from June 9, 2008 until September 5, 2008.

(8) Includes severance payments pursuant to a Transitional Services and Departure Agreement dated April 30, 2008, equal to $83,460.

Grants of Plan-Based Awards in 2008

The following table sets forth, for each of the named executive officers, information about grants of plan-based awards during 2008.

GRANTS OF PLAN-BASED AWARDS 2008

Name	Grant Date	Estimated Possible Payouts Under Non-Equity Incentive Plan Awards(1) Threshold ($)	Target ($)	Maximum ($)	All Other Stock Awards: Number of Shares of Stock or Units (#)(2)	All Other Option Awards: Number of Securities Underlying Options (#)(2)	Exercise or Base Price of Option Awards ($/Sh)	Grant Date Fair Value of Stock and Option Awards ($)
Colin M. Angle			315,658	631,316				
	3/28/2008				16,300		17.13	279,219
	3/28/2008					26,000	17.13	217,935
John J. Leahy		122,504	122,504	245,008				
	6/27/2008				60,000		14.05	843,000
	6/27/2008					200,000	14.05	1,384,540
Joseph W. Dyer			209,076	418,152				
	3/28/2008				11,500		17.13	196,995
	3/28/2008					14,000	17.13	117,349
Glen D. Weinstein			141,197	282,394				
	3/28/2008				7,350		17.13	125,906
	3/28/2008					14,000	17.13	117,349
Alison Dean			57,115	114,230				
	3/28/2008				1,750		17.13	29,978
	7/25/2008				1,333		14.09	18,782
	7/25/2008					5,333	14.09	37,109

Helen Greiner		264,500	529,000			
	3/28/2008			8,800	17.13	150,744
Geoffrey P. Clear		110,622	221,244			
	3/28/2008			3,350	17.13	57,386

(1) This reflects the threshold, target and maximum incentive cash payout levels established under our 2008 Senior Executive Incentive Compensation Plan.

(2) All stock awards and option awards were made pursuant to our 2005 Plan.

Discussion of Summary Compensation and Grants of Plan-Based Awards Tables

The compensation paid to the named executive officers includes salary, cash incentive compensation and equity incentive compensation. In addition, each named executive officer is eligible to receive contributions to his or her 401(k) plan under our matching contribution program.

Executive Agreements

In March 2006, we entered into executive agreements with Messrs. Angle, Clear, Weinstein and Dyer, and Ms. Greiner. In March 2007 and June 2008, we entered into executive agreements with Ms. Dean and Mr. Leahy, respectively. The executive agreements provide for severance payments equal to 50% of such officer s annual base salary, as well as certain continued health benefits, in the event that we terminate his or

her employment other than for cause. In addition, these executive agreements provide that if we experience a change in control and the employment of such officer is terminated without cause, or if such officer terminates his or her employment for certain reasons including a substantial reduction in salary or bonus or geographic movement during the one-year period following the change in control, then all unvested stock options held by such officer become fully-vested and immediately exercisable and such officer is entitled to severance payments equal to 100% of his or her annual base salary and 50% of such officer s annual target cash incentive compensation, as well as certain continued health benefits. The agreements also provide that all options granted to each officer will have their vesting accelerated by 25% upon a change in control.

On October 22, 2008, we entered into an employment separation agreement with Ms. Greiner, which supersedes her executive agreement, and provides for the following, among other things: (i) separation pay equal to one year s base salary, (ii) health benefits coverage for up to four months, (iii) the opportunity to receive a pro-rated cash incentive compensation for fiscal 2008, (iv) annual cash and equity awards pursuant to the Company s non-employee director compensation policy, (v) full acceleration of all of her currently outstanding stock options, restricted stock awards and restricted stock units if Ms. Greiner ceases to serve as a director of the Company and (vi) a general release by Ms. Greiner, in each case in the manner specified in the employment separation agreement.

On April 30, 2008, we entered into a transitional services and departure agreement with Mr. Clear, which supersedes his executive agreement, and provided for certain separation benefits through December 31, 2008 and acceleration of certain unvested stock options and restricted stock awards.

In 2008, salary was approximately 57.9%, 32.4%, 55.4%, 53.7%, 44.3%, 25.2% and 49.9% of the total compensation for Messrs. Angle, Leahy, Dyer and Weinstein, Mses. Dean and Greiner, and Mr. Clear, respectively. In 2007, salary was approximately 83.7%, 87.9%, 83.7%, and 86.9% of the total compensation for Messrs. Angle and Dyer, Ms. Greiner, and Mr. Clear, respectively.

Cash Incentive Compensation

Our named executive officers are eligible to participate in our Senior Executive Incentive Compensation Plan. Pursuant to this plan, we award our named executive officers cash incentive payments based on an evaluation of the achievement against predetermined measurable financial and operational metrics in accordance with the terms of the plan as adopted by the compensation committee. Target cash incentives for named executive officers are generally targeted at the 50th percentile of similar cash incentives provided to officers in peer companies reviewed by the compensation committee in the technology and robotics industries.

For each executive officer, except Mr. Leahy, 100% of his or her target bonus in 2008 was tied to a company-wide revenue threshold. We had to achieve minimum revenue of approximately $300 million for any portion of the bonus to be accrued, with bonus accrual increasing ratably until we achieve revenue of approximately $311 million, at which 100% of the target bonus would have been accrued; provided, however, that the payment of such bonus was conditioned on our pre-tax net income as a percentage of revenue for fiscal 2008 remaining above a pre-determined threshold of 2%. The compensation committee chose revenue achievement as a primary determinant of cash incentive compensation because it believed that, as a growth company, we should reward meaningful revenue growth. The compensation committee conditioned the payment of cash incentive compensation on the achievement of a minimum level of pre-tax net income as a percentage of revenue because it believed that we must balance our growth with a disciplined increase in profitability designed to allow us to achieve our more long-term financial goals.

We achieved our revenue threshold for 2008, but because we did not achieve the minimum level of pre-tax net income, the executive officers, except Mr. Leahy, did not meet performance thresholds under the formula driven portion of the 2008 Senior Executive Incentive Compensation Plan. Because Mr. Leahy joined us in June 2008, after a

substantial portion of the year had passed, the compensation committee provided that his cash incentive compensation would be paid at 100% of his threshold, which was approximately 20.3% of his total compensation. Nevertheless, based upon its discretion under the 2008 Senior Executive Incentive Compensation Plan, the committee determined that cash incentive compensation should be paid based upon a number of factors including the substantial achievement of the fundamental revenue target, the extraordinary

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global economic conditions, the lack of any cash incentive compensation paid pursuant to the 2007 Senior Executive Incentive Compensation Plan , and the comparable cash incentive compensation of companies within our peer group.

For 2008, non-equity incentive compensation was approximately 16.4%, 20.3%, 26.4%, 16.9%, 7.7%, 9.5%, and 6.9% of the total compensation for Messrs. Angle, Leahy, Dyer and Weinstein, Mses. Dean and Greiner, and Mr. Clear, respectively.

Equity Incentive Compensation

Executive officers are eligible to receive restricted stock, stock option grants and other stock awards. These stock-based incentives are based on various factors primarily relating to the responsibilities of the individual officer, their past performance, anticipated future contributions and prior option grants. In general, our compensation committee bases its decisions to grant stock-based incentives on recommendations of management and the compensation committee s analysis of peer group compensation information, with the intention of keeping the executives overall compensation, including the equity component of that compensation, at a competitive level with the comparator companies reviewed by the committee in the technology and robotics industries. Our compensation committee also considers the number of shares of common stock outstanding, the number of shares of common stock authorized for issuance under its equity compensation plans, the number of options and shares held by the executive officer for whom an award is being considered and the other elements of the officer s compensation, as well as our compensation objectives and policies described above. In 2007 and 2008, stock options and restricted stock awards were granted to our named executive officers, as noted in the Grants of Plan-Based Awards-2008 table above. There were no stock options or restricted stock awards granted to our named executive officers in 2006.

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Outstanding Equity Awards at Fiscal Year End

The following table sets forth, for each of the named executive officers, information about unexercised option awards and unvested restricted stock awards that were held as of December 27, 2008.

OUTSTANDING EQUITY AWARDS AT FISCAL YEAR END 2008

	Option Awards				Stock Awards	
Name	Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable	Option Exercise Price ($)	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested (#)	Market Value of Shares or Units of Stock That Have Not Vested ($)
Colin M. Angle	8,001	13,332(1)	16.03	5/25/2014		
		26,000(1)	17.13	3/28/2015	20,299(1)	188,578
John J. Leahy		200,000(2)	14.05	6/27/2015	60,000(2)	557,400
Joseph P. Dyer	113,839		2.33	2/18/2014		
	32,082		2.33	2/18/2014		
	44,328	24,000(3)	2.78	9/17/2014		
	5,001	8,332(4)	16.03	5/25/2014		
		14,000(4)	17.13	3/28/2015	13,999(4)	130,051
Glen D. Weinstein	11,702		1.87	9/27/2010		
	10,000		0.55	12/19/2012		
	12,000	3,000(5)	2.78	4/12/2014		
	39,000	26,000(5)	4.96	2/23/2015		
	9,000	15,000(6)	16.03	5/25/2014		
		14,000(6)	17.13	3/28/2015	11,850(6)	110,087
Alison Dean	4,800	13,754(7)	14.54	8/22/2015		
		11,446(7)	14.54	8/22/2015		
	6,750	5,250(8)	16.46	7/28/2013		
	2,084	4,583(8)	18.74	7/27/2014	2,583(8)	23,996
		5,333(8)	14.09	7/25/2015	875(9)	8,129
Helen Greiner	8,001	13,332(10)	16.03	5/25/2014	12,799(10)	118,903
Geoffrey P. Clear						

(1) Mr. Angle s stock option grants vest over a four-year period, at a rate of twenty-five percent (25%) on the first anniversary of the grant, and quarterly thereafter. Mr. Angle s restricted stock awards vest over a four-year period, at a rate of twenty-five percent (25%) on each anniversary of the grant.

(2) Mr. Leahy s stock option grant vests over a four-year period, at a rate of twenty-five percent (25%) on the first anniversary of the grant, and quarterly thereafter. Mr. Leahy s restricted stock award vests over a four-year period, at a rate of twenty-five percent (25%) on each anniversary of the grant.

(3) Mr. Dyer s stock option grant vests over a five-year period, at a rate of twenty percent (20%) on the first anniversary of the grant, and annually thereafter.

(4) Mr. Dyer s stock option grants vest over a four-year period, at a rate of twenty-five percent (25%) on the first anniversary of the grant, and quarterly thereafter. Mr. Dyer s restricted stock awards vest over a four-year period, at a rate of twenty-five percent (25%) on each anniversary of the grant.

(5) Mr. Weinstein s stock option grants vest over a five-year period, at a rate of twenty percent (20%) on the first anniversary of the grant, and annually thereafter.

(6) Mr. Weinstein s stock option grants vest over a four-year period, at a rate of twenty-five percent (25%) on the first anniversary of the grant, and quarterly thereafter. Mr. Weinstein s restricted stock awards vest over a four-year period, at a rate of twenty-five percent (25%) on each anniversary of the grant.

(7) Ms. Dean s stock option grants vest over a five-year period, at a rate of twenty percent (20%) on the first anniversary of the grant, and annually thereafter.

(8) Ms. Dean s stock option grants vest over a four-year period, at a rate of twenty-five percent (25%) on the first anniversary of the grant, and quarterly thereafter. Ms. Dean s restricted stock awards vest over a four-year period, at a rate of twenty-five percent (25%) on each anniversary of the grant.

(9) Ms. Dean s restricted stock award vests over a two-year period, at a rate of fifty percent (50%) on the six-month anniversary of the grant and fifty percent (50%) on the two-year anniversary of the grant.

(10) Ms. Greiner s stock option grants vest over a four-year period, at a rate of twenty-five percent (25%) on the first anniversary of the grant, and quarterly thereafter. Ms. Greiner s restricted stock awards vest over a four-year period, at a rate of twenty-five percent (25%) on each anniversary of the grant.

Option Exercises and Stock Vested

The following table sets forth, for each of the named executive officers, information with respect to the exercise of stock options and the vesting of restricted stock awards during the year ended December 27, 2008, as well as the year-end value of exercised options and vested restricted stock.

OPTION EXERCISES AND STOCK VESTED 2008

	Option Awards		**Stock Awards**	
Name	**Shares Acquired on Exercise(#)**	**Value Realized on Exercise($)(1)**	**Number of Shares Acquired on Vesting(#)**	**Value Realized on Vesting($)**
Colin M. Angle			7,808	136,868
John J. Leahy				
Joseph W. Dyer			4,557	79,627
Glen D. Weinstein	13,000	202,830	3,100	49,906
Alison Dean	25,000	86,945	1,292	19,333
Helen Greiner			7,808	136,868
Geoffrey P. Clear	52,440	640,052	8,531	128,471

(1) Amounts disclosed in this column were calculated based on the difference between the fair market value of our common stock on the date of exercise and the exercise price of the options in accordance with regulations promulgated under the Exchange Act.

Potential Benefits Upon Termination or Change in Control

Severance and Change in Control Arrangements in General

The executive agreements described under Transactions with Our Executive Officers and Directors below provide that, upon termination of the executive officer s employment without cause, the executive officer is entitled to severance payments equal to 50% of the executive officer s base salary, continued health plan premium payments for up to six months, and any unpaid compensation, benefits or unused vacation accrued. The executive agreements also provide that, upon an involuntary termination upon a change in control, or upon a resignation for good reason upon a change in control, the executive officer is entitled to 100% of the executive officer s base salary, 50% of the executive officer s target cash incentive compensation or other performance, profit-sharing or any other similar arrangement, continued health plan premium payments for up to one year, full vesting of all unvested stock, stock options, awards and rights, and any unpaid compensation, benefits or unused vacation accrued. In addition, upon a change in control, the executive agreements provide for the vesting of 25% of all unvested stock, option, awards and purchase rights granted to the executive officer.

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Cash Payments and/or Acceleration of Vesting Following Certain Termination Events

Assuming the employment of our named executive officers was terminated involuntarily and without cause (not in connection with a change in control) on December 27, 2008, our named executive officers would be entitled to cash payments in the amounts set forth opposite their names in the below tables, subject to any deferrals required under Section 409A of the Internal Revenue Code of 1986, as amended.

Name(1)	Base Salary ($)	Continuation of Health Plan Premium Payments ($)	Accrued Vacation Pay ($)	Total ($)
Colin M. Angle	189,384	9,005	24,647	223,036
John J. Leahy	175,006	9,005	114	184,125
Joseph W. Dyer	162,500	263	25,000	187,763
Glen D. Weinstein	142,437	8,342	19,448	170,227
Alison Dean	115,000	8,065	5,370	128,435

(1) Excludes Ms. Greiner and Mr. Clear, who were not employed by the Company on December 27, 2008.

Assuming the employment of our named executive officers was terminated involuntarily and without cause, or such officers resigned with good reason, during the one-year period following a change in control on December 27, 2008, our named executive officers would be entitled to cash payments in the amounts set forth opposite their names in the below table, subject to any deferrals required under Section 409A of the Internal Revenue Code of 1986, as amended, and acceleration of vesting as set forth in the below table. The following table provides the market value (that is, the value based upon our stock price on December 27, 2008, minus the exercise price) of stock options that would become exercisable or vested as a result of these acceleration events as of December 27, 2008.

Name(1)	Base Salary ($)	Bonus ($)	Continuation of Health Plan Premium Payments ($)	Accrued Vacation Pay ($)	Market Value of Stock Options ($)(2)	Market Value of Restricted Stock ($)	Total ($)
Colin M. Angle	378,769	160,977	18,010	24,647		188,578	770,981
John J. Leahy	350,012	113,754	18,010	114		557,400	1,039,290
Joseph W. Dyer	325,000	105,625	526	25,000	156,240	130,051	742,442
Glen D. Weinstein	284,875	71,219	16,684	19,448	132,110	110,087	634,423
Alison Dean	230,000	28,750	16,130	5,370		32,125	312,375

(1)

Excludes Ms. Greiner and Mr. Clear, who were not employed by the Company on December 27, 2008.

(2) Excludes stock options where the exercise price is greater than market value of our commo#000000">

Shareholders Equity at December 31, 2005	**9,799**	**743,503**	**669,057**	**292,873**	**1,705,433**
Net income			392,502		392,502
Net unrealized gains on securities, net of taxes				159,973	159,973
Currency translation adjustments, net of taxes				(1,680)	(1,680)
Net actuarial pension loss, net of taxes				(25,013)	(25,013)
Comprehensive income					**525,782**
Repurchase of common stock	(140)		(45,880)		(45,880)
Conversion of convertible notes payable	335	108,842			108,842
Restricted stock units expensed		1,342			1,342
Tax benefit on closed stock option plans		874			874
SHAREHOLDERS EQUITY AT DECEMBER 31, 2006	**9,994**	**$ 854,561**	**$ 1,015,679**	**$ 426,153**	**$ 2,296,393**

See accompanying notes to consolidated financial statements.

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CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31,		
	2006	2005	2004
	(dollars in thousands)		
Operating Activities			
Net income	**$ 392,502**	$ 147,915	$ 165,412
Adjustments to reconcile net income to net cash provided by operating activities:			
Deferred income tax expense (benefit)	**30,561**	(44,513)	(29,800)
Depreciation and amortization	**27,610**	29,581	31,336
Net realized investment gains	**(63,608)**	(19,708)	(4,139)
Decrease in receivables	**11,531**	50,274	34,834
Increase in deferred policy acquisition costs	**(6,063)**	(10,363)	(4,295)
Increase in unpaid losses and loss adjustment expenses, net	**273,357**	266,920	567,239
Increase in unearned premiums, net	**26,688**	20,541	7,556
Increase (decrease) in payables to insurance companies	**(56,733)**	33,887	(60,523)
Other	**(124,252)**	76,717	(16,927)
Net Cash Provided By Operating Activities	**511,593**	551,251	690,693
Investing Activities			
Proceeds from sales of fixed maturities and equity securities	**1,559,977**	1,839,065	2,528,166
Proceeds from maturities, calls and prepayments of fixed maturities	**173,997**	164,150	248,760
Cost of fixed maturities and equity securities purchased	**(2,125,618)**	(2,444,059)	(3,497,841)
Net change in short-term investments	**109,042**	(126,827)	(39,702)
Cost of investments in affiliates	**(58,703)**	(14,072)	
Net proceeds from sale of subsidiary		43,237	
Additions to property and equipment	**(9,192)**	(29,498)	(6,963)
Other	**1,715**	727	(116)
Net Cash Used By Investing Activities	**(348,782)**	(567,277)	(767,696)
Financing Activities			
Additions to senior long-term debt	**145,402**		196,816
Repayments and retirement of senior long-term debt	**(4,549)**	(3,603)	(110,000)
Retirement of Junior Subordinated Deferrable Interest Debentures	**(36,421)**	(9,627)	
Repurchases of common stock	**(45,880)**	(15,926)	(3,385)
Other	**(5)**		
Net Cash Provided (Used) By Financing Activities	**58,547**	(29,156)	83,431
Increase (decrease) in cash and cash equivalents	**221,358**	(45,182)	6,428
Cash and cash equivalents at beginning of year	**333,757**	378,939	372,511
Cash And Cash Equivalents At End Of Year	**$ 555,115**	$ 333,757	$ 378,939

See accompanying notes to consolidated financial statements.

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Markel Corporation & Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Markel Corporation markets and underwrites specialty insurance products and programs to a variety of niche markets and operates in three segments of the specialty insurance marketplace: the Excess and Surplus Lines, the Specialty Admitted and the London markets.

a) Basis of Presentation. The accompanying consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (U.S. GAAP) and include the accounts of Markel Corporation and all subsidiaries (the Company). All significant intercompany balances and transactions have been eliminated in consolidation. Certain prior year amounts have been reclassified to conform to the current presentation.

b) Use of Estimates. The preparation of financial statements in accordance with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosure of contingent assets and liabilities. Management periodically reviews its estimates and assumptions. These reviews include evaluating the adequacy of reserves for unpaid losses and loss adjustment expenses, litigation contingencies and the reinsurance allowance for doubtful accounts, as well as analyzing the recoverability of deferred tax assets, assessing goodwill for impairment and evaluating the investment portfolio for other-than-temporary declines in estimated fair value. Actual results may differ from the estimates and assumptions used in preparing the consolidated financial statements.

c) Investments. Investments, other than investments in affiliates, are considered available-for-sale and are recorded at estimated fair value, generally based on quoted market prices. The net unrealized gains or losses on investments, net of deferred income taxes, are included in accumulated other comprehensive income in shareholders equity. A decline in the fair value of any investment below cost that is deemed other-than-temporary is charged to earnings, resulting in a new cost basis for the security.

Premiums and discounts are amortized or accreted over the lives of the related fixed maturities as an adjustment to the yield using the effective interest method. Dividend and interest income are recognized when earned. Realized investment gains or losses are included in earnings and are derived using the first-in, first-out method.

d) Investments in Affiliates. Investments in affiliates includes investments in companies accounted for under the equity method of accounting. The Company records its proportionate share of net income or loss of the investee in net investment income.

e) Cash and Cash Equivalents. The Company considers all investments with original maturities of 90 days or less to be cash equivalents. The carrying value of the Company s cash and cash equivalents approximates fair value.

f) Reinsurance Recoverables. Amounts recoverable from reinsurers are estimated in a manner consistent with the claim liability associated with the reinsured business. Allowances are established

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1. Summary of Significant Accounting Policies (continued)

for amounts deemed uncollectible and reinsurance recoverables are recorded net of these allowances. The Company evaluates the financial condition of its reinsurers and monitors concentration risk to minimize its exposure to significant losses from individual reinsurers.

g) Deferred Policy Acquisition Costs. Costs directly related to the acquisition of insurance premiums, such as commissions to agents and brokers, are deferred and amortized over the related policy period, generally one year. Commissions received related to reinsurance premiums ceded are netted against broker commissions and other acquisition costs in determining acquisition costs eligible for deferral. To the extent that future policy revenues on existing policies are not adequate to cover related costs and expenses, deferred policy acquisition costs are charged to earnings. The Company does not consider anticipated investment income in determining whether a premium deficiency exists.

h) Goodwill. Goodwill is tested for impairment at least annually. The Company completes its annual test during the fourth quarter of each year based upon the results of operations through September 30.

i) Property and Equipment. Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization of property and equipment are calculated using the straight-line method over the estimated useful lives (generally, the life of the lease for leasehold improvements, three to five years for furniture and equipment and three to ten years for other).

j) Income Taxes. The Company records deferred income taxes to reflect the net tax effect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and their tax bases. Deferred tax assets are reduced by a valuation allowance when management believes it is more likely than not that some, or all, of the deferred tax assets will not be realized.

k) Unpaid Losses and Loss Adjustment Expenses. Unpaid losses and loss adjustment expenses are based on evaluations of reported claims and estimates for losses and loss adjustment expenses incurred but not reported. Estimates for losses and loss adjustment expenses incurred but not reported are based on reserve development studies, among other things. The Company does not discount reserves for losses and loss adjustment expenses to reflect estimated present value. The reserves recorded are estimates, and the ultimate liability may be greater than or less than the estimates.

l) Revenue Recognition. Insurance premiums are earned on a pro rata basis over the policy period, generally one year. The cost of reinsurance is initially recorded as prepaid reinsurance premiums and is amortized over the reinsurance contract period in proportion to the amount of insurance protection provided. Premiums ceded are netted against premiums written. The Company uses the periodic method to account for assumed reinsurance from foreign reinsurers. The Company s foreign reinsurers provide sufficient information to record foreign assumed business in the same manner as the Company records assumed business from United States reinsurers.

Markel Corporation & Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

1. Summary of Significant Accounting Policies (continued)

m) Stock Compensation Plans. The Company adopted Statement of Financial Accounting Standards (Statement) No. 123 (revised 2004), *Shared-Based Payment*, in 2006. The adoption of Statement No. 123 (revised 2004) did not have a material impact on the Company s financial position, results of operations or cash flows.

Prior to the adoption of Statement No. 123 (revised 2004), the Company applied the intrinsic value recognition and measurement principles of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations, in accounting for stock-based compensation plans. Under the fair value method principles of Statement No. 123 (revised 2004), pro forma stock-based compensation expense, net of taxes, and pro forma net income would not have differed from amounts reported in 2005 and 2004.

Stock-based compensation expense is recognized as part of underwriting, acquisition and insurance expenses over the requisite service period. Stock-based compensation expense, net of taxes, was $1.8 million in 2006, $1.0 million in 2005 and $1.8 million in 2004.

n) Foreign Currency Translation. The functional currencies of the Company s foreign operations are the currencies in which the majority of their business is transacted. Assets and liabilities of foreign operations are translated into the United States Dollar using the exchange rates in effect at the balance sheet date. Revenues and expenses of foreign operations are translated using the average exchange rate for the period. Gains or losses from translating the financial statements of foreign operations are included, net of tax, in shareholders equity as a component of accumulated other comprehensive income. Gains and losses arising from transactions denominated in a foreign currency, other than a functional currency, are included in net income.

The Company manages its exposure to foreign currency risk primarily by matching assets and liabilities denominated in the same currency. To the extent that assets and liabilities in foreign currencies are not matched, the Company is exposed to foreign currency risk. For functional currencies, the related exchange rate fluctuations are reflected in other comprehensive income (loss).

o) Comprehensive Income. Comprehensive income represents all changes in equity that result from recognized transactions and other economic events during the period. Other comprehensive income (loss) refers to revenues, expenses, gains and losses that under U.S. GAAP are included in comprehensive income but excluded from net income, such as unrealized gains or losses on investments in fixed maturities and equity securities, foreign currency translation adjustments and, in 2006, net actuarial pension loss.

p) Net Income Per Share. Basic net income per share is computed by dividing net income by the weighted average number of common shares outstanding during the year. Diluted net income per share is computed by dividing net income by the weighted average number of common shares and dilutive potential common shares outstanding during the year. Prior to the conversion of the Company s convertible notes payable in

December 2006, diluted net income per share reflected the application of the if-converted method as defined in Statement No. 128, *Earnings Per Share*.

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1. Summary of Significant Accounting Policies (continued)

q) Recent Accounting Pronouncements. In February 2006, the Financial Accounting Standards Board (FASB) issued Statement No. 155, *Accounting for Certain Hybrid Financial Instruments*. Statement No. 155 requires companies to evaluate beneficial interests in securitized financial assets in order to identify whether those interests are freestanding derivatives or contain embedded derivatives that would have to be accounted for separately at fair value. In January 2007, the FASB issued Statement No. 133 Implementation Issue No. B40 (Issue No. B40), *Embedded Derivatives: Application of Paragraph 13(b) to Securitized Interests in Prepayable Financial Assets.* Issue No. B40 exempts securitized interests that contain only an embedded derivative that is tied to the prepayment risk of the underlying financial assets from the evaluation required by Statement No. 155. Statement No. 155 becomes effective for the Company in the first quarter of 2007. The Company will adopt Statement No. 155 and apply Issue No. B40 concurrently and does not expect the adoption of Statement No. 155 to have a material impact on its financial position, results of operations or cash flows.

In September 2006, the FASB issued Statement No. 157, *Fair Value Measurements*. Statement No. 157 establishes a framework for measuring fair value, clarifies the definition of fair value within that framework and expands disclosure requirements regarding the use of fair value measurements. Statement No. 157 becomes effective for the Company in the first quarter of 2008. The Company does not expect the adoption of Statement No. 157 to have a material impact on its financial position, results of operations or cash flows.

In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN No. 48). FIN No. 48 provides recognition criteria and a related measurement model for uncertain tax positions taken or expected to be taken in income tax returns. FIN No. 48 requires that a position taken or expected to be taken in a tax return be recognized in the financial statements when it is more likely than not that the position would be sustained upon examination by tax authorities. Tax positions that meet the more likely than not threshold are then measured using a probability weighted approach recognizing the largest amount of tax benefit that is greater than 50% likely of being realized upon ultimate settlement. FIN No. 48 becomes effective for the Company in the first quarter of 2007. Upon adoption, the Company will be required to apply the provisions of FIN No. 48 to all tax positions and any cumulative effect adjustment will be recognized as an adjustment to retained earnings. The Company is in the process of evaluating FIN No. 48 and currently estimates that the cumulative effect of applying this guidance will result in an increase to retained earnings at January 1, 2007 in the range of $10 million to $25 million as a result of decreasing reserves for uncertain tax positions. This estimate is subject to change as the Company completes its analysis.

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Markel Corporation & Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

2. Investments

a) The following tables summarize the Company s investments.

	December 31, 2006			
(dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Fixed maturities:				
U.S. Treasury securities and obligations of U.S. government agencies	**$ 1,125,912**	**$ 1,381**	**$ (15,698)**	**$ 1,111,595**
Obligations of states, municipalities and political subdivisions	**1,638,768**	**32,617**	**(1,430)**	**1,669,955**
Foreign governments	**177,890**	**1,292**	**(1,234)**	**177,948**
Public utilities	**85,531**	**589**	**(623)**	**85,497**
Convertibles and bonds with warrants	**4,922**	**134**		**5,056**
All other corporate bonds	**1,963,363**	**10,653**	**(23,098)**	**1,950,918**
Total fixed maturities	**4,996,386**	**46,666**	**(42,083)**	**5,000,969**
Equity securities:				
Insurance companies, banks and trusts	**511,021**	**358,226**	**(3,838)**	**865,409**
Industrial, miscellaneous and all other	**548,324**	**354,795**	**(2,255)**	**900,864**
Total equity securities	**1,059,345**	**713,021**	**(6,093)**	**1,766,273**
Short-term investments	**139,499**			**139,499**
Investment in affiliates	**73,439**			**73,439**
TOTAL INVESTMENTS	**$ 6,268,669**	**$ 759,687**	**$ (48,176)**	**$ 6,980,180**

	December 31, 2005			
(dollars in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Fixed maturities:				
U.S. Treasury securities and obligations of U.S. government agencies	$ 957,528	$ 2,326	$ (15,772)	$ 944,082
Obligations of states, municipalities and political subdivisions	1,550,968	33,770	(4,368)	1,580,370
Foreign governments	342,561	2,819	(2,398)	342,982

Public utilities	55,952	914	(302)	56,564
Convertibles and bonds with warrants	48,129	1,799	(150)	49,778
All other corporate bonds	1,631,026	22,853	(14,359)	1,639,520
Total fixed maturities	4,586,164	64,481	(37,349)	4,613,296
Equity securities:				
Insurance companies, banks and trusts	489,980	242,961	(7,250)	725,691
Industrial, miscellaneous and all other	450,310	208,913	(6,358)	652,865
Total equity securities	940,290	451,874	(13,608)	1,378,556
Short-term investments	248,541			248,541
Investments in affiliates	14,072			14,072
TOTAL INVESTMENTS	$ 5,789,067	$ 516,355	$ (50,957)	$ 6,254,465

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2. Investments (continued)

b) The following tables summarize gross unrealized investment losses by the length of time that securities have continuously been in an unrealized loss position.

	December 31, 2006					
	Less than 12 months		12 months or longer		Total	
(dollars in thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Fixed maturities:						
U.S. Treasury securities and obligations of U.S. government agencies	**$ 220,397**	**$ (979)**	**$ 660,736**	**$ (14,719)**	**$ 881,133**	**$ (15,698)**
Obligations of states, municipalities and political subdivisions	**47,119**	**(255)**	**172,027**	**(1,175)**	**219,146**	**(1,430)**
Foreign governments	**59,843**	**(653)**	**29,224**	**(581)**	**89,067**	**(1,234)**
Public utilities	**28,164**	**(197)**	**11,598**	**(426)**	**39,762**	**(623)**
All other corporate bonds	**805,556**	**(9,879)**	**533,614**	**(13,219)**	**1,339,170**	**(23,098)**
Total fixed maturities	**1,161,079**	**(11,963)**	**1,407,199**	**(30,120)**	**2,568,278**	**(42,083)**
Equity securities:						
Insurance companies, banks and trusts	**7,120**	**(1,154)**	**36,731**	**(2,684)**	**43,851**	**(3,838)**
Industrial, miscellaneous and all other	**4,511**	**(86)**	**30,710**	**(2,169)**	**35,221**	**(2,255)**
Total equity securities	**11,631**	**(1,240)**	**67,441**	**(4,853)**	**79,072**	**(6,093)**
TOTAL	**$ 1,172,710**	**$ (13,203)**	**$ 1,474,640**	**$ (34,973)**	**$ 2,647,350**	**$ (48,176)**

At December 31, 2006, the Company held 503 securities with a total estimated fair value of $2.6 billion and gross unrealized losses of $48.2 million. Of the 503 securities, 322 securities had been in a continuous unrealized loss position for greater than one year and had a total estimated fair value of $1.5 billion and gross unrealized losses of $35.0 million. Of these securities, 320 were fixed maturities where the Company expects to receive all interest and principal payments, and two were equity securities where the Company believed the market valuations were low due to market sentiment as opposed to the operating fundamentals and financial conditions of the companies. At December 31, 2006, all securities with unrealized losses were reviewed and the Company believes that there were no indications of declines in estimated fair value that were considered to be other-than-temporary.

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Markel Corporation & Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

2. Investments (continued)

	December 31, 2005					
	Less than 12 months		12 months or longer		Total	
(dollars in thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Fixed maturities:						
U.S. Treasury securities and obligations of U.S. government agencies	$ 615,895	$ (10,173)	$ 234,836	$ (5,599)	$ 850,731	$ (15,772)
Obligations of states, municipalities and political subdivisions	505,508	(4,041)	14,088	(327)	519,596	(4,368)
Foreign governments	128,381	(1,052)	60,582	(1,346)	188,963	(2,398)
Public utilities	15,805	(302)			15,805	(302)
Convertibles and bonds with warrants	17,980	(150)			17,980	(150)
All other corporate bonds	593,731	(10,515)	138,565	(3,844)	732,296	(14,359)
Total fixed maturities	1,877,300	(26,233)	448,071	(11,116)	2,325,371	(37,349)
Equity securities:						
Insurance companies, banks and trusts	65,893	(7,250)			65,893	(7,250)
Industrial, miscellaneous and all other	64,917	(6,358)			64,917	(6,358)
Total equity securities	130,810	(13,608)			130,810	(13,608)
TOTAL	$ 2,008,110	$ (39,841)	$ 448,071	$ (11,116)	$ 2,456,181	$ (50,957)

At December 31, 2005, the Company held 492 securities with a total estimated fair value of $2.5 billion and gross unrealized losses of $51.0 million. Of the 492 securities, 91 securities had been in a continuous unrealized loss position for greater than one year and had a total estimated fair value of $448.1 million and gross unrealized losses of $11.1 million.

c) The amortized cost and estimated fair value of fixed maturities at December 31, 2006 are shown below by contractual maturity.

(dollars in thousands)	Amortized Cost	Estimated Fair Value

Due in one year or less	$ 174,531	$ 174,168
Due after one year through five years	1,281,828	1,275,911
Due after five years through ten years	1,607,833	1,597,725
Due after ten years	1,932,194	1,953,165
Total	$ 4,996,386	$ 5,000,969

Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties, and the lenders may have the right to put the securities back to the borrower. Based on expected maturities, the estimated average duration of the fixed maturities was 4.7 years.

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2. Investments (continued)

d) The following table presents the components of net investment income.

(dollars in thousands)	Years Ended December 31, **2006**	2005	2004
Interest:			
Municipal bonds (tax-exempt)	**$ 68,521**	$ 59,994	$ 42,513
Taxable bonds	**160,890**	152,059	140,998
Short-term investments, including overnight deposits	**24,899**	16,342	10,066
Dividends on equity securities	**25,892**	22,330	18,709
Income from investments in affiliates	**5,439**		
Other	**(5,526)**	(199)	(119)
	280,115	250,526	212,167
Less investment expenses	**9,099**	8,547	8,135
Net Investment Income	**$ 271,016**	$ 241,979	$ 204,032

e) The following table presents realized investment gains (losses) and the change in unrealized holding gains.

(dollars in thousands)	Years Ended December 31, **2006**	2005	2004
Realized gains:			
Fixed maturities	**$ 18,077**	$ 15,954	$ 34,270
Equity securities	**69,497**	21,664	12,429
	87,574	37,618	46,699
Realized losses:			
Fixed maturities	**(13,728)**	(16,475)	(22,197)
Equity securities	**(8,296)**	(467)	(20,363)
Other	**(1,942)**	(968)	
	(23,966)	(17,910)	(42,560)
Net Realized Investment Gains	**$ 63,608**	$ 19,708	$ 4,139
Change in unrealized holding gains:			
Fixed maturities	**$ (22,549)**	$ (63,528)	$ 4,347

Equity securities	**268,662**	(51,189)	159,123
Net Increase (Decrease)	**$ 246,113**	$ (114,717)	$ 163,470

f) At December 31, 2006, the Company had $1.6 billion of investments and cash and cash equivalents (invested assets) held in trust or on deposit for the benefit of policyholders, reinsurers or banks in the event of default by the Company on its obligations. These invested assets and the related liabilities are included on the Company s consolidated balance sheet. The following discussion provides additional detail regarding irrevocable undrawn letters of credit and investments held in trust or on deposit.

The Company s United States insurance companies had invested assets with a carrying value of $38.5 million and $36.0 million on deposit with state regulatory authorities at December 31, 2006 and 2005, respectively.

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Markel Corporation & Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

2. Investments (continued)

Invested assets with a carrying value of $8.3 million and $8.9 million at December 31, 2006 and 2005, respectively, were held in trust for the benefit of cedents of the Company s United States insurance companies.

Invested assets with a carrying value of $106.2 million and $138.5 million at December 31, 2006 and 2005, respectively, were held in trust for the benefit of United States cedents of Markel International Insurance Company Limited (MIICL), a wholly-owned subsidiary, and to facilitate MIICL s accreditation as an alien reinsurer by certain states.

Invested assets with a carrying value of $47.1 million and $41.8 million at December 31, 2006 and 2005, respectively, were held in trust for the benefit of MIICL s United States surplus lines policyholders.

Invested assets with a carrying value of $34.2 million and $34.7 million at December 31, 2006 and 2005, respectively, were held in trust for the benefit of MIICL s Canadian cedents.

Banks have issued irrevocable undrawn letters of credit supporting the Company s contingent liabilities related to certain reinsurance business written in the United States by MIICL. The Company had deposited invested assets with a carrying value of $36.6 million and $37.3 million at December 31, 2006 and 2005, respectively, as collateral against these letters of credit.

The Company had deposited $401.2 million and $276.5 million of invested assets with Lloyd s to support its underwriting activities at December 31, 2006 and 2005, respectively. In addition, the Company had invested assets with a carrying value of $945.4 million and $1.1 billion at December 31, 2006 and 2005, respectively, held in trust for the benefit of syndicate policyholders.

g) At December 31, 2006 and 2005, investments in U.S. Treasury securities and obligations of U.S. government agencies were the only investments in any one issuer that exceeded 10% of shareholders equity.

3. Receivables

The following table presents the components of receivables.

(dollars in thousands)	December 31, 2006	2005
Amounts receivable from agents, brokers and insureds	**$ 267,530**	$ 277,076
Less allowance for doubtful receivables	**6,637**	7,618
	260,893	269,458
Other	**62,089**	65,055
RECEIVABLES	**$ 322,982**	$ 334,513

Amounts receivable from agents, brokers and insureds included $56.1 million and $57.1 million of accrued premium income at December 31, 2006 and 2005, respectively. Accrued premium income represents the difference between estimated cumulative ultimate gross written premiums and cumulative billed premiums. This timing difference arises because producers have obligated the Company to provide coverage but have not yet reported final policy information.

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3. Receivables (continued)

Other receivables included $20.5 million and $43.0 million recoverable from Marsh, Inc. at December 31, 2006 and 2005, respectively. These amounts relate to the 2002 settlement of a reinsurance dispute with Marsh, Inc. and several reinsurers. As a result of the settlement, Marsh, Inc. agreed to pay 57% of future claims from the program involved in the dispute. The receivable from Marsh, Inc. was reduced $11.4 million and $14.3 million during 2006 and 2005, respectively, as a result of a decrease in the estimated loss reserves for the program that gave rise to the reinsurance dispute. Marsh, Inc. is a wholly-owned subsidiary of Marsh & McLennan Companies, Inc.

4. Deferred Policy Acquisition Costs

The following table presents the amounts of policy acquisition costs deferred and amortized.

	Years Ended December 31,		
(dollars in thousands)	**2006**	2005	2004
Balance, beginning of year	**$ 212,329**	$ 204,579	$ 200,284
Policy acquisition costs of sold subsidiary		(2,613)	
Policy acquisition costs deferred	**538,640**	485,258	491,067
Amortization of policy acquisition costs	**(532,577)**	(474,895)	(486,772)
DEFERRED POLICY ACQUISITION COSTS	**$ 218,392**	$ 212,329	$ 204,579

The following table presents the components of underwriting, acquisition and insurance expenses.

	Years Ended December 31,		
(dollars in thousands)	**2006**	2005	2004
Amortization of policy acquisition costs	**$ 532,577**	$ 474,895	$ 486,772
Other operating expenses	**235,276**	175,428	186,678
UNDERWRITING, ACQUISITION AND INSURANCE EXPENSES	**$ 767,853**	$ 650,323	$ 673,450

5. Property and Equipment

The following table presents the components of property and equipment, which are included in other assets on the consolidated balance sheets.

(dollars in thousands)	December 31, 2006	December 31, 2005
Land	**$ 18,262**	$ 18,262
Leasehold improvements	**30,171**	28,835
Furniture and equipment	**58,620**	56,218
Other	**1,798**	1,516
	108,851	104,831
Less accumulated depreciation and amortization	**62,884**	55,287
Property and Equipment	**$ 45,967**	$ 49,544

Depreciation and amortization expense of property and equipment was $9.8 million, $10.1 million and $10.3 million for the years ended December 31, 2006, 2005 and 2004, respectively.

The Company does not own any material properties as it leases substantially all of its facilities and certain furniture and equipment under operating leases with remaining terms up to approximately 12 years.

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Markel Corporation & Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

5. Property and Equipment (continued)

The following table summarizes the Company s minimum annual rental commitments, excluding taxes, insurance and other operating costs payable directly by the Company, for noncancelable operating leases at December 31, 2006.

Years Ending December 31,	*(dollars in thousands)*
2007	$ 15,413
2008	14,425
2009	13,899
2010	12,297
2011	8,767
2012 and thereafter	30,487
Total	$ 95,288

Total rental expense for the years ended December 31, 2006, 2005 and 2004 was approximately $15.5 million, $13.2 million and $13.3 million, respectively.

6. Goodwill

Goodwill is tested for impairment at least annually. The Company completes an annual test during the fourth quarter of each year based upon the results of operations through September 30. There was no indication of goodwill impairment during 2006 or 2005.

The carrying amounts of goodwill by reporting unit at December 31, 2006 and 2005 were as follows: Excess and Surplus Lines, $81.8 million, and London Insurance Market, $257.9 million.

7. Income Taxes

Income before income taxes includes the following components.

	Years Ended December 31,		
(dollars in thousands)	**2006**	2005	2004
Domestic	**$ 466,750**	$ 245,190	$ 276,264
Foreign	**86,651**	(59,190)	(52,219)
Income Before Income Taxes	**$ 553,401**	$ 186,000	$ 224,045

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7. Income Taxes (continued)

Income tax expense includes the following components.

(dollars in thousands)	Years Ended December 31,		
	2006	2005	2004
Current:			
Federal domestic operations	**$ 130,180**	$ 81,892	$ 84,749
Federal foreign operations	**158**	706	3,684
Total current tax expense	**130,338**	82,598	88,433
Deferred:			
Federal domestic operations	**6,741**	(15,180)	(7,100)
Federal foreign operations	**(1,930)**	(8,720)	(2,863)
Foreign foreign operations	**25,750**	(20,613)	(19,837)
Total deferred tax expense (benefit)	**30,561**	(44,513)	(29,800)
Income Tax Expense	**$ 160,899**	$ 38,085	$ 58,633

In general, the Company is not subject to state income taxation; therefore, state income tax expense is not material to the consolidated financial statements.

The Company made net income tax payments of $145.6 million, $65.9 million and $94.2 million in 2006, 2005 and 2004, respectively. Current income taxes payable were $12.2 million and $19.6 million at December 31, 2006 and 2005, respectively, and were included in other liabilities on the consolidated balance sheets.

Reconciliations of the United States corporate income tax rate to the effective tax rate on income before income taxes are presented in the following table.

	Years Ended December 31,		
	2006	2005	2004
United States corporate tax rate	**35%**	35%	35%
Tax-exempt investment income	**(5)**	(12)	(7)
Sale of subsidiary		(4)	
Differences between financial reporting and tax bases			(2)

Tax reserve adjustment		1	
Other	**(1)**		
EFFECTIVE TAX RATE	**29%**	20%	26%

Substantially all of the Company s continuing international operations are taxed directly or indirectly by both the United States and United Kingdom. However, subject to certain limitations, the United States allows a credit against its tax for any United Kingdom tax generated by Markel International. As a result of differences between the United States and United Kingdom tax systems, distinct deferred tax assets and deferred tax liabilities exist in each of these jurisdictions.

Markel Corporation & Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

7. Income Taxes (continued)

The following table presents the components of domestic and foreign deferred tax assets and liabilities.

(dollars in thousands)	December 31, 2006	December 31, 2005
Assets:		
Differences between financial reporting and tax bases	**$ 108,674**	$ 95,527
Unpaid losses and loss adjustment expenses not yet deductible for income tax purposes	**138,152**	144,048
Unearned premiums recognized for income tax purposes	**54,826**	55,621
Net operating loss carryforwards	**150,982**	222,075
Domestic asset on foreign tax losses	**25,658**	66,971
Domestic asset on future foreign taxable items	**65,232**	62,919
Total gross deferred tax assets	**543,524**	647,161
Less valuation allowance	**(43,899)**	(44,381)
Total gross deferred tax assets, net of allowance	**499,625**	602,780
Liabilities:		
Differences between financial reporting and tax bases	**78,973**	41,800
Unpaid losses and loss adjustment expenses deductible for income tax purposes in excess of financial statement purposes	**23**	91,453
Deferred policy acquisition costs	**67,541**	67,872
Accumulated other comprehensive income	**229,466**	157,700
Reinsurance recoveries not yet subject to income tax		42,293
Domestic liability on future foreign deductible items	**29,348**	30,358
Domestic liability on undistributed earnings of foreign subsidiaries	**27,129**	16,358
Other	**28,024**	20,828
Total gross deferred tax liabilities	**460,504**	468,662
Net Deferred Tax Asset	**$ 39,121**	$ 134,118
Net deferred tax asset foreign	**106,990**	143,347
Net deferred tax liability domestic	**(67,869)**	(9,229)
Net Deferred Tax Asset	**$ 39,121**	$ 134,118

The net deferred tax asset at December 31, 2006 and 2005 is included in other assets on the consolidated balance sheets.

Upon acquiring Markel International, the Company established a $45.8 million valuation allowance, substantially all of which related to pre-acquisition losses at Markel Capital. A valuation allowance was considered necessary due to the uncertainty of realizing a future tax benefit on these losses. During 2006, $0.5 million of the deferred tax asset was realized and the valuation allowance was reduced. During 2004, $2.9 million of the deferred tax asset established upon the acquisition of Markel International was realized, and both the valuation allowance and goodwill were reduced. This reduction in the valuation allowance was partially offset by an increase of $1.5 million resulting from management s determination that it is more likely than not that some of the Company s post-acquisition losses for its Bermuda-based subsidiary will not be realized.

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7. Income Taxes (continued)

At December 31, 2006, the Company had approximately $505 million of net operating losses, which were principally attributed to Markel Capital. Approximately $380 million of these losses can be carried forward indefinitely to offset Markel Capital s future taxable income, while remaining losses of $125 million expire between the years 2018 and 2025. The Company estimates that it will realize $292.3 million of the gross deferred tax assets, including net operating losses, recorded at December 31, 2006 through the reversal of existing temporary differences attributable to the gross deferred tax liabilities. The Company believes that it is more likely than not that it will realize the remaining $158.4 million of gross deferred tax assets, net of the valuation allowance, by generating future taxable income and by utilizing prudent and feasible tax planning strategies if future taxable income is not sufficient. While management believes the valuation allowance at December 31, 2006 is adequate, changes in management s estimate of future taxable income to be generated by its foreign subsidiaries or changes in the Company s ability to utilize tax planning strategies could result in an increase in the valuation allowance through a charge to earnings.

Provisions for United States income taxes on undistributed earnings of foreign subsidiaries are made only on those amounts in excess of the funds that are considered to be permanently reinvested. Pre-acquisition earnings of the Company s foreign subsidiaries are considered permanently reinvested and no provision for United States income taxes has been recorded. If these pre-acquisition earnings were not considered permanently reinvested, the estimated additional deferred income tax liability would not be material to the Company s consolidated financial statements.

In July 2006, the Internal Revenue Service (IRS) completed its examination of the Company s 2003 federal income tax return. No material adjustments were made as a result of this examination. The Company s 2002 federal income tax return was closed to audit in September 2006. At that time, management determined that tax liabilities were less than previously estimated, resulting in a $3.4 million reduction in 2006 income tax expense. In addition, the Company s 2001 federal income tax return was closed to audit in September 2005. At that time, management determined that tax liabilities were $2.5 million less than previously estimated. This change in estimated tax liabilities was recognized as a reduction in 2005 income tax expense. Additionally, the Company s 2000 federal income tax return was closed to audit in September 2004. As a result, management determined that tax liabilities were $22.5 million less than previously estimated. The Company reduced 2004 income tax expense by $4.1 million, reduced goodwill related to the Markel International acquisition by $14.7 million and increased common stock related to closed stock option plans by $3.7 million.

Markel Corporation & Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

8. Unpaid Losses and Loss Adjustment Expenses

a) The following table presents a reconciliation of consolidated beginning and ending reserves for losses and loss adjustment expenses.

	Years Ended December 31,		
(dollars in thousands)	**2006**	2005	2004
NET RESERVES FOR LOSSES AND LOSS ADJUSTMENT EXPENSES, BEGINNING OF YEAR	**$ 4,039,377**	$ 3,841,091	$ 3,315,599
Foreign currency movements, commutations, dispositions and other	**172,492**	(142,974)	91,618
ADJUSTED NET RESERVES FOR LOSSES AND LOSS ADJUSTMENT EXPENSES, BEGINNING OF YEAR	**4,211,869**	3,698,117	3,407,217
Incurred losses and loss adjustment expenses:			
Current year	**1,264,918**	1,350,568	1,274,426
Prior years	**(132,339)**	(50,585)	33,917
TOTAL INCURRED LOSSES AND LOSS ADJUSTMENT EXPENSES	**1,132,579**	1,299,983	1,308,343
Payments:			
Current year	**208,310**	227,288	212,108
Prior years	**799,519**	717,157	679,624
TOTAL PAYMENTS	**1,007,829**	944,445	891,732
Foreign exchange adjustment	**1,207**	(28)	3,059
Reinsurance to close Lloyd s syndicates			14,204
Change in recoverable from Marsh, Inc. (see note 3)	**(11,400)**	(14,250)	
NET RESERVES FOR LOSSES AND LOSS ADJUSTMENT EXPENSES, END OF YEAR	**4,326,426**	4,039,377	3,841,091
Reinsurance recoverable on unpaid losses	**1,257,453**	1,824,300	1,641,276
GROSS RESERVES FOR LOSSES AND LOSS ADJUSTMENT EXPENSES, END OF YEAR	**$ 5,583,879**	$ 5,863,677	$ 5,482,367

Beginning of year net reserves for losses and loss adjustment expenses are adjusted, when applicable, for the impact of changes in foreign currency rates, commutations, acquisitions and dispositions. In 2006, the increase in beginning of year net reserves for losses and loss adjustment expenses was primarily due to an unfavorable movement of $101.9 million in the foreign currency rate of exchange between the United States Dollar and the United Kingdom Sterling and a $51.8 million increase related to the completion of several reinsurance commutations. In 2005, the reduction to the beginning of year net reserves for losses and loss adjustment expenses was primarily due to a

favorable movement of $103.1 million in the foreign currency rate of exchange between the United States Dollar and the United Kingdom Sterling and a $45.2 million decrease related to the sale of Corifrance. The increase in the beginning of year net reserves for losses and loss adjustment expenses in 2004 was primarily due to $67.8 million of unfavorable movement in the foreign currency rate of exchange between the United States Dollar and the United Kingdom Sterling.

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8. Unpaid Losses and Loss Adjustment Expenses (continued)

In 2006, incurred losses and loss adjustment expenses included $132.3 million of favorable development on prior years loss reserves, which was primarily due to $182.1 million of loss reserve redundancies experienced at the Shand Professional/Products Liability unit as a result of the favorable insurance market conditions experienced in recent years. This favorable development on prior years loss reserves was partially offset by $61.1 million of adverse loss reserve development on Hurricanes Katrina, Rita and Wilma (the 2005 Hurricanes). During 2006, losses on the 2005 Hurricanes were primarily concentrated in the contract property and delegated authority books of business included in the Excess and Surplus Lines and London Insurance Market segments. The Company also recognized $16.7 million of adverse development on prior years loss reserves on asbestos and environmental exposures and related reinsurance bad debt in 2006.

This year s review of asbestos and environmental loss reserves in both the U.S. and international operations was completed during the third quarter of 2006. During both the 2006 and 2005 reviews, the Company noted an increase in the severity of losses on reported claims, which resulted in an increase in the Company s estimate of ultimate loss reserves for asbestos and environmental exposures and related reinsurance bad debt. The increase in the allowance for potentially uncollectible reinsurance was required to provide for potential collection disputes with reinsurers and to increase reserves for financially weak or insolvent reinsurers.

Current year incurred losses and loss adjustment expenses for 2005 included $188.7 million of net losses on the 2005 Hurricanes. Prior years incurred losses and loss adjustment expenses reflect favorable development in 2005 of $50.6 million, which was primarily due to $126.4 million of loss reserve redundancies experienced at the Shand Professional/Products Liability and Markel Specialty Program Insurance units as a result of the favorable insurance market conditions experienced in recent years. In 2005, the favorable development on prior years loss reserves was partially offset by $31.3 million of loss reserve development on asbestos and environmental exposures and related reinsurance bad debt and $35.4 million of adverse development at the Markel Brokered Excess and Surplus Lines unit.

In 2005, the adverse development on prior years loss reserves at the Markel Brokered Excess and Surplus Lines unit included $26.1 million of losses related to general and products liability programs, including the California commercial and residential contractors programs, and claims handling costs associated with these and other programs. This adverse development was primarily for the 1999 to 2002 accident years and was based upon the Company s determination that the losses on reported claims for this book of business were higher than expected. In addition to the increase in losses on reported claims, a higher than expected incidence of newly reported claims was experienced.

In 2005, the adverse development discussed previously was more than offset by favorable development on prior years loss reserves primarily as a result of the positive effect of price increases across most product lines in recent years. Of the $126.4 million of loss reserve redundancies experienced at the Shand Professional/Product Liability and Markel Specialty Program Insurance units, $111.1 million was related to favorable development on the 2002 to 2004 accident years. Approximately three-quarters of this redundancy was related to the specified medical, medical malpractice and products programs at the Shand Professional/Products Liability unit and the casualty programs at the Markel Specialty Program Insurance unit.

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Markel Corporation & Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

8. Unpaid Losses and Loss Adjustment Expenses (continued)

Prior years incurred losses and loss adjustment expenses of $33.9 million in 2004 included loss reserve increases of $55.3 million at the Markel Brokered Excess and Surplus Lines unit and $30.0 million at Markel International, as well as allowances for potentially uncollectible reinsurance of $19.0 million. These reserve increases were partially offset by net redundancies of $70.4 million primarily from the Shand Professional/Products Liability, Markel Specialty Program Insurance and Essex Excess and Surplus Lines units.

The increase in prior years loss reserves for the Markel Brokered Excess and Surplus Lines unit included $34.9 million of reserve increases during 2004, primarily related to the 1999 to 2002 accident years for the unit s California commercial and residential contractors programs. During 2004, the Company determined that the development of reported claims for this book of business was higher than expected. The remaining reserve increases at this unit were attributed to other casualty programs across various accident years.

The 2004 increase in prior years loss reserves at Markel International was primarily due to adverse development of the 1997 to 2001 accident years on the U.S. casualty reinsurance, financial institution risks, professional indemnity and general liability exposures, most of which are no longer written. The prior years loss reserve development was identified as part of a claims review concluded in early 2004, which indicated that these lines of business were taking longer to develop than previously estimated.

The 2004 increase in prior years loss reserves for allowances for potentially uncollectible reinsurance was primarily due to deterioration in the financial condition of several reinsurers who participated in reinsurance treaties covering business written in the Excess and Surplus Lines and Other segments.

In 2004, the net redundancies at the Shand Professional/Products Liability, Markel Specialty Program Insurance and Essex Excess and Surplus Lines units were primarily attributed to the 2002 and 2003 accident years and were due to the positive effect of price increases across most product lines. Approximately half of this redundancy was related to the medical malpractice and specified professions programs at the Shand Professional/Products Liability unit, the casualty and accident and health programs at the Markel Specialty Program Insurance unit and the casualty programs at the Essex Excess and Surplus Lines unit.

Reinsurance to close Lloyd s syndicates (RITC) represents the amount due from minority participants in a year of account. Prior to 2001, Markel Capital provided less than 100% of the capacity to the Company s syndicates. For years of account prior to 2001, the Company recorded its pro rata share of syndicates assets, liabilities, revenues and expenses. The minority participants paid the Company to assume their share of outstanding liabilities and related claims handling costs (including claims incurred but not reported), net of estimated reinsurance recoverables. When RITC transactions were recorded, there was no impact to the Company s results of operations. As of January 1, 2005, all pre-2001 years of account were closed.

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8. Unpaid Losses and Loss Adjustment Expenses (continued)

Inherent in the Company s reserving practices is the desire to establish reserves that are more likely redundant than deficient. As such, the Company seeks to establish loss reserves that will ultimately prove to be adequate. Furthermore, the Company s philosophy is to price its insurance products to make an underwriting profit, not to increase written premiums. Management continually attempts to improve its loss estimation process by refining its ability to analyze loss development patterns, claim payments and other information, but uncertainty remains regarding the potential for adverse development of estimated ultimate liabilities.

The Company uses a variety of techniques to establish the liabilities for unpaid losses and loss adjustment expenses, all of which involve significant judgments and assumptions. These techniques include detailed statistical analysis of past claim reporting, settlement activity, claim frequency and severity, policyholder loss experience, industry loss experience and changes in market conditions, policy forms and exposures. Greater judgment may be required when new product lines are introduced or when there have been changes in claims handling practices, as the statistical data available may be insufficient. Estimates reflect implicit and explicit assumptions regarding the potential effects of economic and social inflation, judicial decisions, law changes, and recent trends in these factors. In some of the Company s markets, and where the Company acts as a reinsurer, the timing and amount of information reported about underlying claims is in the control of third parties. This can also affect estimates and require re-estimation as new information becomes available.

The Company believes the process of evaluating past experience, adjusted for the effects of current developments and anticipated trends, is an appropriate basis for predicting future events. Management currently believes the Company s gross and net reserves, including the reserves for environmental and asbestos exposures, are adequate. There is no precise method, however, for evaluating the impact of any significant factor on the adequacy of reserves, and actual results will differ from original estimates.

b) The Company s exposure to asbestos and environmental (A&E) claims resulted from policies written by acquired insurance operations before their acquisitions by the Company. The Company s exposure to A&E claims originated from umbrella, excess and commercial general liability (CGL) insurance policies and assumed reinsurance contracts that were written on an occurrence basis from the 1970s to mid-1980s. Exposure also originated from claims-made policies written by the Company that were designed to cover environmental risks provided that all other terms and conditions of the policy were met.

A&E claims include property damage and clean-up costs related to pollution, as well as personal injury allegedly arising from exposure to hazardous materials. After 1986, the Company began underwriting CGL coverage with pollution exclusions, and in some lines of business the Company began using a claims-made form. These changes significantly reduced the Company s exposure to future A&E claims on post-1986 business.

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Markel Corporation & Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

8. Unpaid Losses and Loss Adjustment Expenses (continued)

The following table provides a reconciliation of beginning and ending A&E reserves for losses and loss adjustment expenses, which are a component of consolidated reserves for losses and loss adjustment expenses.

	Years Ended December 31,		
(dollars in thousands)	**2006**	2005	2004
Net Reserves for A&E Losses and Loss Adjustment Expenses, Beginning of Year	**$ 211,283**	$ 243,196	$ 250,709
Commutations and other	**13,399**	(43,749)	12,057
Adjusted Net Reserves for A&E Losses and Loss Adjustment Expenses, Beginning of Year	**224,682**	199,447	262,766
Incurred losses and loss adjustment expenses	**17,237**	22,099	2,049
Payments	**27,480**	10,263	21,619
Net Reserves for A&E Losses and Loss Adjustment Expenses, End of Year	**214,439**	211,283	243,196
Reinsurance recoverable on unpaid losses	**145,524**	184,480	188,683
Gross Reserves for A&E Losses and Loss Adjustment Expenses, End of Year	**$ 359,963**	$ 395,763	$ 431,879

Incurred losses and loss adjustment expenses for 2006 and 2005 were primarily due to adverse development of asbestos-related reserves. At December 31, 2006, asbestos-related reserves were $272.1 million and $148.2 million on a gross and net basis, respectively.

Net reserves for reported claims and net incurred but not reported reserves for A&E exposures were $123.2 million and $91.2 million, respectively, at December 31, 2006. Inception-to-date net paid losses and loss adjustment expenses for A&E related exposures totaled $314.8 million at December 31, 2006, which includes $48.4 million of litigation-related expense.

The Company s reserves for losses and loss adjustment expenses related to A&E exposures represent management s best estimate of ultimate settlement values. A&E reserves are monitored by management, and the Company s statistical analysis of these reserves is reviewed by the Company s independent actuaries. A&E exposures are generally subject to significant uncertainty due to potential severity and an uncertain legal climate. A&E reserves could be subject to increases in the future; however, management believes the Company s gross and net A&E reserves at December 31, 2006 are adequate.

9. Convertible Notes Payable

During 2001, the Company issued $408.0 million principal amount at maturity, $112.9 million net proceeds, of Liquid Yield Option Notes (LYONs). The LYONs were zero coupon senior notes issued at a price of $283.19 per LYON, representing a yield to maturity of 4.25%, with a stated maturity of June 5, 2031. Until their conversion in December 2006, the Company used the effective yield method to recognize the accretion of the discount from the issue price to the face amount of the LYONs at maturity. The accretion of the discount is included in interest expense.

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9. Convertible Notes Payable (continued)

As of April 1, 2005, each LYON became convertible into 1.1629 shares of the Company s common stock. During 2006, the LYONs were converted, which resulted in the issuance of approximately 335,000 shares of the Company s common stock. The weighted average number of common shares outstanding related to the LYONs was included in the Company s calculation of diluted net income per share for the year ended December 31, 2006. No LYONs had been converted as of December 31, 2005. The common shares that would have been issued if the LYONs had been converted were included in the Company s calculation of diluted net income per share for the year ended December 31, 2005.

The estimated fair value based on quoted market prices of the convertible notes payable was approximately $108 million at December 31, 2005.

10. Senior Long-Term Debt

The following table summarizes the Company s senior long-term debt.

	December 31,	
(dollars in thousands)	**2006**	2005
7.20% unsecured senior notes, due August 15, 2007, interest payable semi-annually, net of unamortized discount of $373 in 2006 and $1,012 in 2005	**$ 72,659**	$ 72,020
7.00% unsecured senior notes, due May 15, 2008, interest payable semi-annually, net of unamortized discount of $1,261 in 2006 and $2,279 in 2005	**91,789**	95,221
6.80% unsecured senior notes, due February 15, 2013, interest payable semi-annually, net of unamortized discount of $1,658 in 2006 and $1,927 in 2005	**245,007**	244,738
7.35% unsecured senior notes, due August 15, 2034, interest payable semi-annually, net of unamortized discount of $2,927 in 2006 and $3,034 in 2005	**197,073**	196,966
7.50% unsecured senior debentures, due August 22, 2046, interest payable quarterly, net of unamortized discount of $4,550 in 2006	**145,450**	
Senior Long -Term Debt	**$ 751,978**	$ 608,945

On August 22, 2006, the Company issued $150 million of 7.50% unsecured senior debentures due August 22, 2046. Net proceeds to the Company were $145.4 million and a portion was used to retire the Junior Subordinated Deferrable Interest Debentures on January 2, 2007. The remaining proceeds will be used to retire the 7.20% unsecured senior notes due August 15, 2007, or for general corporate purposes.

On August 25, 2005, the Company entered into a revolving credit facility that provides $375 million of capacity for working capital and other general corporate purposes and expires December 2010. The Company may select from two interest rate options for balances outstanding under the facility and pays a commitment fee (0.15% at December 31, 2006) on the unused portion of the facility based on the Company s debt to total capital ratio as calculated under the agreement. At both December 31, 2006 and 2005, the Company had no borrowings outstanding under the revolving credit facility.

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Markel Corporation & Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

10. Senior Long-Term Debt (continued)

At December 31, 2006, the Company was in compliance with all covenants contained in its revolving credit facility. To the extent that the Company was not in compliance with its covenants, the Company s access to the credit facility could be restricted. While the Company believes such events are unlikely, the inability to access the credit facility could adversely affect the Company s liquidity.

The Company s unsecured senior notes are not redeemable; however, the Company s 7.50% unsecured senior debentures are redeemable by the Company at any time after August 22, 2011. None of the Company s senior long-term debt is subject to any sinking fund requirements.

The estimated fair value based on quoted market prices of the Company s senior long-term debt was approximately $801 million and $647 million at December 31, 2006 and 2005, respectively.

The following table summarizes the future principal payments due at maturity on senior long-term debt as of December 31, 2006.

Years Ending December 31,	*(dollars in thousands)*
2007	$ 73,032
2008	93,050
2009	
2010	
2011	
2012 and thereafter	596,665
Total Principal Payments	$ 762,747
Less unamortized discount	(10,769)
Senior Long-Term Debt	$ 751,978

The Company paid $46.7 million, $44.5 million and $31.4 million in interest on its senior long-term debt during the years ended December 31, 2006, 2005 and 2004, respectively.

11. Junior Subordinated Deferrable Interest Debentures (8.71% Junior Subordinated Debentures)

On January 8, 1997, the Company arranged the sale of $150 million of Company-Obligated Mandatorily Redeemable Preferred Capital Securities (8.71% Capital Securities) issued under an Amended and Restated Declaration of Trust dated January 13, 1997 (the Declaration) by Markel Capital Trust I (the Trust), a statutory business trust sponsored and wholly-owned by the Company. Proceeds from the sale of the 8.71% Capital Securities were used to purchase the Company s 8.71% Junior Subordinated Debentures due January 1, 2046, issued to the Trust under an indenture dated January 13, 1997 (the Indenture). The 8.71% Junior Subordinated Debentures are the sole assets of the Trust. The Company has the right to defer interest payments on the 8.71% Junior Subordinated Debentures for up to five years. Taken together, the Company s obligations under the Debentures, the Indenture, the Declaration and a guarantee made by the Company provide, in the aggregate, a full, irrevocable and unconditional guarantee of payments of distributions and other amounts due on the 8.71% Capital Securities. No other subsidiary of the Company guarantees the 8.71% Junior Subordinated Debentures or the 8.71% Capital Securities. In the event of default under the Indenture, the Trust may not make distributions on,

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11. Junior Subordinated Deferrable Interest Debentures (8.71% Junior Subordinated Debentures) (continued)

or repurchases of, the Trust s common securities. During a period in which the Company elects to defer interest payments or in the event of default under the Indenture, the Company may not make distributions on, or repurchases of, the Company s capital stock or debt securities ranking equal or junior to the 8.71% Junior Subordinated Debentures. In 2006, the Company repurchased $34.7 million principal amount of its 8.71% Junior Subordinated Debentures. The Company redeemed the remaining outstanding 8.71% Junior Subordinated Debentures for $111.0 million on January 2, 2007.

The Company paid $10.6 million, $12.8 million and $13.1 million in interest on the 8.71% Junior Subordinated Debentures during the years ended December 31, 2006, 2005 and 2004, respectively. The estimated fair value based on quoted market prices of the 8.71% Junior Subordinated Debentures was approximately $111 million and $150 million at December 31, 2006 and 2005, respectively.

12. Shareholders Equity

a) The Company had 50,000,000 shares of no par value common stock authorized of which 9,994,263 shares and 9,798,538 shares were issued and outstanding at December 31, 2006 and 2005, respectively. The Company also has 10,000,000 shares of no par value preferred stock authorized, none of which were issued or outstanding at December 31, 2006 or 2005.

In August 2005, the Company s Board of Directors approved the repurchase of up to $200 million of common stock pursuant to a share repurchase program (the Program). Under the Program, the Company may repurchase outstanding shares of common stock from time to time, primarily through open-market transactions. The Program has no expiration date but may be terminated by the Board of Directors at any time. In 2006, the Company repurchased 139,800 shares of common stock at a cost of $45.9 million under the Program.

b) Net income per share is determined by dividing net income by the applicable weighted average shares outstanding.

	Years Ended December 31,		
(in thousands, except per share amounts)	**2006**	2005	2004
Net income as reported	**$ 392,502**	$ 147,915	$ 165,412
Interest expense, net of tax, on convertible notes payable	**2,489**	2,648	1,855
Adjusted net income	**$ 394,991**	$ 150,563	$ 167,267
Basic common shares outstanding	**9,709**	9,827	9,849
Dilutive effect of convertible notes payable	**303**	335	335
Other dilutive potential common shares	**12**	9	6
Diluted shares outstanding	**10,024**	10,171	10,190

Basic net income per share	**$ 40.43**	$ 15.05	$ 16.79
Diluted net income per share	**$ 39.40**	$ 14.80	$ 16.41

Average closing common stock market prices are used to calculate the dilutive effect attributable to stock options and restricted stock.

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Markel Corporation & Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

12. Shareholders Equity (continued)

c) The Company s Employee Stock Purchase and Bonus Plan provides a method for employees and directors to purchase shares of the Company s common stock on the open market. The plan encourages share ownership by providing for the award of bonus shares to participants equal to 10% of the net increase in the number of shares owned under the plan in a given year, excluding shares acquired through the plan s loan program component. Under the loan program, the Company offers subsidized unsecured loans so participants may purchase shares and awards bonus shares equal to 5% of the shares purchased with a loan. The Company has authorized 100,000 shares for purchase under this plan, of which 13,198 and 21,267 shares were available for purchase at December 31, 2006 and 2005, respectively. At December 31, 2006 and 2005, loans outstanding under the plan, which are included in receivables on the consolidated balance sheets, totaled $16.2 million and $17.3 million, respectively.

d) The Markel Corporation Omnibus Incentive Plan (Omnibus Incentive Plan) provides for grants or awards of cash, restricted stock, restricted stock units, performance grants and other stock-based awards to employees and directors. The Omnibus Incentive Plan does not authorize grants of stock options. The Omnibus Incentive Plan is administered by the Compensation Committee of the Company s Board of Directors (Compensation Committee) and will terminate on March 5, 2013. At December 31, 2006, there were 150,000 shares reserved for issuance under the Omnibus Incentive Plan. As of December 31, 2006, 6,000 Restricted Stock Units, as defined by the Omnibus Incentive Plan, have been awarded to the Company s non-employee directors. The Company has also provided for performance-based Restricted Stock Unit awards to certain associates and executive officers. Under the terms of these awards, as of December 31, 2006, 18,746 Restricted Stock Units have been awarded to certain associates and executive officers based upon meeting performance conditions determined by a subcommittee of the Compensation Committee. Awards granted to non-employee directors vest ratably over a five-year period from the date of grant, while awards granted to certain associates and executive officers vest at the end of the fifth year following the year for which the Compensation Committee determines performance conditions have been met. At the end of the vesting period, recipients are entitled to receive one share of the Company s common stock for each vested Restricted Stock Unit.

The following table summarizes nonvested Restricted Stock Unit awards.

	Number of Units	Weighted Average Grant-Date Fair Value
Nonvested units at January 1, 2006	16,502	$ 304.99
Granted	5,444	324.00
Vested	(1,488)	275.03
Nonvested units at December 31, 2006	20,458	$ 312.23

The fair value of Restricted Stock Units is determined based on the closing price of the Company s common shares on the grant date. The weighted average grant-date fair value of Restricted Stock Units awarded in 2006, 2005 and 2004 was $324.00, $366.69 and $268.99, respectively. As of December 31, 2006, unrecognized compensation cost related to nonvested Restricted Stock Units was $3.3 million, which is expected to be recognized over a weighted average period of 3.1 years. The fair value of Restricted Stock Units vested during 2006, 2005 and 2004 was $0.4 million, $0.3 million and $0.4 million, respectively.

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12. Shareholders Equity (continued)

e) In connection with the acquisition of Markel International, the Company provided for the conversion of options under Markel International s Octavian Stock Option Plan (Octavian Plan) into options to purchase the Company s common shares. The Octavian Plan provided for the issuance of options to members of management of Octavian (now Markel Syndicate Management) based on profit commissions receivable by Markel Syndicate Management for the 1997 to 2000 years of account at Lloyd s. At December 31, 2006 and 2005, 444 options and 962 options, respectively, were outstanding and exercisable under the Octavian Plan. The outstanding options have a nominal exercise price, and no further options are available for issuance under the Octavian Plan. Options expire seven years from the date of issue.

The Company s weighted average remaining contractual life for stock options outstanding under the Octavian Plan was 3.3 years at December 31, 2006.

13. Other Comprehensive Income (Loss)

Other comprehensive income (loss) includes net holding gains (losses) on securities arising during the period less reclassification adjustments for net gains included in net income. Other comprehensive income (loss) also includes foreign currency translation adjustments and, in 2006, net actuarial pension loss. The related tax expense (benefit) on net holding gains (losses) on securities arising during the period was $108.4 million, $(33.2) million and $58.7 million for 2006, 2005 and 2004, respectively. The related tax expense on the reclassification adjustments for net gains included in net income was $22.3 million, $6.9 million and $1.4 million for 2006, 2005 and 2004, respectively. The related tax expense (benefit) on foreign currency translation adjustments was $(0.9) million, $(5.2) million and $0.5 million for 2006, 2005 and 2004, respectively. The related tax benefit on the net actuarial pension loss was $13.5 million for 2006.

14. Reinsurance

The Company purchases reinsurance in order to reduce its retention on individual risks and enable it to underwrite policies with sufficient limits to meet policyholder needs. In a reinsurance transaction, an insurance company transfers, or cedes, all or part of its exposure in return for a portion of the premium. The ceding of insurance does not legally discharge the Company from its primary liability for the full amount of the policies, and the Company will be required to pay the loss and bear collection risk if the reinsurer fails to meet its obligations under the reinsurance agreement.

A credit risk exists with reinsurance ceded to the extent that any reinsurer is unable to meet the obligations assumed under the reinsurance agreements. Allowances are established for amounts deemed uncollectible. The Company evaluates the financial condition of its reinsurers and monitors concentration of credit risk arising from its exposure to individual reinsurers. At December 31, 2006 and 2005, balances recoverable from the Company s ten largest reinsurers, by group, represented approximately 71% and 62%, respectively, of the reinsurance recoverable on paid and unpaid losses. At December 31, 2006, the Company s largest reinsurance balance was due from the Munich Re Group and represented 14% of the reinsurance recoverable on paid and unpaid losses.

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Markel Corporation & Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

14. Reinsurance (continued)

The following table summarizes the Company s reinsurance allowance for doubtful accounts.

	Years Ended December 31,		
(dollars in thousands)	**2006**	2005	2004
REINSURANCE ALLOWANCE, BEGINNING OF YEAR	**$ 194,337**	$ 177,441	$ 149,398
Additions:			
Charged to expense	**(1,686)**	29,978	19,674
Charged to other accounts	**15,700**	2,657	4,697
RITC (see note 8)			5,542
TOTAL REINSURANCE ALLOWANCE ADDITIONS	**14,014**	32,635	29,913
Deductions	**23,356**	15,739	1,870
REINSURANCE ALLOWANCE, END OF YEAR	**$ 184,995**	$ 194,337	$ 177,441

Amounts charged to expense in 2005 and 2004 were primarily due to the deterioration in the financial condition of certain reinsurers, most of whom no longer participate in treaties with the Company.

Management believes the Company s reinsurance allowance for doubtful accounts is adequate at December 31, 2006; however, the deterioration in the credit quality of existing reinsurers or disputes over reinsurance agreements could result in additional charges.

The following table summarizes the effect of reinsurance on premiums written and earned.

	Years Ended December 31,		
	2006	2005	2004

(dollars in thousands)	**Written**	**Earned**	Written	Earned	Written	Earned
Direct	**$ 2,365,802**	**$ 2,374,250**	$ 2,252,730	$ 2,272,038	$ 2,355,796	$ 2,405,687
Assumed	**170,428**	**165,889**	148,604	132,848	162,604	158,634
Ceded	**(341,285)**	**(355,758)**	(428,740)	(466,425)	(468,016)	(510,434)
Net Premiums	**$ 2,194,945**	**$ 2,184,381**	$ 1,972,594	$ 1,938,461	$ 2,050,384	$ 2,053,887

Incurred losses and loss adjustment expenses were net of reinsurance recoverables (ceded incurred losses and loss adjustment expenses) of $67.0 million, $616.5 million and $339.4 million for the years ended December 31, 2006, 2005 and 2004, respectively. Ceded incurred losses and loss adjustment expenses in 2005 included ceded losses on the 2005 Hurricanes of $567.9 million.

The percentage of assumed earned premiums to net earned premiums for the years ended December 31, 2006, 2005 and 2004 was approximately 8%, 7% and 8%, respectively.

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15. Contingencies

The Company s estimates of losses from the 2005 Hurricanes assume that flood exclusions in its property policies apply to flood damage in the New Orleans area following Hurricane Katrina. However, beginning in late November 2006, Louisiana state and federal trial courts ruled in a number of cases (most of which the Company was not a party to) that flood damage following the New Orleans area levee breaches may not be excluded from coverage under policies similar to those the Company has written. These rulings are being appealed, and the outcome is uncertain. If the rulings are upheld and it is determined that flood damage is covered under the Company s policies, losses associated with Hurricane Katrina will increase. The Company is currently evaluating this impact and cannot quantify the range of the increase at this time, but it may be material.

In April 2006, the Company received notice of a lawsuit filed in the United States District Court for the Northern District of Georgia by New Cingular Wireless Headquarters, LLC and several other corporate insureds against Marsh & McLennan Companies, Inc., Aon Corporation and approximately 100 insurers, including the Company s subsidiary, Essex Insurance Company, and the Company s syndicate at Lloyd s, Markel Syndicate 3000. The lawsuit seeks unspecified monetary damages and alleges that brokers and insurers colluded and engaged in prohibited conduct via market service agreements and other means that resulted in inflated premiums and reduced coverage. The case has been transferred to the United States District Court in New Jersey for coordinated pre-trial proceedings in the consolidated case already pending there known as In re: Insurance Brokerage Antitrust Litigation. In February 2007, Essex Insurance Company and Markel Syndicate 3000 settled these claims against them. The settlement did not have a material impact on the Company s financial condition or results of operations.

Other contingencies arise in the normal conduct of the Company s operations and are not expected to have a material impact on the Company s financial condition or results of operations. However, adverse outcomes are possible and could negatively impact the Company s financial condition and results of operations.

16. Related Party Transactions

The Company engages in certain related party transactions in the normal course of business. These transactions are at arm s length and are immaterial to the Company s consolidated financial statements.

17. Statutory Financial Information

a) The following table includes unaudited selected information for the Company s wholly-owned domestic insurance subsidiaries as filed with state insurance regulatory authorities.

	Years Ended December 31,		
(dollars in thousands)	**2006**	2005	2004
Net income	**$ 339,662**	$ 209,645	$ 185,493

Statutory capital and surplus	**$ 1,376,836**	$ 1,147,519	$ 1,140,975

The laws of the domicile states of the Company s domestic insurance subsidiaries govern the amount of dividends that may be paid to the Company. Generally, statutes in the domicile states of the Company s domestic insurance subsidiaries require prior approval for payment of extraordinary as opposed to ordinary dividends. At December 31, 2006, the Company s domestic insurance subsidiaries could pay up to $335.3 million during the following 12 months under the ordinary dividend regulations.

In converting from statutory accounting principles to U.S. GAAP, typical adjustments include deferral of policy acquisition costs, differences in the calculation of deferred income taxes and the inclusion of net unrealized holding gains or losses relating to fixed maturities in shareholders equity.

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Markel Corporation & Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

17. Statutory Financial Information (continued)

The Company does not use any permitted statutory accounting practices that are different from prescribed statutory accounting practices.

b) MIICL files an annual audited return with the Financial Services Authority (FSA) in the United Kingdom. Assets and liabilities reported within the annual FSA return are prepared subject to specified rules concerning valuation and admissibility.

The following table summarizes MIICL s unaudited estimated FSA Return net income (loss) and policyholders surplus.

(dollars in thousands)	Years Ended December 31,		
	2006	2005	2004
Net income (loss)	**$ 27,610**	$ 13,490	$ (3,454)
Policyholders surplus	**$ 312,612**	$ 284,032	$ 246,970

MIICL s ability to pay dividends is limited by applicable FSA requirements, which require MIICL to give 14 days advance notice to the FSA of its intention to declare and pay a dividend. In addition, MIICL must comply with the United Kingdom Companies Act of 1985, which provides that dividends may only be paid out of distributable profits.

18. Segment Reporting Disclosures

The Company operates in three segments of the specialty insurance marketplace: the Excess and Surplus Lines, the Specialty Admitted and the London markets.

All investing activities are included in the Investing segment. Lines of business that have been discontinued in conjunction with an acquisition and non-strategic insurance subsidiaries are included in Other for purposes of segment reporting.

The Company considers many factors, including the nature of the underwriting units insurance products, production sources, distribution strategies and regulatory environment in determining how to aggregate operating segments.

For 2006, 22% of the Company s gross written premiums related to foreign risks, of which 36% were from the United Kingdom. For 2005, 21% of the Company s gross written premiums related to foreign risks, of which 42% were from the United Kingdom. For 2004, 24% of the Company s gross written premiums related to foreign risks, of which 40% were from the United Kingdom. In each of these years, the United Kingdom was the only individual foreign country from which gross written premiums were material. Gross written premiums are attributed to individual countries based upon location of risk.

Segment profit or loss for each of the Company s operating segments is measured by underwriting profit or loss. The property and casualty insurance industry commonly defines underwriting profit or loss as earned premiums net of losses and loss adjustment expenses and underwriting, acquisition and insurance expenses. Underwriting profit or loss does not replace operating income or net income computed in accordance with U.S. GAAP as a measure of profitability. Underwriting profit or loss provides a basis for management to evaluate the Company s underwriting performance. Segment profit for the Investing segment is measured by net investment income and net realized investment gains or losses.

The Company does not allocate assets to the Excess and Surplus Lines, Specialty Admitted and London Insurance Market operating segments for management reporting purposes. Total invested assets and the related net investment income are allocated to the Investing segment since these assets are available for payment of losses and expenses for all operating segments. The Company does not allocate capital expenditures for long-lived assets to any of its operating segments for management reporting purposes.

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18. Segment Reporting Disclosures (continued)

a) The following tables summarize the Company s segment disclosures.

(dollars in thousands)	Year Ended December 31, 2006					
	Excess and Surplus Lines	Specialty Admitted	London Insurance Market	Investing	Other	Consolidated
Gross premium volume	**$ 1,465,725**	**$ 340,483**	**$ 729,160**	**$**	**$ 862**	**$ 2,536,230**
Net written premiums	**1,228,797**	**322,466**	**643,485**		**197**	**2,194,945**
Earned premiums	**1,242,184**	**317,401**	**624,599**		**197**	**2,184,381**
Losses and loss adjustment expenses	**538,943**	**180,556**	**391,395**		**21,685**	**1,132,579**
Amortization of policy acquisition costs	**308,518**	**76,153**	**147,906**			**532,577**
Other operating expenses	**115,408**	**32,596**	**85,322**		**1,950**	**235,276**
Underwriting profit (loss)	**279,315**	**28,096**	**(24)**		**(23,438)**	**283,949**
Net investment income				**271,016**		**271,016**
Net realized investment gains				**63,608**		**63,608**
Segment profit (loss)	**$ 279,315**	**$ 28,096**	**$ (24)**	**$ 334,624**	**$ (23,438)**	**$ 618,573**
Interest expense						**65,172**
Income before income taxes						**$ 553,401**
U.S. GAAP combined ratio[1]	**78%**	**91%**	**100%**		**NM[2]**	**87%**

(dollars in thousands)	Year Ended December 31, 2005					
	Excess and Surplus Lines	Specialty Admitted	London Insurance Market	Investing	Other	Consolidated
Gross premium volume	$ 1,439,744	$ 318,717	$ 640,986	$	$ 1,887	$ 2,401,334
Net written premiums	1,160,948	299,665	510,836		1,145	1,972,594
Earned premiums	1,138,525	291,273	507,518		1,145	1,938,461
Losses and loss adjustment expenses	674,926	147,590	443,964		33,503	1,299,983
Amortization of policy acquisition costs	271,707	70,683	132,505			474,895
Other operating expenses	95,712	22,739	60,540		(3,563)	175,428
Underwriting profit (loss)	96,180	50,261	(129,491)		(28,795)	(11,845)
Net investment income				241,979		241,979
Net realized investment gains				19,708		19,708

Segment profit (loss)	$ 96,180	$ 50,261	$ (129,491)	$ 261,687	$ (28,795)	$ 249,842
Interest expense						63,842
Income before income taxes						$ 186,000
U.S. GAAP combined ratio [1]	92%	83%	126%		NM [2]	101%

[1] The U.S. GAAP combined ratio is a measure of underwriting performance and represents the relationship of incurred losses, loss adjustment expenses and underwriting, acquisition and insurance expenses to earned premiums.

[2] NM Ratio is not meaningful.

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Markel Corporation & Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

18. Segment Reporting Disclosures (continued)

	Year Ended December 31, 2004					
(dollars in thousands)	Excess and Surplus Lines	Specialty Admitted	London Insurance Market	Investing	Other	Consolidated
Gross premium volume	$ 1,478,210	$ 294,114	$ 700,002	$	$ 46,074	$ 2,518,400
Net written premiums	1,156,044	276,363	580,730		37,247	2,050,384
Earned premiums	1,146,142	265,671	604,070		38,004	2,053,887
Losses and loss adjustment expenses	655,801	142,654	474,186		35,702	1,308,343
Amortization of policy acquisition costs	260,130	64,381	153,898		8,363	486,772
Other operating expenses	82,661	20,693	75,893		7,431	186,678
Underwriting profit (loss)	147,550	37,943	(99,907)		(13,492)	72,094
Net investment income				204,032		204,032
Net realized investment gains				4,139		4,139
Segment profit (loss)	$ 147,550	$ 37,943	$ (99,907)	$ 208,171	$ (13,492)	$ 280,265
Interest expense						56,220
Income before income taxes						$ 224,045
U.S. GAAP combined ratio[1]	87%	86%	117%		NM[2]	96%

[1] The U.S. GAAP combined ratio is a measure of underwriting performance and represents the relationship of incurred losses, loss adjustment expenses and underwriting, acquisition and insurance expenses to earned premiums.

[2] NM Ratio is not meaningful.

b) The following table summarizes deferred policy acquisition costs, unearned premiums and unpaid losses and loss adjustment expenses by segment.

(dollars in thousands)	Deferred Policy Acquisition Costs	Unearned Premiums	Unpaid Losses and Loss Adjustment Expenses
December 31, 2006			
Excess and Surplus Lines	**$ 124,762**	**$ 580,608**	**$ 2,568,967**
Specialty Admitted	**34,123**	**150,741**	**264,923**
London Insurance Market	**59,507**	**276,452**	**2,051,440**
Other			**698,549**
TOTAL	**$ 218,392**	**$ 1,007,801**	**$ 5,583,879**
December 31, 2005			
Excess and Surplus Lines	$ 125,148	$ 606,480	$ 2,699,763
Specialty Admitted	33,110	144,724	256,475
London Insurance Market	54,071	242,533	2,077,293
Other			830,146
TOTAL	$ 212,329	$ 993,737	$ 5,863,677

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18. Segment Reporting Disclosures (continued)

c) The following table reconciles segment assets to the Company s consolidated balance sheets.

(dollars in thousands)	December 31,		
	2006	2005	2004
Segment Assets:			
Investing	**$ 7,535,295**	$ 6,588,222	$ 6,316,747
Other	**2,552,836**	3,225,876	3,080,839
TOTAL ASSETS	**$ 10,088,131**	$ 9,814,098	$ 9,397,586

d) The following table summarizes segment earned premiums by major product grouping.

(dollars in thousands)	Property	Casualty	Professional/ Products Liability	Other	Consolidated
Year Ended December 31, 2006					
Excess and Surplus Lines	**$ 204,257**	**$ 404,861**	**$ 368,160**	**$ 264,906**	**$ 1,242,184**
Specialty Admitted	**127,725**	**137,755**		**51,921**	**317,401**
London Insurance Market	**218,493**	**61,344**	**242,257**	**102,505**	**624,599**
Other				**197**	**197**
EARNED PREMIUMS	**$ 550,475**	**$ 603,960**	**$ 610,417**	**$ 419,529**	**$ 2,184,381**
Year Ended December 31, 2005					
Excess and Surplus Lines	$ 146,811	$ 423,799	$ 386,097	$ 181,818	$ 1,138,525
Specialty Admitted	122,329	126,893		42,051	291,273
London Insurance Market	144,986	54,621	236,405	71,506	507,518
Other				1,145	1,145
EARNED PREMIUMS	$ 414,126	$ 605,313	$ 622,502	$ 296,520	$ 1,938,461
Year Ended December 31, 2004					
Excess and Surplus Lines	$ 175,986	$ 446,725	$ 390,056	$ 133,375	$ 1,146,142
Specialty Admitted	116,273	112,337		37,061	265,671
London Insurance Market	204,421	63,643	260,331	75,675	604,070
Other				38,004	38,004
EARNED PREMIUMS	$ 496,680	$ 622,705	$ 650,387	$ 284,115	$ 2,053,887

The Company does not manage products at this level of aggregation. The Company offers over 90 major product lines and manages these products in logical groupings within each underwriting unit.

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Markel Corporation & Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

19. Employee Benefit Plans

a) The Company maintains a defined contribution plan for its United States employees, the Markel Corporation Retirement Savings Plan, in accordance with Section 401(k) of the Internal Revenue Code. The Company provides another defined contribution plan for Markel International employees. This plan is in line with local market terms and conditions of employment. Expenses relating to the Company s defined contribution plans were $10.3 million, $9.5 million and $8.8 million in 2006, 2005 and 2004, respectively.

b) The Terra Nova Pension Plan is a defined benefit plan which covers Markel International employees who meet the eligibility conditions set out in the plan. The plan has been closed to new participants since 2001. The cost of providing pensions for employees is charged to earnings over the average working life of employees according to actuarial recommendations. Final benefits are based on the employee s years of credited service and the higher of pensionable compensation received in the calendar year preceding retirement or the best average pensionable compensation received in any three consecutive years in the ten years preceding retirement.

In 2006, the FASB issued Statement No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans*, which requires an employer to recognize the funded status of defined benefit and other postretirement plans as an asset or liability on the consolidated balance sheet. Funded status represents the difference between the fair value of plan assets and the projected benefit obligation. Changes in the net actuarial pension loss, net of taxes, are required to be recognized through other comprehensive income in the year in which the changes occur. Statement No. 158 also requires an employer to measure plan assets and benefit obligations as of the date of its year-end consolidated balance sheet. The recognition and disclosure provisions of Statement No. 158 became effective for the Company as of December 31, 2006. The measurement provision of Statement No. 158 becomes effective for the Company as of December 31, 2008. The Company uses December 31 as the measurement date for the Terra Nova Pension Plan. Statement No. 158 does not permit retrospective application.

The following table summarizes the incremental effects of applying Statement No. 158 to individual line items on the Company s consolidated balance sheet at December 31, 2006.

(dollars in thousands)	Before Application of Statement No. 158	Adjustments Required by Statement No. 158	After Application of Statement No. 158
Net pension asset	$ 27,947	$ (27,947)	$
Net deferred tax asset	25,652	13,469	39,121
Total assets	10,102,609	(14,478)	10,088,131
Liability for pension benefits		10,535	10,535
Total liabilities	7,781,203	10,535	7,791,738
Net actuarial pension loss, net of taxes		(25,013)	(25,013)
Total shareholders equity	2,321,406	(25,013)	2,296,393
Total liabilities and shareholders equity	10,102,609	(14,478)	10,088,131

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19. Employee Benefit Plans (continued)

The following table summarizes the funded status of the Terra Nova Pension Plan and the amounts recognized on the accompanying consolidated balance sheets of the Company.

(dollars in thousands)	Years Ended December 31, 2006	2005
Change in projected benefit obligation:		
Projected benefit obligation at beginning of period	**$ 83,257**	$ 75,439
Service cost	**1,931**	2,033
Interest cost	**4,342**	3,834
Participant contributions	**57**	
Benefits paid	**(2,251)**	(1,872)
Actuarial loss	**4,871**	12,684
Foreign exchange adjustment	**12,149**	(8,861)
Projected Benefit Obligation at End of Year	**$ 104,356**	$ 83,257
Change in plan assets:		
Fair value of plan assets at beginning of period	**$ 72,558**	$ 67,410
Actual gain on plan assets	**9,589**	13,535
Employer contributions	**3,119**	1,286
Participant contributions	**57**	
Benefits paid	**(2,251)**	(1,872)
Foreign exchange adjustment	**10,749**	(7,801)
Fair Value of Plan Assets at End of Year	**$ 93,821**	$ 72,558
Funded status of the plan	**$ (10,535)**	$ (10,699)
Net actuarial pension loss	**38,482**	34,039
Total	**$ 27,947**	$ 23,340

In 2006, the net actuarial pension loss was recognized as a component of accumulated other comprehensive income, net of a tax benefit of $13.5 million, and the liability for pension benefits, or the funded status of the plan, was included in other liabilities on the December 31, 2006 consolidated balance sheet in accordance with Statement No. 158. In 2005, the net actuarial pension loss was offset in part by the funded status of the plan and a net pension asset of $23.3 million was included in other assets on the December 31, 2005 consolidated balance sheet.

The following table summarizes the components of net periodic benefit cost and the weighted average assumptions for the Terra Nova Pension Plan.

(dollars in thousands)	Years Ended December 31, 2006	2005	2004
Components of net periodic benefit cost:			
Service cost	**$ 1,931**	$ 2,033	$ 2,143
Interest cost	**4,342**	3,834	3,614
Expected return on plan assets	**(6,273)**	(5,117)	(4,665)
Amortization of net actuarial pension loss	**1,844**	1,768	1,949

Net Periodic Benefit Cost	**$ 1,844**	$ 2,518	$ 3,041
Weighted average assumptions as of December 31:			
Discount rate	**5.3%**	4.9%	5.4%
Expected return on plan assets	**7.5%**	8.0%	8.0%
Rate of compensation increase	**5.0%**	4.8%	4.8%

Markel Corporation & Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

19. Employee Benefit Plans (continued)

Plan assets, which consist primarily of equity securities and fixed maturities, are valued using current market quotations. The projected benefit obligation and the net periodic benefit cost are determined by independent actuaries using assumptions provided by the Company. In determining the discount rate, the Company uses the current yield on high-quality, fixed-income investments that have maturities corresponding to the anticipated timing of estimated defined benefit payments. The Company s discount rate approximates a bond yield from a published index that includes AA rated corporate bonds with maturities of 15 years or more. The expected return on plan assets is estimated based upon the anticipated average yield on the plan assets. Asset returns reflect management s belief that 4.5% is a reasonable rate of return to anticipate for fixed maturities given current market conditions and future expectations. In addition, the expected return on plan assets includes an assumption that equity securities will outperform fixed maturities by approximately 3.5% over the long term. The rate of compensation increase is based upon historical experience and management s expectation of future compensation.

Management s discount rate and rate of compensation increase assumptions at December 31, 2006 were used to calculate the Company s projected benefit obligation. Management s discount rate, expected return on plan assets and rate of compensation increase assumptions at December 31, 2005 were used to calculate the net periodic benefit cost for 2006. The Company estimates that net periodic benefit cost in 2007 will include an expense of $1.9 million resulting from the amortization of the net actuarial pension loss included as a component of accumulated other comprehensive income at December 31, 2006.

At December 31, 2006 and 2005, the fair value of plan assets exceeded the plan s accumulated benefit obligation of $88.8 million and $70.5 million, respectively. The Company expects to make plan contributions of $3.0 million in 2007.

The Company s target asset allocation for the plan is 83% to 87% equity securities and 13% to 17% fixed maturities. At December 31, 2006, the actual allocation of assets in the plan was 86% equity securities and 14% fixed maturities. At December 31, 2005, the actual allocation of plan assets was 85% equity securities and 15% fixed maturities.

Investments are managed by a third-party investment manager. Equity securities are primarily invested in an index fund that is allocated 70% to shares of United Kingdom companies and 30% to companies in other markets. The primary objective of investing in this fund is to earn rates of return that are consistently in excess of inflation. Investing in equity securities, over the long term, has provided rates of return that are significantly higher than investments in fixed maturities. As the Company s obligations under this pension plan are expected to be paid out over a period in excess of thirty years, the Company primarily invests in equity securities. Fixed maturity investments are allocated between two index funds, one that includes United Kingdom government securities and one that includes securities issued by other foreign governments. The assets in these funds are invested to meet the Company s obligations for current pensioners and those individuals nearing retirement. The plan does not invest in the Company s common shares.

The benefits expected to be paid in each year from 2007 to 2011 are $2.4 million, $2.5 million, $2.7 million, $2.8 million and $3.1 million, respectively. The aggregate benefits expected to be paid in the five years from 2012 to 2016 are $18.5 million. The expected benefits to be paid

are based on the same assumptions used to measure the Company s projected benefit obligation at December 31, 2006 and include estimated future employee service.

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19. Employee Benefit Plans (continued)

c) Markel Syndicate Management also provides certain Markel International employees with one of two defined benefit pension plans (Markel Syndicate Management Plans) run in connection with the multi-employer Lloyd s Superannuation Scheme (the Scheme). The Markel Syndicate Management Plans, which are closed to new participants, are similar in operation to the Terra Nova Pension Plan, although the benefit structure differs. Contributions to the Scheme were $3.1 million, $3.3 million and $0.9 million in 2006, 2005 and 2004, respectively. During 2006, the Company gave notice to the trustees of the Scheme of its intent to withdraw. As a result, the Company established a liability of $7.7 million for its obligations under the Scheme. In the unlikely event that the Company is unable to withdraw from the Scheme and other employers fail to fund their obligations under the Scheme, Markel Syndicate Management may be required to make up a shortfall, if any, between the assets of the Scheme and the projected benefit obligation.

20. Markel Corporation (Parent Company Only) Financial Information

The following parent company only condensed financial information reflects the financial condition, results of operations and cash flows of Markel Corporation.

CONDENSED BALANCE SHEETS

	December 31,	
	2006	2005
	(dollars in thousands)	
ASSETS		
Investments, available-for-sale, at estimated fair value:		
Fixed maturities (amortized cost of $147,314 in 2006 and $45,789 in 2005)	**$ 148,419**	$ 45,616
Equity securities (cost of $128,209 in 2006 and $129,178 in 2005)	**192,667**	166,833
Short-term investments (estimated fair value approximates cost)	**30,675**	19,955
TOTAL INVESTMENTS, AVAILABLE-FOR-SALE	**371,761**	232,404
Cash and cash equivalents	**169,455**	57,986
Investments in consolidated subsidiaries	**2,631,208**	2,295,422
Notes receivable from subsidiaries	**33,129**	33,129
Other assets	**41,561**	32,900
TOTAL ASSETS	**$ 3,247,114**	$ 2,651,841
LIABILITIES AND SHAREHOLDERS EQUITY		
Income taxes payable	**$ 4,155**	$ 23,814
Deferred income taxes	**27,589**	20,922
Convertible notes payable		98,891
Senior long-term debt	**751,978**	608,945
Junior Subordinated Deferrable Interest Debentures	**106,379**	141,045

Other liabilities	**60,620**	52,791
Total Liabilities	**950,721**	946,408
Total Shareholders Equity	**2,296,393**	1,705,433
Total Liabilities and Shareholders Equity	**$ 3,247,114**	$ 2,651,841

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Markel Corporation & Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

20. Markel Corporation (Parent Company Only) Financial Information (continued)

CONDENSED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

	Years Ended December 31,		
	2006	2005	2004
	(dollars in thousands)		
Revenues			
Net investment income	**$ 5,709**	$ 5,421	$ 1,447
Dividends on common stock of consolidated subsidiaries	**215,171**	243,414	118,955
Net realized investment gains	**22,445**	263	14,711
Other	**2**	1,227	46
Total Revenues	**243,327**	250,325	135,159
Expenses			
Interest	**65,146**	63,835	56,214
Other	**3,028**	48	3,582
Total Expenses	**68,174**	63,883	59,796
Income Before Equity In Undistributed Earnings Of Consolidated Subsidiaries And Income Taxes	**175,153**	186,442	75,363
Equity in undistributed earnings of consolidated subsidiaries	**184,651**	(68,809)	78,469
Income tax benefit	**(32,698)**	(30,282)	(11,580)
Net Income	**$ 392,502**	$ 147,915	$ 165,412
Other Comprehensive Income (Loss)			
Net unrealized gains (losses) on securities, net of taxes:			
Net holding gains (losses) arising during the period	**$ 32,842**	$ (8,939)	$ 25,020
Consolidated subsidiaries net holding gains (losses) arising during the period	**168,476**	(52,816)	83,925
	201,318	(61,755)	108,945
Less reclassification adjustments for net gains included in net income	**(14,589)**	(171)	(9,562)
Less consolidated subsidiaries reclassification adjustments for net gains (losses) included in net income	**(26,756)**	(12,639)	6,872
	(41,345)	(12,810)	(2,690)

Net unrealized gains (losses)	**159,973**	(74,565)	106,255
Consolidated subsidiaries currency translation adjustments, net of taxes	**(1,680)**	(9,709)	1,010
Consolidated subsidiaries net actuarial pension loss, net of taxes	**(25,013)**		
TOTAL OTHER COMPREHENSIVE INCOME (LOSS)	**133,280**	(84,274)	107,265
COMPREHENSIVE INCOME	**$ 525,782**	$ 63,641	$ 272,677

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20. Markel Corporation (Parent Company Only) Financial Information (continued)

CONDENSED STATEMENTS OF CASH FLOWS

	Years Ended December 31,		
	2006	2005	2004
	(dollars in thousands)		
Operating Activities			
Net income	**$ 392,502**	$ 147,915	$ 165,412
Adjustments to reconcile net income to net cash provided by operating activities	**(241,048)**	53,955	(56,299)
Net Cash Provided by Operating Activities	**151,454**	201,870	109,113
Investing Activities			
Proceeds from sales of fixed maturities and equity securities	**190,854**	187,419	162,592
Proceeds from maturities, calls and prepayments of fixed maturities	**5,139**	5,000	300
Cost of fixed maturities and equity securities purchased	**(272,585)**	(288,281)	(188,653)
Net change in short-term investments	**(10,720)**	11,935	(18,890)
Decrease in notes receivable due from subsidiaries		2,700	
Capital contributions to subsidiaries	**(5,000)**	(57,467)	(140,424)
Additions to property and equipment	**(2,930)**	(1,808)	(1,884)
Other	**(3,290)**	(50)	(1,259)
Net Cash Used by Investing Activities	**(98,532)**	(140,552)	(188,218)
Financing Activities			
Additions to senior long-term debt	**145,402**		196,816
Repayments and retirement of senior long-term debt	**(4,549)**	(3,603)	(110,000)
Retirement of Junior Subordinated Deferrable Interest Debentures	**(36,421)**	(9,627)	
Repurchases of common stock	**(45,880)**	(15,926)	(3,385)
Other	**(5)**		
Net Cash Provided (Used) by Financing Activities	**58,547**	(29,156)	83,431
Increase in cash and cash equivalents	**111,469**	32,162	4,326
Cash and cash equivalents at beginning of year	**57,986**	25,824	21,498
Cash and Cash Equivalents at End of Year	**$ 169,455**	$ 57,986	$ 25,824

21. Sale of Subsidiary

On January 11, 2005, the Company sold its wholly-owned reinsurance subsidiary, Corifrance, to a subsidiary of Fairfax (the buyer) for approximately $57 million. Under the terms of the sales agreement, the Company agreed to indemnify the buyer through December 31, 2007 for

any adverse development of loss reserves up to the purchase price. Corifrance was considered by the Company to be a non-strategic subsidiary, and its results were included in the Other segment. The gain on the sale of Corifrance was $5.5 million and was included in underwriting, acquisition and insurance expenses in the Other segment. Included in the gain was the realization of the cumulative foreign currency translation adjustment on Corifrance. The gain was partially offset by the establishment of a contingent obligation to indemnify the buyer if loss reserves prove to be deficient.

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Markel Corporation & Subsidiaries

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders

Markel Corporation:

We have audited the accompanying consolidated balance sheets of Markel Corporation and subsidiaries (the Company) as of December 31, 2006 and 2005, and the related consolidated statements of income and comprehensive income, changes in shareholders equity, and cash flows for each of the years in the three-year period ended December 31, 2006. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Markel Corporation and subsidiaries as of December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles.

As discussed in note 19 to the consolidated financial statements, the Company adopted Statement of Financial Accounting Standards No. 158 related to defined benefit pension and other postretirement plans as of December 31, 2006.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Markel Corporation s internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 22, 2007 expressed an unqualified opinion on management s assessment of, and the effective operation of, internal control over financial reporting.

/s/ KPMG LLP

Richmond, Virginia

February 22, 2007

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders

Markel Corporation:

We have audited management s assessment, included in the accompanying *Management s Report on Internal Control over Financial Reporting,* that Markel Corporation (the Company) maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management s assessment and an opinion on the effectiveness of the Company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management s assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Markel Corporation & Subsidiaries

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM (continued)

In our opinion, management s assessment that Markel Corporation maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also, in our opinion, Markel Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Markel Corporation and subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of income and comprehensive income, changes in shareholders equity, and cash flows for each of the years in the three-year period ended December 31, 2006, and our report dated February 22, 2007 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

Richmond, Virginia

February 22, 2007

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MANAGEMENT S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934. Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Management does not expect that its internal control over financial reporting will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected. The design of any system of internal control over financial reporting also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

Under the supervision and with the participation of management, including the Chairman and Chief Executive Officer and the Senior Vice President and Chief Financial Officer, we evaluated the effectiveness of our internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on our evaluation, we have concluded that we maintained effective internal control over financial reporting as of December 31, 2006.

KPMG LLP, our independent registered public accounting firm, has issued an attestation report on management s assessment of the company s internal control over financial reporting, which is included herein.

/s/ Alan I. Kirshner	/s/ Richard R. Whitt, III
Alan I. Kirshner	Richard R. Whitt, III
Chairman of the Board and Chief Executive Officer	Senior Vice President and Chief Financial Officer

February 22, 2007

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Markel Corporation & Subsidiaries

QUARTERLY FINANCIAL INFORMATION

The following table presents the unaudited quarterly results of consolidated operations for 2006, 2005 and 2004.

(dollars in thousands, except per share amounts)	Quarters Ended			
	Mar. 31	June 30	Sept. 30	Dec. 31
2006				
Operating revenues	**$ 619,630**	**$ 614,788**	**$ 634,414**	**$ 650,173**
Income before income taxes	**111,000**	**132,087**	**144,626**	**165,688**
Net income	**76,590**	**90,432**	**104,098**	**121,382**
Comprehensive income	**45,094**	**31,776**	**236,987**	**211,925**
Net income per share:				
Basic	**$ 7.87**	**$ 9.36**	**$ 10.77**	**$ 12.41**
Diluted	**7.67**	**9.11**	**10.47**	**12.17**
Common stock price ranges:				
High	**$ 350.33**	**$ 361.99**	**$ 411.50**	**$ 494.00**
Low	**315.50**	**325.00**	**332.44**	**389.76**
2005				
Operating revenues	$ 570,179	$ 553,929	$ 496,412	$ 579,628
Income (loss) before income taxes	108,168	85,953	(166,595)	158,474
Net income (loss)	75,718	60,167	(111,098)	123,128
Comprehensive income (loss)	(26,123)	122,696	(142,818)	109,886
Net income (loss) per share:				
Basic	$ 7.69	$ 6.11	$ (11.31)	$ 12.57
Diluted	7.47	5.95	(11.31)	12.21
Common stock price ranges:				
High	$ 373.00	$ 355.20	$ 347.00	$ 333.00
Low	338.30	331.70	307.50	307.41
2004				
Operating revenues	$ 561,448	$ 563,248	$ 572,954	$ 564,408
Income before income taxes	62,170	86,819	7,402	67,654
Net income	42,276	59,037	13,825	50,274
Comprehensive income (loss)	94,262	(41,662)	69,834	150,243
Net income per share:				
Basic	$ 4.29	$ 5.99	$ 1.40	$ 5.11
Diluted	4.20	5.84	1.40	4.97
Common stock price ranges:				
High	$ 288.11	$ 303.45	$ 313.00	$ 365.00
Low	252.00	276.00	266.50	290.00

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MANAGEMENT S DISCUSSION & ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Critical Accounting Estimates

The accompanying consolidated financial statements and related notes have been prepared in accordance with U.S. generally accepted accounting principles (U.S. GAAP) and include the accounts of Markel Corporation and all subsidiaries. For a discussion of our significant accounting policies, see note 1 of the notes to consolidated financial statements.

Critical accounting estimates are those estimates that both are important to the portrayal of our financial condition and results of operations and require us to exercise significant judgment. The preparation of financial statements in accordance with U.S. GAAP requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosure of material contingent assets and liabilities, including litigation contingencies. These estimates, by necessity, are based on assumptions about numerous factors.

We review our critical accounting estimates and assumptions quarterly. These reviews include evaluating the adequacy of reserves for unpaid losses and loss adjustment expenses and the reinsurance allowance for doubtful accounts, analyzing the recoverability of deferred tax assets, assessing goodwill for impairment and evaluating the investment portfolio for other-than-temporary declines in estimated fair value. Actual results may differ materially from the estimates and assumptions used in preparing the consolidated financial statements.

Unpaid Losses and Loss Adjustment Expenses

Our consolidated balance sheet included estimated unpaid losses and loss adjustment expenses of $5.6 billion and reinsurance recoverable on unpaid losses of $1.3 billion at December 31, 2006 compared to $5.9 billion and $1.8 billion, respectively, at December 31, 2005. We do not discount our reserves for losses and loss adjustment expenses to reflect estimated present value.

We accrue liabilities for unpaid losses and loss adjustment expenses based upon estimates of the ultimate amounts payable. We maintain reserves for specific claims incurred and reported (case reserves) and reserves for claims incurred but not reported (IBNR reserves).

Reported claims are in various stages of the settlement process, and the corresponding reserves for reported claims are based primarily on case-by-case evaluations of the individual claims. Case reserves consider our estimate of the ultimate cost to settle the claims, including investigation and defense of lawsuits resulting from the claims, and may be subject to adjustment for differences between costs originally estimated and costs subsequently re-estimated or incurred. Each claim is settled individually based upon its merits, and some claims may take years to settle, especially if legal action is involved.

As of any balance sheet date, all claims have not yet been reported, and some claims may not be reported for many years. As a result, the liability for unpaid losses and loss adjustment expenses includes significant estimates for incurred but not reported claims.

U.S. GAAP requires that IBNR reserves be based on the estimated ultimate cost of settling claims, including the effects of inflation and other social and economic factors, using past experience adjusted for current trends and any other factors that would modify past experience. IBNR reserves are generally calculated by subtracting paid losses and case reserves from estimated ultimate losses. IBNR reserves were 57% of total unpaid losses and loss adjustment expenses at December 31, 2006 compared to 54% at December 31, 2005.

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Markel Corporation & Subsidiaries

MANAGEMENT S DISCUSSION & ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

Our liabilities for unpaid losses and loss adjustment expenses can generally be categorized into two distinct groups, short-tail business and long-tail business. Short-tail business refers to lines of business, such as property, accident and health, motorcycle, watercraft and marine hull exposures for which losses are usually known and paid shortly after the loss actually occurs. Long-tail business describes lines of business for which specific losses may not be known and reported for some period and losses take much longer to emerge. Given the time frame over which long-tail exposures are ultimately settled, there is greater uncertainty and volatility in these lines than in short-tail lines of business. Our long-tail coverages consist of most casualty lines including professional liability, directors and officers liability, products liability, general liability and excess and umbrella exposures. Some factors that contribute to the uncertainty and volatility of long-tail casualty programs, and thus require a significant degree of judgment in the reserving process, include the inherent uncertainty as to the length of reporting and payment development patterns, the possibility of judicial interpretations or legislative changes that might impact future loss experience relative to prior loss experience and the potential lack of comparability of the underlying data used in performing loss reserve analyses.

Our ultimate liability may be greater or less than current reserves. Changes in our estimated ultimate liability for loss reserves generally occur as the result of the emergence of unanticipated loss activity, the completion of specific actuarial or claims studies or changes in internal or external factors. We closely monitor new information on reported claims and use statistical analyses prepared by our actuaries to evaluate the adequacy of our recorded reserves. We are required to exercise considerable judgment when assessing the relative credibility of loss development trends. Our philosophy is to establish loss reserves that are more likely redundant than deficient. This means that we seek to establish loss reserves that will ultimately prove to be adequate. As a result, if new information or trends indicate an increase in frequency or severity of claims in excess of what we initially anticipated, we generally respond quickly and increase loss reserves. If, however, frequency or severity trends are more favorable than initially anticipated, we often wait to evaluate experience in additional periods to confirm the credibility of the trend before reducing our loss reserves. In addition, for long-tail lines of business, trends develop over longer periods of time, and as a result, we give credibility to these trends more slowly than for short-tail or less volatile lines of business.

Each quarter, our actuaries prepare estimates of the ultimate liability for unpaid losses and loss adjustment expenses based on established actuarial methods. Management reviews these estimates, supplements the actuarial analyses with information provided by claims, underwriting and other operational personnel and determines its best estimate of loss reserves, which is recorded in our financial statements. Our procedures for determining the adequacy of loss reserves at the end of the year are substantially similar to the procedures applied at the end of each interim period.

Additionally, once a year, generally at the end of the third quarter, we conduct a detailed review of our liability for unpaid losses and loss adjustment expenses for asbestos and environmental (A&E) claims. If there is significant development on A&E claims in advance of the annual review, such development is considered by our actuaries and by management as part of our quarterly review process. We consider a detailed annual review appropriate because A&E claims develop slowly, are typically reported and paid many years after the loss event occurs and, historically, have exhibited a high degree of variability.

Any adjustments resulting from our interim or year-end reviews, including changes in estimates, are recorded as a component of losses and loss adjustment expenses in the period of the change. Reserve changes that increase previous estimates of ultimate claims cost are referred to as unfavorable or adverse development, deficiencies or reserve strengthening. Reserve changes that decrease previous estimates of ultimate claims cost are referred to as favorable development or redundancies.

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In establishing our liabilities for unpaid losses and loss adjustment expenses, our actuaries estimate an ultimate loss ratio, by accident year, for each of our over 90 major product lines with input from our underwriting and claims associates. In estimating an ultimate loss ratio for a particular line of business, our actuaries may use one or more actuarial reserving methods and select from these a single point estimate. To varying degrees, these methods include detailed statistical analysis of past claim reporting, settlement activity, claim frequency and severity, policyholder loss experience, industry loss experience and changes in market conditions, policy forms and exposures. The actuarial methods we use include:

Paid Loss Development This method uses historical loss payment patterns to estimate future loss payment patterns. Our actuaries use the historical loss patterns to develop factors that are applied to current paid loss amounts to calculate expected ultimate losses.

Incurred Loss Development This method uses historical loss reporting patterns to estimate future loss reporting patterns. Our actuaries use the historical loss patterns to develop factors that are applied to current reported losses to calculate expected ultimate losses.

Bornhuetter-Ferguson Paid Loss Development This method divides the projection of ultimate losses into the portion that has already been paid and the portion that has yet to be paid. The portion that has yet to be paid is estimated as the product of three amounts: the premium earned for the exposure period, the expected loss ratio and the percentage of ultimate losses that are still unpaid. The expected loss ratio is selected by considering historical loss ratios, adjusted for any known changes in pricing, loss trends, adequacy of case reserves, changes in administrative practices and other relevant factors.

Bornhuetter-Ferguson Incurred Loss Development This method is identical to the Bornhuetter-Ferguson paid loss development method, except that it uses the percentage of ultimate losses that are still unreported, instead of the percentage of ultimate losses that are still unpaid.

Frequency/Severity Under this method, expected ultimate losses are equal to the product of the expected ultimate number of claims and the expected ultimate average cost per claim. Our actuaries use historical reporting patterns and severity patterns to develop factors that are applied to the current reported amounts to calculate expected ultimate losses.

Each actuarial method has its own set of assumptions and its own strengths and limitations, with no one method being better than the others in all situations. For example, if a particular line of business has experienced significant changes in claims handling practices that would impact the comparability of case reserves between periods, we would make appropriate adjustments to the data and would give less credibility to the incurred loss development method. Our actuaries select the reserving methods that they believe will produce the most reliable estimate for the class of business being evaluated. Greater judgment may be required when we introduce new product lines or when there have been changes in claims handling practices, as the statistical data available may be insufficient. In these instances, we may rely upon assumptions applied to similar lines of business, rely more heavily on industry experience or take into account changes in underwriting guidelines and risk selection. For example, in 2003, we began offering a specialty underwriting facility for alternative risk transfer, which was a class of business we had not previously underwritten. Given our limited historical experience with this program, we have relied more heavily on data from similar lines of business that we have underwritten for some time and on available external data. In the future, as we develop more experience with our alternative risk transfer program, our actuarial methods may rely more on our historical experience.

MANAGEMENT S DISCUSSION & ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

A key assumption in most actuarial analyses is that past development patterns will repeat themselves in the future, absent a significant change in internal or external factors that influence the ultimate cost of our unpaid losses and loss adjustment expenses. Our estimates reflect implicit and explicit assumptions regarding the potential effects of external factors, including economic and social inflation, judicial decisions, law changes and recent trends in these factors. Our actuarial analyses are based on statistical analysis, but also consist of reviewing internal factors that are difficult to analyze statistically, including underwriting and claims handling changes. In some of our markets, and where we act as a reinsurer, the timing and amount of information reported about underlying claims are in the control of third parties. This can also affect estimates and require re-estimation as new information becomes available.

As indicated above, we may use one or more actuarial reserving methods, which incorporate numerous underlying judgments and assumptions, to establish our estimate of ultimate loss reserves. While we use our best judgment in establishing our estimate for loss reserves, applying different assumptions and variables could lead to significantly different loss reserve estimates.

Loss frequency and loss severity are two key measures of loss activity that often result in adjustments to actuarial assumptions relative to ultimate loss reserve estimates. Loss frequency measures the number of claims per unit of insured exposure. When the number of newly reported claims is higher than anticipated, generally speaking, loss reserves are increased. Conversely, loss reserves are generally decreased when fewer claims are reported than expected. Loss severity measures the average size of a claim. When the average severity of reported claims is higher than originally estimated, loss reserves are typically increased. When the average claim size is lower than anticipated, loss reserves are typically decreased. For example, over the past three years, we have experienced redundancies on prior years loss reserves at the Shand Professional/Products Liability unit as a result of decreases in loss severity, while over the same period of time we have experienced deficiencies on prior years loss reserves at the Markel Brokered Excess and Surplus Lines unit (formerly referred to as the Investors Brokered Excess and Surplus Lines unit) as a result of increased loss frequency and severity. Additionally, we have experienced increases in loss frequency and loss severity related to our asbestos and environmental exposures.

Changes in prior years loss reserves, including the trends and factors that impacted loss reserve development, as well as the likelihood that such trends and factors could result in future loss reserve development, are discussed in further detail under Results of Operations.

Loss reserves are established for each of our product lines at management s best estimate, which is generally higher than the corresponding actuarially calculated point estimate. The actuarial point estimate represents our actuaries estimate of the most likely amount that will ultimately be paid to settle the loss reserves we have recorded at a particular point in time; however, there is inherent uncertainty in the point estimate as it is the expected value in a range of possible reserve estimates. In some cases, actuarial analyses, which are based on statistical analysis, cannot fully incorporate all of the subjective factors that affect development of losses. In other cases, management s perspective of these more subjective factors may differ from the actuarial perspective. Subjective factors where management s perspective may differ from that of the actuaries include: the credibility and timeliness of claims information received from third parties, economic and social inflation, judicial decisions, law changes, changes in underwriting or claims handling practices and other current and developing trends. As a result, the actuarially calculated point estimates for each of our lines of business represent starting points for management s quarterly review of loss reserves.

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Management s best estimate of net reserves for unpaid losses and loss adjustment expenses exceeded the actuarially calculated point estimate by $256 million, or 6.3%, at December 31, 2006, compared to $175 million, or 4.5%, at December 31, 2005. The difference between management s best estimate and the actuarially calculated point estimate for both periods is primarily associated with our long-tail business at the Shand Professional/Products Liability unit and at Markel International. The increase in the difference from 2005 to 2006 was primarily due to management attributing less credibility than our actuaries to emerging favorable trends in the London Insurance Market segment. During 2006, the actuarial point estimate of loss reserves in the London Insurance Market segment was reduced as a result of favorable loss reserve development on recent accident years. Given past unfavorable and volatile development in this segment and consistent with our reserving philosophy, management did not incorporate this emerging favorable trend into its best estimate to the same extent as the actuaries.

Management also considers the range, or variability, of reasonably possible losses determined by our actuaries when establishing its best estimate for loss reserves. The actuarial ranges represent our actuaries estimate of a likely lowest amount and highest amount that will ultimately be paid to settle the loss reserves we have recorded at a particular point in time. The range determinations are based on estimates and actuarial judgments and are intended to encompass reasonably likely changes in one or more of the factors that were used to determine the point estimates. Using statistical models, our actuaries establish high and low ends of a range of reasonable reserve estimates for each of our operating segments.

The following table summarizes our reserves for net unpaid losses and loss adjustment expenses and the actuarially established high and low ends of a range of reasonable reserve estimates, by segment, at December 31, 2006.

(dollars in millions)	Net Loss Reserves Held	Low End of Actuarial Range[(1)]	High End of Actuarial Range[(1)]
Excess and Surplus Lines	$ 2,070.7	$ 1,801.2	$ 2,177.2
Specialty Admitted	240.4	192.9	249.1
London Insurance Market	1,586.0	1,235.5	1,641.6
Other	429.3	249.8	733.0

(1) Due to the actuarial methods used to determine the separate ranges for each segment of our business, it is not appropriate to aggregate the high or low ends of the separate ranges to determine the high and low ends of the actuarial range on a consolidated basis.

Undue reliance should not be placed on these ranges of estimates as they are only one of many points of reference used by management to determine its best estimate of ultimate losses. Further, actuarial ranges may not be a true reflection of the potential variability between loss reserves estimated at the balance sheet date and the ultimate cost of settling claims. Actuarial ranges are developed based on known events as of the valuation date, while ultimate losses are subject to events and circumstances that are unknown as of the valuation date. For example, the Claims and Reserves table on page 104, which provides a summary of historical development between originally estimated loss reserves and ultimate claims costs, illustrates this potential variability, reflecting a cumulative deficiency in net reserves of 34% for the 2000 and prior accident years. A significant portion of the cumulative deficiency that occurred during those periods included adverse loss reserve development at Markel International, which we acquired in March 2000. Historically, we have experienced greater volatility on acquired books of business than on existing books of business. The increases in pre-acquisition loss reserves at Markel International were primarily associated with books of business that were not subject to our underwriting

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discipline and that subsequently experienced unfavorable loss development that exceeded our initial expectations. We believe that, as a result of applying greater underwriting discipline, including improved risk selection and pricing, on business currently being written, total recorded loss reserves at Markel International are unlikely to vary to the same degree as we have historically experienced.

We place less reliance on the range established for our Other segment than on the ranges established for our remaining three segments. The range established for our Other segment includes exposures related to acquired lines of business, many of which are no longer being written, that were not subject to our underwriting discipline and controls. Additionally, A&E exposures, which are subject to an uncertain and unfavorable legal environment, account for approximately 50% of the loss reserves considered in the range established for our Other segment.

Our exposure to A&E claims results from policies written by acquired insurance operations before their acquisitions. The exposure to A&E claims originated from umbrella, excess and commercial general liability (CGL) insurance policies and assumed reinsurance contracts that were written on an occurrence basis from the 1970s to mid-1980s. Exposure also originated from claims-made policies that were designed to cover environmental risks provided that all other terms and conditions of the policy were met. A&E claims include property damage and clean-up costs related to pollution, as well as personal injury allegedly arising from exposure to hazardous materials. After 1986, we began underwriting CGL coverage with pollution exclusions, and in some lines of business we began using a claims-made form. These changes significantly reduced our exposure to future A&E claims on post-1986 business.

There is significant judgment required in estimating the amount of our potential exposure from A&E claims due to the limited and variable historical data on A&E losses as compared to other types of claims, the potential significant reporting delays of claims from insureds to insurance companies and the continuing evolution of laws and judicial interpretations of those laws relative to A&E exposures. Due to these unique aspects of A&E exposures, the ultimate value of loss reserves for A&E claims cannot be estimated using traditional methods and is subject to greater uncertainty than other types of claims. Other factors contributing to the significant uncertainty in estimating A&E reserves include: uncertainty as to the number and identity of insureds with potential exposure; uncertainty as to the number of claims filed by exposed, but not ill, individuals; uncertainty as to the settlement values to be paid; difficulty in properly allocating responsibility and liability for the loss, especially if the claim involves multiple insurance providers or multiple policy periods; growth in the number and significance of bankruptcies of asbestos defendants; uncertainty as to the financial status of companies that insured or reinsured all or part of A&E claims; and inconsistent court decisions and interpretations with respect to underlying policy intent and coverage.

Due to these uncertainties, it is not possible to estimate our ultimate liability for A&E exposures with the same degree of reliability as with other types of exposures. Future development will be affected by the factors mentioned above and could have a material effect on our results of operations, cash flows and financial position. As of December 31, 2006, our consolidated balance sheet included estimated net reserves for A&E losses and loss adjustment expenses of $214.4 million. We seek to establish appropriate reserve levels for A&E exposures; however, these reserves could be subject to increase in the future. We have established A&E reserves without regard to the potential passage of asbestos reform legislation. These reserves are not discounted to present value and are forecasted to pay out over the next 50 years.

Reinsurance Allowance for Doubtful Accounts

We evaluate and adjust reserves for uncollectible reinsurance based upon our collection experience, the financial condition of our reinsurers, collateral held and the development of our gross loss reserves. Our consolidated balance sheets at December 31, 2006 and 2005 included a reinsurance allowance for doubtful accounts of $185.0 million and $194.3 million, respectively.

Reinsurance recoverables recorded on insurance losses ceded under reinsurance contracts are subject to judgments and uncertainties similar to those involved in estimating gross loss reserves. In addition to these uncertainties, our reinsurance recoverables may prove uncollectible if the reinsurers are unable or unwilling to perform under the reinsurance contracts. In establishing our reinsurance allowance for amounts deemed uncollectible, we evaluate the financial condition of our reinsurers and monitor concentration of credit risk arising from our exposure to individual reinsurers. To determine if an allowance is necessary, we consider, among other factors, published financial information, reports from rating agencies, payment history, collateral held and our legal right to offset balances recoverable against balances we may owe. Our reinsurance allowance for doubtful accounts is subject to uncertainty and volatility due to the time lag involved in collecting amounts recoverable from reinsurers. Over the period of time that losses occur, reinsurers are billed and amounts are ultimately collected, economic conditions, as well as the operational and financial performance of particular reinsurers, may change and these changes may affect the reinsurers willingness and ability to meet their contractual obligation to us. It is also difficult to fully evaluate the impact of major catastrophic events on the financial stability of reinsurers, as well as the access to capital that reinsurers may have when such events occur. The ceding of insurance does not legally discharge us from our primary liability for the full amount of the policies, and we will be required to pay the loss and bear collection risk if the reinsurers fail to meet their obligations under the reinsurance contracts.

Deferred Income Taxes

We record deferred income taxes as assets or liabilities on our consolidated balance sheets to reflect the net tax effect of the temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and their respective tax bases. Deferred tax assets are reduced by a valuation allowance when management believes it is more likely than not that some, or all, of the deferred tax assets will not be realized. At December 31, 2006, a net deferred tax asset of $39.1 million was recorded and included a valuation allowance of $43.9 million. A valuation allowance was necessary primarily due to the uncertainty of realizing a future tax benefit on pre-acquisition net operating losses at Markel International. Our net operating losses, including pre-acquisition losses, are principally attributable to Markel Capital Limited. The majority of our net operating losses can be carried forward indefinitely to offset Markel Capital Limited s future taxable income. In evaluating our ability to realize the net deferred tax asset and the adequacy of the valuation allowance at December 31, 2006, we have made estimates regarding the future taxable income of our foreign subsidiaries and judgments about our ability to utilize prudent and feasible tax planning strategies. A change in these estimates and judgments could result in an increase in the valuation allowance through a charge to earnings. See note 7 of the notes to consolidated financial statements for a further discussion of our net operating losses and the related valuation allowance.

Goodwill

Our consolidated balance sheet as of December 31, 2006 included goodwill from acquired businesses of $339.7 million. This amount has been recorded as a result of prior business acquisitions accounted for under the purchase method of accounting. Goodwill is tested for impairment at least annually. We completed our annual test for impairment during the fourth quarter of 2006 based upon results of operations through September 30, 2006 and determined that there was no indication of impairment.

A significant amount of judgment is required in performing goodwill impairment tests. Such tests include estimating the fair value of our reporting units. We compare the estimated fair value of our reporting units to their respective carrying amounts including goodwill. For this purpose, fair value refers to the amount for which the entire reporting unit may be bought or sold. The methods we use for estimating reporting unit fair values include market quotations, asset and liability fair values and other valuation techniques, such as discounted cash flows and multiples of earnings or revenues. With the exception of market quotations, all of these methods involve significant estimates and assumptions.

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Investments

We complete a detailed analysis each quarter to assess whether the decline in the fair value of any investment below cost is deemed other-than-temporary. All securities with an unrealized loss are reviewed. Unless other factors cause us to reach a contrary conclusion, investments with a fair market value of less than 80% of cost for more than 180 days are deemed to have a decline in value that is other-than-temporary. A decline in value that is considered to be other-than-temporary is charged to earnings based on the fair value of the security at the time of assessment, resulting in a new cost basis for the security.

Risks and uncertainties are inherent in our other-than-temporary decline in fair value assessment methodology. Risks and uncertainties include, but are not limited to, incorrect or overly optimistic assumptions about financial condition or liquidity, incorrect or overly optimistic assumptions about future prospects, inadequacy of any underlying collateral, unfavorable changes in economic or social conditions and unfavorable changes in interest rates or credit ratings.

Our Business

The following discussion and analysis should be read in conjunction with Selected Financial Data, the consolidated financial statements and related notes and the discussion under Risk Factors, Critical Accounting Estimates and Safe Harbor and Cautionary Statement.

We market and underwrite specialty insurance products and programs to a variety of niche markets and believe that our specialty product focus and niche market strategy enable us to develop expertise and specialized market knowledge. We seek to differentiate ourselves from competitors by our expertise, service, continuity and other value-based considerations. We compete in three segments of the specialty insurance marketplace: the Excess and Surplus Lines, the Specialty Admitted and the London markets. Our financial goals are to earn consistent underwriting profits and superior investment returns to build shareholder value.

Our Excess and Surplus Lines segment is comprised of five underwriting units, our Specialty Admitted segment consists of three underwriting units and our London Insurance Market segment is comprised of the ongoing operations of Markel International. During 2005, we announced the formation of a new underwriting unit, Markel Global Marine and Energy, which specializes in marine and energy coverages worldwide. The Markel Global Marine and Energy unit began writing business in our Specialty Admitted segment during the third quarter of 2006.

Our Excess and Surplus Lines segment writes property and casualty insurance outside of the standard market for hard-to-place risks including catastrophe-exposed property, professional liability, products liability, general liability, commercial umbrella and other coverages tailored for unique exposures.

Our Specialty Admitted segment writes risks that, although unique and hard-to-place in the standard market, must remain with an admitted insurance company for marketing and regulatory reasons. Our underwriting units in this segment write specialty program insurance for well-defined niche markets and personal and commercial property and liability coverages.

We participate in the London Market through Markel International, which includes Markel Capital Limited and Markel International Insurance Company Limited (MIICL), wholly-owned subsidiaries. Markel Capital Limited is the corporate capital provider for Markel Syndicate 3000 at Lloyd s, which is managed by Markel Syndicate Management Limited, a wholly-owned subsidiary. Our London Insurance Market segment writes specialty property, casualty, professional liability and marine insurance and reinsurance.

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Lines of business that have been discontinued in conjunction with an acquisition and non-strategic insurance subsidiaries are included in Other for purposes of segment reporting. This segment includes development on asbestos and environmental loss reserves and, until its sale on January 11, 2005, the results of Corifrance, a wholly-owned reinsurance subsidiary. For a discussion of our sale of Corifrance, see note 21 of the notes to consolidated financial statements.

A favorable insurance market is commonly referred to as a hard market within the insurance industry and is characterized by stricter coverage terms, higher prices and lower underwriting capacity. We believe the industry began to experience favorable conditions late in 2000, which accelerated following the significant insured losses from the terrorist attacks of September 11, 2001. The events of September 11, 2001, when combined with poor underwriting and price competition over a sustained period of time, left a number of insurance companies insolvent or with significantly depleted amounts of surplus. Demand for insurance products to manage risks accelerated, while total underwriting capacity in the marketplace decreased, which created a number of opportunities for us to grow our business. In 2001, we began to re-underwrite our existing programs at higher prices to increase our confidence in the potential for underwriting profits. During 2003 and 2004, we continued to receive rate increases compared to prior years for most product lines; however, the rate of increase slowed and, in certain lines, rates declined. We continued to experience increased competition during 2005, which resulted in modest rate increases in some lines of business and declines in other lines compared to 2004. With the exception of large rate increases on catastrophe-exposed business, we continued to experience increased competition throughout 2006, most notably in our professional liability programs, where rates were generally down 5% to 10%, and our casualty programs, where rates were generally flat to down 5%. We expect that competition in the property and casualty insurance industry will remain strong in 2007.

We believe that the rates currently being obtained on our books of business are at levels that support our underwriting profit targets. We remain focused on writing business that we believe will allow us to achieve our goal of underwriting profitability. As a result, premium volume may vary when we alter our product offerings to maintain or improve our underwriting profitability.

For further discussion of our lines of business, principal products offered, distribution channels, competition and underwriting philosophy, see the discussion under Business Overview beginning on page 12.

Key Performance Indicators

We measure financial success by our ability to compound growth in book value per share at a high rate of return over a long period of time. We recognize that it is difficult to grow book value consistently each year, so we measure ourselves over a five-year period. We believe that growth in book value per share is the most comprehensive measure of our success because it includes all underwriting and investing results. We measure underwriting results by our underwriting profit or loss and combined ratio. We measure investing results by our total investment return. These measures are discussed in greater detail under Results of Operations.

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MANAGEMENT S DISCUSSION & ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

Results of Operations

The following table compares the components of net income.

(dollars in thousands)	Years Ended December 31,		
	2006	2005	2004
Underwriting profit (loss)	**$ 283,949**	$ (11,845)	$ 72,094
Net investment income	**271,016**	241,979	204,032
Net realized investment gains	**63,608**	19,708	4,139
Interest expense	**(65,172)**	(63,842)	(56,220)
Income tax expense	**(160,899)**	(38,085)	(58,633)
NET INCOME	**$ 392,502**	$ 147,915	$ 165,412

Net income for 2006 increased 165% compared to 2005 and decreased 11% in 2005 compared to 2004. The increase in net income for 2006 compared to 2005 was due to improved underwriting performance, higher net realized investment gains and higher net investment income, offset in part by higher income tax expense. The decrease in 2005 net income was primarily due to producing an underwriting loss in 2005 compared to an underwriting profit in 2004, partially offset by higher net investment income and net realized investment gains and lower income tax expense. The components of net income are discussed in further detail under Underwriting Results, Investing Results and Other Expenses.

Underwriting Results

Underwriting profits are a key component of our strategy to grow book value per share. We believe that the ability to achieve consistent underwriting profits demonstrates knowledge and expertise, commitment to superior customer service and the ability to manage insurance risk. The property and casualty insurance industry commonly defines underwriting profit or loss as earned premiums net of losses and loss adjustment expenses and underwriting, acquisition and insurance expenses. We use underwriting profit or loss as a basis for evaluating our underwriting performance.

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The following table compares selected data from our underwriting operations.

(dollars in thousands)	Years Ended December 31, 2006	2005	2004
Gross premium volume	**$ 2,536,230**	$ 2,401,334	$ 2,518,400
Net written premiums	**$ 2,194,945**	$ 1,972,594	$ 2,050,384
Net retention	**87%**	82%	81%
Earned premiums	**$ 2,184,381**	$ 1,938,461	$ 2,053,887
Losses and loss adjustment expenses	**$ 1,132,579**	$ 1,299,983	$ 1,308,343
Underwriting, acquisition and insurance expenses	**$ 767,853**	$ 650,323	$ 673,450
Underwriting profit (loss)	**$ 283,949**	$ (11,845)	$ 72,094
U.S. GAAP COMBINED RATIOS [1]			
Excess and Surplus Lines	**78%**	92%	87%
Specialty Admitted	**91%**	83%	86%
London Insurance Market	**100%**	126%	117%
Other	**NM(2)**	NM(2)	NM(2)
Markel Corporation (Consolidated)	**87%**	101%	96%

(1) The U.S. GAAP combined ratio is a measure of underwriting performance and represents the relationship of incurred losses, loss adjustment expenses and underwriting, acquisition and insurance expenses to earned premiums. A combined ratio less than 100% indicates an underwriting profit, while a combined ratio greater than 100% reflects an underwriting loss.

(2) NM Ratio is not meaningful. Further discussion of Other underwriting loss follows.

The 2006 combined ratio improved from 2005 primarily due to lower underwriting losses related to Hurricanes Katrina, Rita and Wilma (the 2005 Hurricanes) and more favorable development on prior years loss reserves. The 2005 combined ratio increased from 2004 primarily due to higher current year incurred losses and loss adjustment expenses as a result of losses sustained from the 2005 Hurricanes, which were partially offset by favorable development on prior years loss reserves in 2005.

The 2006 combined ratio included $54.9 million, or 3 points, of underwriting losses related to the 2005 Hurricanes compared to $246.3 million, or 12 points, of underwriting losses on the 2005 Hurricanes included in the 2005 combined ratio. In 2006, the losses on the 2005 Hurricanes were comprised of $61.1 million of net losses, partially offset by a $6.1 million reduction to previously estimated additional reinsurance costs. In 2005, the losses on the 2005 Hurricanes were comprised of $188.7 million of net losses and $57.6 million of additional reinsurance costs.

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The following table summarizes the impact of the 2005 Hurricanes on our underwriting profit (loss), by segment.

(dollars in thousands)	Net Losses on 2005 Hurricanes	Additional Reinsurance Costs on 2005 Hurricanes[1]	Total Losses on 2005 Hurricanes
Year Ended December 31, 2006			
Excess and Surplus Lines	**$ 16,496**	**$ (2,570)**	**$ 13,926**
Specialty Admitted	**794**	**(598)**	**196**
London Insurance Market	**43,799**	**(2,979)**	**40,820**
Total	**$ 61,089**	**$ (6,147)**	**$ 54,942**
Year Ended December 31, 2005			
Excess and Surplus Lines	$ 90,676	$ 28,446	$ 119,122
Specialty Admitted	13,998	1,439	15,437
London Insurance Market	84,015	27,759	111,774
Total	$ 188,689	$ 57,644	$ 246,333

[1] Additional reinsurance costs (increased) decreased both net written and net earned premiums and relate to reinstatement premiums on catastrophe reinsurance treaties.

The additional losses on the 2005 Hurricanes during 2006 were primarily concentrated in our contract property and delegated authority books of business included in the Excess and Surplus Lines and London Insurance Market segments. Business written in these divisions typically focuses on small-to-medium commercial insureds and is placed by a network of wholesale agents. At December 31, 2005, our contract property and delegated authority divisions had significant numbers of hurricane claims reported for which they had not received loss adjustment reports in order to set specific case reserves. Based on the loss adjustment reports received in the first quarter of 2006, the average severity per claim was determined to be significantly higher than had been estimated at December 31, 2005. We continue to closely monitor reported claims and will adjust our estimates of gross and net losses as new information becomes available.

Our estimates of losses from the 2005 Hurricanes assume that flood exclusions in our property policies apply to flood damage in the New Orleans area following Hurricane Katrina. However, beginning in late November 2006, Louisiana state and federal trial courts ruled in a number of cases (most of which we were not a party to) that flood damage following the New Orleans area levee breaches may not be excluded from coverage under policies similar to ours. These rulings are being appealed, and the outcome is uncertain. If the rulings are upheld and it is determined that flood damage is covered under policies like ours, our gross losses associated with Hurricane Katrina will increase. We are currently evaluating this impact and cannot quantify the range of the increase at this time, but it may be material. Since our estimated gross losses on Hurricane Katrina exceeded the coverage provided by our various reinsurance programs, any increase in Hurricane Katrina gross losses will increase our net losses by approximately the same amount.

The 2004 combined ratio included $79.8 million, or 4 points, of underwriting losses related to Hurricanes Charley, Frances, Ivan and Jeanne (the 2004 Hurricanes). The losses on the 2004 Hurricanes were comprised of $77.5 million of net losses and $2.3 million of additional reinsurance costs.

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The level of hurricane activity and insured losses in 2005 and 2004 was significantly more than we expected. Following the 2005 hurricane season, we reviewed the modeling tools and the underwriting guidelines and procedures we use to underwrite catastrophe-exposed business and we redefined our corporate philosophy regarding the management of property catastrophe exposure. We have developed three guiding principles for our catastrophe-exposed product lines. First, each product needs to produce sufficient underwriting profit so that it can absorb catastrophe losses and meet our return goals over a five-year period. Second, we want to limit our overall catastrophe exposure so that in an active catastrophe year, such as 2004 or 2005, we would be able to absorb the catastrophe losses and still produce a consolidated underwriting profit. Third, given an extreme catastrophic event, we want to protect the financial strength of the company.

In order to meet these guidelines, we reduced our aggregate catastrophe exposures in areas where we believed we were overexposed. In addition, we have instituted stricter underwriting standards, lower policy limits, higher deductibles and significantly higher prices for catastrophe-exposed business.

Effective August 1, 2006, we renewed our catastrophe reinsurance program. While we have reduced our aggregate catastrophe exposure and increased pricing, the market for catastrophe reinsurance has become more difficult with lower capacity and higher pricing. Given these factors, we decided to retain a larger share of our net catastrophe exposure. The restructuring of our catastrophe-exposed business is an on-going process; however, we believe that future events similar in magnitude to those experienced in 2005 would result in lower net catastrophe losses than we incurred on the 2005 Hurricanes.

In addition to the impact of the benign hurricane season experienced this year, the 2006 combined ratio improved due to favorable development of prior years loss reserves of $132.3 million compared to $50.6 million of favorable development on prior years loss reserves in 2005 and $33.9 million of adverse development in 2004. The favorable development on prior years loss reserves, before considering $61.1 million of adverse development on the 2005 Hurricanes, was primarily due to loss reserve redundancies of $182.1 million at the Shand Professional/Products Liability unit. The favorable development on prior years losses in 2005 was primarily due to loss reserve redundancies of $96.1 million at the Shand Professional/Products Liability unit, partially offset by $35.4 million of adverse development at the Markel Brokered Excess and Surplus Lines unit. In 2004, the adverse development on prior years loss reserves was primarily due to loss reserve deficiencies of $55.3 million at the Markel Brokered Excess and Surplus Lines unit and $30.0 million at Markel International, which were partially offset by favorable development on prior years loss reserves of $36.0 million at the Shand Professional/Products Liability unit.

Over the past three years, we have experienced significant redundancies in prior years loss reserves on the 2002 to 2004 accident years across all of our segments. During 2006, we saw the emergence of a positive trend on the 2005 accident year as well. The product lines that have produced these redundancies are primarily long-tail books of business that take several years to fully develop. The positive trend in these prior years loss reserves was partially the result of the more favorable rates and terms associated with a hard insurance market that began in 2000. Although the hard insurance market created expectations of improved underwriting results, the full impact from this favorable environment could not be quantified when we initially established loss reserves for these years.

In connection with our quarterly reviews of loss reserves, the actuarial methods we used exhibited a favorable trend for the 2002 to 2005 accident years. This trend was observed using statistical analysis of actual loss experience for those years, particularly with regard to loss severity at our Shand Professional/ Products Liability unit, which developed more favorably than we had expected based upon our historical experience. In each quarterly review of loss reserves, based upon our latest evaluation of

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claims development patterns in these long-tail and often volatile lines of business, we gave more credibility to the positive trend. As a result, our actuaries reduced their estimates of ultimate losses, and management reduced prior years loss reserves accordingly.

While we believe that prior years loss reserves for the 2002 to 2005 accident years may continue to develop favorably in 2007, we caution readers not to place undue reliance on this positive trend. Beginning in 2004, we saw a softening of the insurance market and experienced a slow down in the rate of increase in prices as a result of increased competition. Competition remained strong in 2005 and increased further in 2006, resulting in deterioration in pricing in both periods. Similar to the impact of the hardening of the insurance market that began in 2000 and as discussed previously, the impact of the softening insurance market on our underwriting results cannot be fully quantified in advance.

The following discussion provides more detail by segment of the underwriting results described above. This segment-based discussion is supplemented by a summary of prior years loss reserve development on page 96.

Excess and Surplus Lines Segment

The Excess and Surplus Lines segment s combined ratio for 2006 was 78% (including 1 point of losses on the 2005 Hurricanes) compared to 92% (including 10 points of losses on the 2005 Hurricanes) in 2005 and 87% (including 2 points of losses on the 2004 Hurricanes) in 2004. The improvement in the Excess and Surplus Lines segment s combined ratio for 2006 was primarily due to lower losses on the 2005 Hurricanes and more favorable development on prior years loss reserves during 2006 compared to 2005. Compared to 2004, the impact of the increased hurricane losses during 2005 was partially offset by more favorable development of prior years loss reserves. The 2005 combined ratio included $90.7 million of net losses and $28.4 million of additional reinsurance costs for the 2005 Hurricanes.

In 2006, the Excess and Surplus Lines segment s results included $160.1 million of favorable development on prior years loss reserves compared to $66.3 million of favorable development on prior years loss reserves in 2005 and $10.8 million of adverse development on prior years loss reserves in 2004. The improvement experienced during 2006 was primarily due to more favorable development at the Shand Professional/Products Liability unit and less adverse development at the Markel Brokered Excess and Surplus Lines unit compared to 2005, partially offset by $16.5 million of unfavorable prior years loss reserve development in 2006 on the 2005 Hurricanes. The improvement experienced during 2005 was primarily due to more favorable development at the Shand Professional/ Product Liability unit and less adverse development at the Markel Brokered Excess and Surplus Lines unit compared to 2004.

The favorable development of prior years loss reserves during 2006 included $182.1 million of redundancies at the Shand Professional/Products Liability unit, of which $157.5 million was on the 2002 to 2005 accident years. This favorable development was primarily the result of the positive effect of price increases across most product lines. We initially attributed most of the increase in rates during those years to greater loss exposure; however, based upon actual loss experience on this predominantly long-tail book of business, loss severity on these accident years has been lower than originally anticipated. The product lines that produced the majority of the redundancy at this unit were the specified medical, medical malpractice and products liability programs, where the average

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claim severity estimate on the 2002 to 2005 accident years declined by 20% in 2006 compared to 2005. As a result of this decrease in severity, our actuarial estimates of the ultimate liability for unpaid losses and loss adjustment expenses were reduced, and management reduced prior years loss reserves accordingly.

During 2005, prior years loss reserves at the Markel Brokered Excess and Surplus Lines unit included $35.4 million of adverse development, of which $26.1 million related to general and products liability programs, including the California commercial and residential contractors programs, and claims handling costs associated with these and other programs. As further described in the next paragraph, the adverse development within the general and products liability programs was primarily for the 1999 to 2002 accident years and was the result of our determination, based on loss development experience, that the average claim severity assumption for these programs needed to be increased by 2%. In addition to the increased severity on reported claims, we experienced a higher than expected incidence of newly reported claims, resulting in a 6% increase in our average claim frequency assumption for these same programs. As a result of the increase in loss frequency and severity experienced during 2005 for these programs and considering the recent history of similar increases in 2003 and 2004, our actuaries increased their estimate of ultimate losses, and management increased prior years loss reserves accordingly.

During 2005 and 2004, actual reported claims at the Markel Brokered Excess and Surplus Lines unit, primarily on the 1999 to 2002 accident years, exceeded expectations resulting in our actuaries revising their estimates of our ultimate losses at this unit. The losses experienced in 2005 and 2004 were concentrated in our casualty book of business, primarily on the general and products liability programs. In these programs, we, like other insurers, were adversely impacted by the geographic concentration of unfavorable litigation for construction-related exposures included in our commercial and residential contractors book of business in New York and California. As a result of these factors, the estimation of ultimate losses at this unit was subject to greater volatility. We no longer write contractors business in either California or New York. As a result of exiting certain books of business and re-underwriting and re-pricing the on-going casualty programs, we believe the business written at this unit since 2002 has met our underwriting profit targets. There was no significant adverse development on these books of business during 2006.

The adverse development of prior years loss reserves in 2005 as discussed above was more than offset by $115.8 million of favorable development in prior years loss reserves at other operating units in this segment. Of this amount, $96.1 million related to the Shand Professional/Products Liability unit. This favorable development, which included $83.8 million on the 2002 to 2004 accident years, was primarily the result of the positive effect of price increases across most product lines. The product lines which produced the majority of the redundancy at this unit were the specified medical, medical malpractice and products liability programs, where the average claim severity estimate on the 2002 to 2004 accident years declined by 15% in 2005 compared to 2004.

During 2004, prior years loss reserves included $55.3 million of adverse development at the Markel Brokered Excess and Surplus Lines unit. Of this amount, $34.9 million was related to our California commercial and residential contractors programs. This adverse development was primarily on the 1999 to 2002 accident years and was based upon our determination that the development of reported claims for this book of business was higher than expected. The remaining loss reserve increases at this unit were attributed to other casualty programs across various accident years.

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Markel Corporation & Subsidiaries

MANAGEMENT S DISCUSSION & ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

Specialty Admitted Segment

The Specialty Admitted segment s combined ratio for 2006 was 91% compared to 83% (including 5 points of losses on the 2005 Hurricanes) in 2005 and 86% (including 3 points of losses on the 2004 Hurricanes) in 2004. The increase in the 2006 combined ratio was primarily due to lower favorable development on prior years loss reserves compared to 2005. Compared to 2004, the increased hurricane losses in 2005 were more than offset by lower current year loss ratios and greater favorable development of prior years loss reserves. The 2005 combined ratio included $14.0 million of net losses and $1.4 million of additional reinsurance costs for the 2005 Hurricanes.

The Specialty Admitted segment s results included $12.8 million of favorable development on prior years loss reserves in 2006 compared to $31.4 million and $24.2 million in 2005 and 2004, respectively. In 2006, $8.5 million of the favorable development on prior years loss reserves was on the 2005 accident year. In 2005, $28.4 million of the favorable development on prior years losses was on the 2002 to 2004 accident years. The favorable development in each of the periods presented was primarily due to the positive effect of price increases across most product lines and lower severity on claims reported than originally anticipated. Over the past three years, the majority of the redundancy in this segment was attributable to the casualty programs at the Markel Specialty Program Insurance unit.

London Insurance Market Segment

The London Insurance Market segment s combined ratio for 2006 was 100% (including 7 points of losses on the 2005 Hurricanes) compared to 126% (including 22 points of losses on the 2005 Hurricanes) in 2005 and 117% (including 7 points of losses on the 2004 Hurricanes) in 2004. During 2006, unfavorable prior years loss reserve development of $43.8 million on the 2005 Hurricanes was partially offset by $25.3 million of favorable development on other prior years loss reserves. The combined ratio for 2006 also improved due to a lower current year loss ratio resulting in part from lower frequency and severity of losses on several property classes of business compared to 2005. The 2005 combined ratio included $84.0 million of net losses and $27.8 million of additional reinsurance costs for the 2005 Hurricanes. The impact of increased hurricane losses in 2005 was partially offset by less adverse development on prior years loss reserves compared to 2004.

The London Insurance Market segment s 2006 combined ratio included $22.8 million of favorable development on prior years losses on the 2002 to 2005 accident years, primarily on professional liability programs at the Professional and Financial Risks and Retail divisions. The London Insurance Market segment s improved underwriting performance each of the past two years, before considering the effects of the hurricanes, reflects our continued efforts to strengthen Markel International s operating performance and financial position through a focus on expense control and underwriting discipline, which includes improved risk selection and pricing and appropriate use of reinsurance for business currently being written. While management believes that reserves for losses and loss adjustment expenses within our London Insurance Market segment are more likely to prove redundant than deficient, adverse development is possible. In addition, the underwriting performance for this segment may vary to a greater degree than our other segments due to Markel International s current mix of business, which includes a higher percentage of catastrophe-exposed business, and due to less reliance being placed on reinsurance by this unit despite having higher average policy limits.

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The London Insurance Market segment s combined ratio for 2004 included $30.0 million of loss reserve increases for adverse development on the 1997 to 2001 accident years for U.S. casualty reinsurance, financial institution risks and professional indemnity and general liability exposures, most of which are no longer written. The $30.0 million of prior years loss reserve development was identified as part of a claims review completed in early 2004, which indicated that these lines of business were taking longer to develop than previously estimated. The prolonged development pattern for the 1997 to 2001 accident years was primarily due to the soft insurance market conditions at that time and a higher than expected frequency of new claims reported.

Other Segment

The majority of the losses and loss adjustment expenses and the underwriting, acquisition and insurance expenses for the Other segment are associated with asbestos and environmental exposures or discontinued Markel International programs, most of which were discontinued upon acquisition, or shortly thereafter. Given the insignificant amount of premium earned in the Other segment, we evaluate this segment s underwriting performance in terms of dollars of underwriting loss instead of its combined ratio.

The Other segment produced an underwriting loss of $23.4 million in 2006 compared to an underwriting loss of $28.8 million in 2005 and $13.5 million in 2004. The underwriting loss in 2006 and in 2005 included $16.7 million and $31.3 million, respectively, of loss reserve development on asbestos and environmental exposures and related reinsurance bad debt. The increase in asbestos and environmental reserves in both years was a result of the completion of our annual review of these exposures. In 2004, the underwriting loss for the Other segment included $6.0 million of allowances for financially weak reinsurers and for collection disputes.

Bankruptcies of asbestos defendants coupled with significant increases in the number of claims from exposed, but not ill, individuals continue to increase the insurance industry s asbestos exposures. Each year we complete an actuarial review of our asbestos and environmental exposures. We completed this year s review of asbestos and environmental loss reserves for both our U.S. and international operations during the third quarter of 2006. During both our 2006 and 2005 reviews, we noted an increase in the severity of losses on reported claims, which caused us to increase our estimate of ultimate loss reserves for asbestos and environmental exposures. The increase in the allowance for potentially uncollectible reinsurance was required to provide for potential collection disputes with reinsurers and to increase reserves for financially weak or insolvent reinsurers. No adjustments to loss reserves resulted from the 2004 review. The need to increase asbestos loss reserves in two of the past three years demonstrates that asbestos and environmental reserves are subject to significant uncertainty due to potential loss severity and frequency resulting from the uncertain and unfavorable legal climate. We seek to establish appropriate reserve levels for asbestos and environmental exposures; however, these reserves could be subject to increases in the future. We have established asbestos and environmental reserves without regard to the potential passage of asbestos reform legislation. These reserves are not discounted to present value and are forecasted to pay out over the next 50 years. See note 8 of the notes to consolidated financial statements for further discussion of our exposures to asbestos and environmental claims.

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Markel Corporation & Subsidiaries

MANAGEMENT S DISCUSSION & ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

The following tables summarize the increases (decreases) in prior years loss reserves by segment, as discussed above.

	Year Ended December 31, 2006				
(dollars in millions)	Excess & Surplus Lines	Specialty Admitted	London Insurance Market	Other	Total
2005 Hurricanes	**$ 16.5**	**0.8**	**43.8**		**$ 61.1**
Professional/Products Liability	**(182.1)**				**(182.1)**
Markel International			**(25.3)**		**(25.3)**
Asbestos exposures[(1)]				**16.7**	**16.7**
Net other prior years (redundancy) deficiency	**5.5**	**(13.6)**		**5.4**	**(2.7)**
INCREASE (DECREASE)	**$ (160.1)**	**(12.8)**	**18.5**	**22.1**	**$ (132.3)**

	Year Ended December 31, 2005				
(dollars in millions)	Excess & Surplus Lines	Specialty Admitted	London Insurance Market	Other	Total
Brokered Excess & Surplus Lines	$ 35.4				$ 35.4
Professional/Products Liability	(96.1)				(96.1)
Specialty Program Insurance		(30.3)			(30.3)
Asbestos exposures[(1)]				31.3	31.3
Allowance for reinsurance recoverables	14.1			1.3	15.4
Net other prior years (redundancy) deficiency	(19.7)	(1.1)	14.5		(6.3)
INCREASE (DECREASE)	$ (66.3)	(31.4)	14.5	32.6	$ (50.6)

	Year Ended December 31, 2004				
(dollars in millions)	Excess &	Specialty	London	Other	Total

	Surplus Lines	Admitted	Insurance Market		
Brokered Excess & Surplus Lines	$ 55.3				$ 55.3
Professional/Products Liability	(36.0)				(36.0)
Essex Excess & Surplus Lines	(18.9)				(18.9)
Specialty Program Insurance		(18.1)			(18.1)
U.S. casualty reinsurance and financial institution risks			10.0		10.0
Professional indemnity and general liability			20.0		20.0
Allowance for reinsurance recoverables	13.0			6.0	19.0
Net other prior years (redundancy) deficiency	(2.6)	(6.1)	7.2	4.1	2.6
INCREASE (DECREASE)	$ 10.8	(24.2)	37.2	10.1	$ 33.9

[1] Asbestos exposures include related allowances for reinsurance bad debt.

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Over the past three years, we have experienced both favorable and unfavorable development on prior years loss reserves ranging from 1% to 3% of beginning of year net loss reserves. In 2006 and 2005, we experienced favorable development of $132.3 million, or 3% of beginning of year net loss reserves, and $50.6 million, or 1% of beginning of year net loss reserves, respectively. In 2004, we experienced adverse development of $33.9 million, or 1% of beginning of year net loss reserves.

The favorable trend in prior years loss reserve movements over the three-year period ended December 31, 2006 was primarily the result of increasing redundancies at the Shand Professional/Products Liability unit ($36.0 million in 2004, $96.1 million in 2005 and $182.1 million in 2006) as a result of lower than anticipated average claims severity and decreasing deficiencies at the Markel Brokered Excess and Surplus Lines unit ($55.3 million in 2004, $35.4 million in 2005 and $7.8 million in 2006) as a result of our efforts to re-underwrite and re-price the ongoing casualty programs. Also contributing to this favorable trend are the improved underwriting results within our London Insurance Market segment (deficiencies of $37.2 million in 2004 and $14.5 million in 2005 compared to a redundancy, before considering the effects of the 2005 Hurricanes, of $25.3 million in 2006) as a result of improved risk selection and the favorable rates and terms associated with the London market in recent years.

While we believe that it is possible that there will be additional reductions to prior years loss reserves in future periods at the Shand Professional/Products Liability unit, it is unlikely that the redundancies experienced would exceed 2006 levels due to the softening of the insurance market since 2004, which has resulted in a deterioration in pricing and a reduction in our premium volume at this unit. While further adverse development at the Markel Brokered Excess and Surplus Lines unit is possible, we believe that reserves for unpaid losses and loss adjustment expenses are adequate as of December 31, 2006, and that business written at this unit since 2002 is more likely to prove redundant than deficient. It is also reasonably likely that there could be additional reductions to prior years loss reserves at Markel International, where we also believe that business written since 2002 is more likely to prove redundant than deficient.

It is difficult for management to predict the duration and magnitude of an existing trend and, on a relative basis, it is even more difficult to predict the emergence of factors or trends that are unknown today but may have a material impact on loss reserve development. In assessing the likelihood of whether the above favorable trends will continue and whether other trends may develop, we believe that a reasonably likely movement in prior years loss reserves during 2007 would range from a redundancy of approximately 4%, or $175 million, to a deficiency of approximately 2%, or $75 million, of December 31, 2006 net loss reserves.

Premiums

The following table summarizes gross premium volume by segment.

GROSS PREMIUM VOLUME *(dollars in thousands)*	Years Ended December 31,		
	2006	2005	2004
Excess and Surplus Lines	**$ 1,465,725**	$ 1,439,744	$ 1,478,210
Specialty Admitted	**340,483**	318,717	294,114
London Insurance Market	**729,160**	640,986	700,002
Other	**862**	1,887	46,074
TOTAL	**$ 2,536,230**	$ 2,401,334	$ 2,518,400

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Markel Corporation & Subsidiaries

MANAGEMENT S DISCUSSION & ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

Excess and Surplus Lines Segment

Excess and Surplus Lines segment gross premium volume increased 2% in 2006 compared to 2005. The increase in gross premium volume in 2006 was primarily due to new programs written by Markel Re s Specialized Markel Alternative Risk Transfer (SMART) division. In 2006, the increased volume from the SMART division was partially offset by lower volume in our professional liability programs at the Shand Professional/Products Liability unit due to increased competition. Gross premium volume declined 3% in 2005 compared to 2004 primarily due to increased competition across all units in this segment and lower premium writings at the Markel Brokered Excess and Surplus Lines unit as a result of the re-underwriting and exiting of certain books of business.

Specialty Admitted Segment

Specialty Admitted segment gross premium volume increased 7% in 2006 compared to 2005 and increased 8% in 2005 compared to 2004. The increase in gross premium volume in 2006 was primarily due to a new lumber products program at the Markel Specialty Program Insurance unit. In 2005, the increase in premium volume was primarily due to higher policy counts resulting from increased submissions in the Markel Risk Solutions facility and the accident and health division at the Markel Specialty Program Insurance unit.

London Insurance Market Segment

London Insurance Market segment gross premium volume increased 14% in 2006 compared to 2005. Gross premium volume increased in 2006 primarily due to rate increases achieved by Markel International s Marine and Energy and Non-Marine Property divisions. As a result of the 2005 Hurricanes, we received large rate increases on our catastrophe-exposed classes of business during

2006. London Insurance Market segment gross premium volume decreased 8% in 2005 compared to 2004. The 2005 decrease in gross premium volume was primarily due to our decision to withdraw from the aviation insurance market in late 2004 and increased competition experienced throughout 2005, primarily in the Professional and Financial Risks and Non-Marine Property divisions.

Other Segment

Other gross premium volume in 2004 consisted primarily of writings at Corifrance, which was sold in January 2005.

The following table summarizes net written premiums by segment.

NET WRITTEN PREMIUMS *(dollars in thousands)*	Years Ended December 31,		
	2006	2005	2004

Excess and Surplus Lines	**$ 1,228,797**	$ 1,160,948	$ 1,156,044
Specialty Admitted	**322,466**	299,665	276,363
London Insurance Market	**643,485**	510,836	580,730
Other	**197**	1,145	37,247
TOTAL	**$ 2,194,945**	$ 1,972,594	$ 2,050,384

As part of our underwriting philosophy, we seek to offer products with limits that do not require significant amounts of reinsurance. We purchase reinsurance in order to reduce our retention on individual risks and enable us to write policies with sufficient limits to meet policyholder needs. Net retention of gross premium volume was 87% in 2006 compared to 82% in 2005 and 81% in 2004. Net written premiums for 2005 were reduced by $57.6 million of additional reinsurance costs resulting

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from the 2005 Hurricanes. As a result of these additional reinsurance costs, our net retention of gross premium volume was reduced by 3% in 2005. Net retention of gross premium volume has increased consistent with our strategy to retain more of our profitable business. The increase in retention in both 2006 and 2005 was primarily due to purchasing lower amounts of reinsurance in the Excess and Surplus Lines and London Insurance Market segments.

The following table summarizes earned premiums by segment.

EARNED PREMIUMS *(dollars in thousands)*	Years Ended December 31,		
	2006	2005	2004
Excess and Surplus Lines	**$ 1,242,184**	$ 1,138,525	$ 1,146,142
Specialty Admitted	**317,401**	291,273	265,671
London Insurance Market	**624,599**	507,518	604,070
Other	**197**	1,145	38,004
TOTAL	**$ 2,184,381**	$ 1,938,461	$ 2,053,887

Excess and Surplus Lines earned premiums increased 9% in 2006 compared to a decrease of 1% in 2005. Earned premiums in 2005 were reduced by $28.4 million of additional reinsurance costs resulting from the 2005 Hurricanes. Before considering the effects of the hurricanes, the growth in Excess and Surplus Lines earned premiums in both 2006 and 2005 reflected higher net written premiums over the past several years at most of our Excess and Surplus Lines units.

Specialty Admitted earned premiums increased 9% in 2006 and 10% in 2005. Earned premiums in 2005 were reduced by $1.4 million of additional reinsurance costs resulting from the 2005 Hurricanes. The increase in both years was primarily due to higher gross premium volume in existing lines of business and growth in new programs over the past several years.

London Insurance Market earned premiums increased 23% in 2006 compared to a decrease of 16% in 2005. Earned premiums in 2005 were reduced by $27.8 million of additional reinsurance costs resulting from the 2005 Hurricanes. In addition to the effects of the hurricanes, the increase in 2006 earned premiums was due to higher net written premiums over the past year as a result of significant rate increases in 2006 on catastrophe-exposed classes of business and higher net retentions. In addition to the effects of the hurricanes, the decline in 2005 earned premiums was the result of lower net written premiums compared to 2004, which was primarily due to increased competition and exiting certain programs in the London market.

Other earned premiums declined in 2005 compared to 2004 due to the sale of Corifrance in January 2005.

Investing Results

Our business strategy recognizes the importance of both consistent underwriting profits and superior investment returns to build shareholder value. We rely on sound underwriting practices to produce investable funds while minimizing underwriting risk. We believe it is important to evaluate investment performance by measuring total investment return. Total investment return includes items that impact net income, such as net investment income and realized investment gains or losses, as well as changes in unrealized holding gains or losses, which do not impact net income. Our focus on long-term total investment return results in variability in the level of realized and unrealized investment gains or losses from one period to the next. Taxable equivalent total investment return provides a measure of investment performance that considers the yield of both taxable and tax-exempt investments on an equivalent basis.

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Markel Corporation & Subsidiaries

MANAGEMENT S DISCUSSION & ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

The following table summarizes our investment performance.

	Years Ended December 31,		
(dollars in thousands)	**2006**	2005	2004
Net investment income	**$ 271,016**	$ 241,979	$ 204,032
Net realized investment gains	**$ 63,608**	$ 19,708	$ 4,139
Increase (decrease) in net unrealized holding gains	**$ 246,113**	$ (114,717)	$ 163,470
Investment yield[1]	**4.0%**	3.8%	3.6%
Taxable equivalent total investment return, before foreign currency effect	**9.6%**	2.9%	6.6%
Taxable equivalent total investment return[2]	**11.2%**	1.5%	7.9%
Ending portfolio balance	**$ 7,535,295**	$ 6,588,222	$ 6,316,747

(1) Investment yield reflects net investment income as a percentage of average invested assets.

(2) Taxable equivalent total investment return includes net investment income, realized investment gains or losses, the change in market value of the investment portfolio and the effect of foreign exchange movements during the period as a percentage of average invested assets. Tax-exempt interest and dividend payments are grossed up using the U.S. corporate tax rate to reflect an equivalent taxable yield.

Investments and cash and cash equivalents (invested assets) grew approximately 14% in 2006 as compared to 4% in 2005 and 18% in 2004. The increase in the investment portfolio in 2006 was primarily due to cash flows from operations of $511.6 million and an increase in net unrealized holding gains of $246.1 million. The increase in the investment portfolio in 2005 was primarily due to cash flows from operations of $551.3 million partially offset by a decline in net unrealized holding gains of $114.7 million.

Net investment income for 2006 increased 12% compared to 2005 and increased 19% in 2005 compared to 2004. The increase in both 2006 and 2005 was due to higher invested assets and higher investment yields than in the previous year. The increase in investment yields over the past two years reflects the impact of rising interest rates experienced within the fixed income market over the same period.

Net realized investment gains in both 2006 and 2005 were primarily related to equity securities that were sold either because of merger and acquisition activity by the underlying company or based upon our belief that the securities did not have the desired potential for further appreciation. Net realized investment gains in 2004 were primarily attributed to sales of fixed maturities and were the result of our efforts to manage interest rate volatility and our decision to sell certain government securities and buy higher yielding fixed income investments, including tax-exempt municipal bonds. Variability in the timing of realized and unrealized investment gains and losses should be expected.

We recognized $22.0 million, $16.9 million and $42.6 million of gross realized losses on our fixed maturities and equity securities for the years ended December 31, 2006, 2005 and 2004, respectively. Proceeds received on securities sold at a loss were $0.9 billion in 2006, $1.1 billion in 2005 and $1.5 billion in 2004.

For each of the last three years, gross realized losses were recognized on fixed maturities and equity securities that were sold to reallocate capital to other investments with greater potential for long-term investment returns. Additionally, our efforts to manage against interest rate volatility

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resulted in the recognition of gross realized losses as we attempt to maintain the duration on our portfolio and purchase more high-credit quality investments.

Approximately 38% of the gross realized losses in 2006 related to securities that had been in a continuous unrealized loss position for less than one year. Gross realized losses in 2006 included $4.5 million of write downs for other-than-temporary declines in the estimated fair market value of two equity securities that had been in a continuous unrealized loss position for greater than one year. The most significant write down was for a real estate investment trust and investment bank where the value had declined as a result of the changing interest rate environment.

Approximately 93% of the gross realized losses in 2005 related to securities that had been in a continuous unrealized loss position for less than one year. In 2005, we did not recognize any write downs for other-than-temporary declines in the estimated fair market value of securities.

Approximately 81% of the gross realized losses in 2004 related to securities that had been in a continuous unrealized loss position for less than one year. Gross realized losses for 2004 included $20.3 million of write downs for other-than-temporary declines in estimated fair market value for four securities. The most significant write down, representing approximately 83% of our total write downs for the year, was for an equity security of a risk and insurance services firm, which at the time of write down was under government investigation.

The increase in net unrealized holding gains during 2006 was primarily due to the appreciation of our equity portfolio. The increase in market value for equity securities was due in part to our focus on large cap value stocks, including our investment concentration in the property and casualty insurance industry discussed in more detail under Market Risk Disclosures, which after experiencing pricing pressure in 2005 produced favorable returns in 2006. The decrease in net unrealized holding gains during 2005 was due to the decline in market value of both our fixed maturity and equity security portfolios. The decline in market value for fixed maturities was primarily due to the increase in interest rates during 2005. The decline in market value for equity securities was due in part to our focus on large cap value stocks, which experienced pricing pressure in 2005. The increase in net unrealized holding gains during 2004 was primarily due to appreciation in our equity securities.

We complete a detailed analysis each quarter to assess whether the decline in the value of any investment below its cost basis is deemed other-than-temporary. All securities with an unrealized loss are reviewed.

At December 31, 2006 and 2005, we held securities with gross unrealized losses of $48.2 million and $51.0 million, respectively. Gross unrealized losses at both December 31, 2006 and 2005 were less than 1% of our total invested assets. At December 31, 2006 and 2005, all securities with unrealized losses were reviewed and we believe that there were no indications of declines in estimated fair value that were considered to be other-than-temporary. See note 2(b) of the notes to consolidated financial statements for further discussion of unrealized losses.

Markel Corporation & Subsidiaries

MANAGEMENT S DISCUSSION & ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

Other Expenses

Interest expense was $65.2 million in 2006 compared to $63.8 million in 2005 and $56.2 million in 2004. During the third quarter of 2006, we issued $150 million of 7.50% unsecured senior debentures, due August 22, 2046. Interest expense from the new debt issuance was partially offset by lower interest expense on our 8.71% Junior Subordinated Debentures due to our retirement of a portion of these debentures during 2006. The increase in 2005 was primarily due to the August 2004 issuance of $200 million of 7.35% unsecured senior notes, due August 15, 2034.

We reported an effective tax rate of 29% in 2006 compared to 20% in 2005 and 26% in 2004. During 2006, our 2002 federal income tax year was closed to audit and management determined that tax liabilities were less than previously estimated, resulting in a $3.4 million tax benefit during 2006. Before considering this benefit, the estimated annual effective tax rate was 30% for the year ended December 31, 2006. During 2005, our 2001 federal income tax year was closed to audit. As a result, we recognized a tax benefit of $2.5 million. Before considering this benefit, the estimated annual effective tax rate was 22% for the year ended December 31, 2005. During 2004, our 2000 federal income tax year was closed to audit. As a result, we recognized a tax benefit of $4.1 million. Before considering this benefit, our estimated annual effective tax rate was 28% for the year ended December 31, 2004. The effective tax rate in all years presented differs from the statutory tax rate of 35% primarily as a result of tax-exempt investment income. See note 7 of the notes to consolidated financial statements for a discussion of factors affecting the realization of our gross deferred tax assets.

In June 2006, the Financial Accounting Standards Board issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN No. 48). FIN No. 48 provides recognition criteria and a related measurement model for uncertain tax positions taken or expected to be taken in income tax returns. FIN No. 48 requires that a position taken or expected to be taken in a tax return be recognized in the financial statements when it is more likely than not that the position would be sustained upon examination by tax authorities. Tax positions that meet the more likely than not threshold are then measured using a probability weighted approach recognizing the largest amount of tax benefit that is greater than 50% likely of being realized upon ultimate settlement. FIN No. 48 becomes effective for us in the first quarter of 2007. Upon adoption, we will be required to apply the provisions of FIN No. 48 to all tax positions and any cumulative effect adjustment will be recognized as an adjustment to retained earnings. We are in the process of evaluating FIN No. 48 and currently estimate that the cumulative effect of applying this guidance will result in an increase to retained earnings at January 1, 2007 in the range of $10 million to $25 million as a result of decreasing reserves for uncertain tax positions. This estimate is subject to change as we complete our analysis.

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Comprehensive Income

We reported comprehensive income of $525.8 million, $63.6 million and $272.7 million in 2006, 2005 and 2004, respectively. The improvement in 2006 compared to 2005 was primarily due to higher net income as a result of an increase in underwriting profits and an increase in the market value of the investment portfolio during 2006. The decrease in 2005 was primarily due to a decline in the market value of the investment portfolio during 2005 compared to an increase in the market value of the investment portfolio during 2004.

In accordance with our adoption of Statement of Financial Accounting Standards No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans*, comprehensive income for 2006 included net actuarial pension loss, net of taxes, of $25.0 million.

Claims And Reserves

We maintain reserves for specific claims incurred and reported, reserves for claims incurred but not reported and reserves for uncollectible reinsurance. Our ultimate liability may be greater or less than current reserves. In the insurance industry, there is always the risk that reserves may prove inadequate. We continually monitor reserves using new information on reported claims and a variety of statistical techniques. Anticipated inflation is reflected implicitly in the reserving process through analysis of cost trends and the review of historical development. We do not discount our reserves for losses and loss adjustment expenses to reflect estimated present value.

The first line of the following table shows our net reserves for losses and loss adjustment expenses adjusted for commutations, acquisitions, dispositions and other items, including the impact of changes in foreign currency rates. This adjustment is accomplished by revising the reserves for losses and loss adjustment expenses as originally estimated at the end of each year and all prior years for reserves either reassumed from reinsurers or ceded back to cedents through reinsurance commutation agreements. Adjustments are also made for insurance company acquisitions or dispositions completed in recent years and for the effects of changes in foreign currency rates since the reserves for losses and loss adjustment expenses were originally estimated.

The upper portion of the table shows the cumulative amount paid with respect to the previously recorded reserves as of the end of each succeeding year. The lower portion of the table shows the re-estimated amount of the previously recorded reserves based on experience as of the end of each succeeding year, including cumulative payments made since the end of the respective year. For example, the liability for losses and loss adjustment expenses at the end of 2001 for 2001 and all prior years, adjusted for commutations, acquisitions, dispositions, and other, was originally estimated to be $2,486.7 million. Five years later, as of December 31, 2006, this amount was re-estimated to be $3,169.2 million, of which $2,065.6 million had been paid, leaving a reserve of $1,103.6 million for losses and loss adjustment expenses for 2001 and prior years remaining unpaid as of December 31, 2006.

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Markel Corporation & Subsidiaries

MANAGEMENT S DISCUSSION & ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

The following table represents the development of reserves for loss and loss adjustment expenses for the period 1996 through 2006.

(dollars in millions)	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Net reserves, end of year, adjusted for commutations, acquisitions, dispositions and other	**$ 1,227.2**	**1,391.8**	**1,631.3**	**2,018.4**	**2,151.6**	**2,486.7**	**2,955.7**	**3,420.8**	**3,841.0**	**4,211.9**	**4,326.4**
Paid (cumulative) as of:											
One year later	146.7	161.1	248.7	550.3	607.7	647.7	702.1	679.6	717.2	**799.5**	
Two years later	266.2	345.1	576.2	908.3	1,030.3	1,169.7	1,214.1	1,194.1	**1,256.5**		
Three years later	399.5	539.6	836.2	1,179.8	1,410.8	1,536.2	1,615.7	**1,597.8**			
Four years later	528.6	667.2	1,001.6	1,421.2	1,646.3	1,840.2	**1,932.5**				
Five years later	619.9	782.6	1,123.2	1,559.0	1,867.7	**2,065.6**					
Six years later	698.3	856.6	1,214.7	1,711.7	**2,027.2**						
Seven years later	752.3	921.7	1,295.8	**1,818.9**							
Eight years later	804.2	983.9	**1,371.4**								
Nine years later	857.5	**1,040.6**									
Ten years later	**896.3**										
Reserves re-estimated as of:											
One year later	1,201.2	1,354.4	1,592.8	2,030.9	2,289.1	2,618.3	3,084.2	3,454.7	3,790.4	**4,079.6**	
Two years later	1,177.2	1,318.2	1,586.2	2,124.9	2,403.0	2,799.5	3,268.6	3,475.2	**3,635.7**		
Three years later	1,146.5	1,288.6	1,627.8	2,208.1	2,580.3	3,042.9	3,343.8	**3,410.7**			
Four years later	1,099.4	1,316.7	1,679.5	2,339.5	2,779.5	3,161.5	**3,331.0**				
Five years later	1,126.0	1,363.7	1,774.1	2,393.5	2,868.3	**3,169.2**					
Six years later	1,172.0	1,435.6	1,820.3	2,465.6	**2,878.3**						
Seven years later	1,241.0	1,417.3	1,865.2	**2,473.3**							
Eight years later	1,246.1	1,444.3	**1,883.6**								
Nine years later	1,273.6	**1,466.4**									
Ten years later	**1,294.2**										
Net cumulative redundancy (deficiency)	**$ (67.0)**	**(74.6)**	**(252.3)**	**(454.9)**	**(726.7)**	**(682.5)**	**(375.3)**	**10.1**	**205.3**	**132.3**	
Cumulative %	(5%)	(5%)	(15%)	(23%)	(34%)	(27%)	(13%)	0%	5%	3%	
Gross reserves, end of year, adjusted for commutations, acquisitions, dispositions and other	$ 1,800.9	1,898.8	2,202.2	2,677.8	3,079.3	3,822.0	4,464.4	4,915.0	5,352.5	6,135.2	5,583.9
Reinsurance recoverable, adjusted for commutations, acquisitions, dispositions and other	573.7	507.0	570.9	659.4	927.7	1,335.3	1,508.7	1,494.2	1,511.5	1,923.3	1,257.5

Net reserves, end of year, adjusted for commutations, acquisitions, dispositions and other	**$ 1,227.2**	**1,391.8**	**1,631.3**	**2,018.4**	**2,151.6**	**2,486.7**	**2,955.7**	**3,420.8**	**3,841.0**	**4,211.9**	**4,326.4**
Gross re-estimated reserves	2,083.2	2,201.8	2,821.5	3,749.7	4,468.2	4,978.4	4,963.4	4,897.4	5,063.3	5,927.1	
Re-estimated recoverable	789.0	735.4	937.9	1,276.4	1,589.9	1,809.2	1,632.4	1,486.7	1,427.6	1,847.5	
Net re-estimated reserves	**$ 1,294.2**	**1,466.4**	**1,883.6**	**2,473.3**	**2,878.3**	**3,169.2**	**3,331.0**	**3,410.7**	**3,635.7**	**4,079.6**	
Gross cumulative redundancy (deficiency)	**$ (282.3)**	**(303.0)**	**(619.3)**	**(1,071.9)**	**(1,388.9)**	**(1,156.4)**	**(499.0)**	**17.6**	**289.2**	**208.1**	

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Net cumulative redundancy (deficiency) represents the change in the estimate from the original balance sheet date to the date of the current estimate. For example, the 2001 liability for losses and loss adjustment expenses developed a $682.5 million deficiency from December 31, 2001 to December 31, 2006. Conditions and trends that have affected the development of loss reserves in the past may not necessarily occur in the future. Accordingly, it may not be appropriate to extrapolate future redundancies or deficiencies based on the table. Gross cumulative redundancy (deficiency) is presented before deductions for reinsurance. Gross deficiencies and redundancies may be significantly more or less than net deficiencies and redundancies due to the nature and extent of applicable reinsurance. The net and gross cumulative redundancies as of December 31, 2006 for 2005 and prior years were primarily due to redundancies that developed during 2006 at the Shand Professional/Products Liability unit on the 2002 to 2005 accident years. See Underwriting Results for further discussion of changes in prior years loss reserves.

See note 8 of the notes to consolidated financial statements and the discussion under Critical Accounting Estimates for a discussion of estimates and assumptions related to the reserves for losses and loss adjustment expenses.

Liquidity And Capital Resources

We seek to maintain prudent levels of liquidity and financial leverage for the protection of our policyholders, creditors and shareholders. Our target capital structure includes approximately 30% debt. Our debt to total capital ratio was 27% at December 31, 2006 and 33% at December 31, 2005. The decrease in our 2006 debt to total capital ratio from 2005 is due in part to the conversion of our convertible notes payable during 2006. As a result of this conversion, we issued approximately 335,000 shares of common stock. See note 9 of the notes to consolidated financial statements for further discussion of our convertible notes payable. After December 31, 2006, we redeemed the remaining 8.71% Junior Subordinated Debentures, which lowered our debt to total capital ratio. From time to time, our debt to total capital ratio may increase due to business opportunities that may be financed in the short term with debt. Alternatively, from time to time, our debt to total capital ratio may fall below our target capital structure, which provides us with additional borrowing capacity to respond quickly when future opportunities arise.

At December 31, 2006, our holding company (Markel Corporation) held $541.2 million of invested assets, which approximated 8.3 times annual interest expense. Holding company invested assets at December 31, 2006 increased from the prior year primarily due to $210.6 million of dividends received during 2006 from our domestic insurance subsidiaries and the desire to retain holding company liquidity in anticipation of our redemption of the remaining 8.71% Junior Subordinated Debentures. In order to maintain prudent levels of liquidity, we seek to maintain invested assets at Markel Corporation of at least two times annual interest expense.

In August 2005, our Board of Directors approved the repurchase of up to $200 million of common stock pursuant to a share repurchase program (the Program). Under the Program, we may repurchase outstanding shares of common stock from time to time, primarily through open-market transactions. As of December 31, 2006, we have repurchased 159,200 shares of our common stock at a cost of $52.1 million under the Program.

Our insurance operations collect premiums and pay current claims, reinsurance costs and operating expenses. Premiums collected and positive cash flows from the insurance operations are invested primarily in short-term investments and long-term fixed maturities. Short-term investments

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Markel Corporation & Subsidiaries

MANAGEMENT S DISCUSSION & ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

held by our insurance subsidiaries provide liquidity for projected claims, reinsurance costs and operating expenses. As a holding company, Markel Corporation receives cash from its subsidiaries as reimbursement for operating and other administrative expenses it incurs. The reimbursements are made within the guidelines of various management agreements between the holding company and its subsidiaries.

The holding company has historically relied upon dividends from its subsidiaries to meet debt service obligations. Under the insurance laws of the various states in which our domestic insurance subsidiaries are incorporated, an insurer is restricted in the amount of dividends it may pay without prior approval of regulatory authorities. At December 31, 2006, our domestic insurance subsidiaries could pay dividends of $335.3 million during the following twelve months under these laws. There are also regulatory restrictions on the amount of dividends that our foreign insurance subsidiaries may pay. We must provide 14 days advance notice to the Financial Services Authority prior to receiving dividends from MIICL. In addition, our foreign insurance subsidiaries must comply with the United Kingdom Companies Act of 1985, which provides that dividends may only be paid out of distributable profits.

Net cash provided by operating activities decreased to $511.6 million in 2006 from $551.3 million in 2005 and $690.7 million in 2004. The decrease in 2006 was primarily due to higher claim payments related to hurricanes and higher income tax payments in 2006 compared to 2005, offset in part by collections of reinsurance balances related to the 2005 Hurricanes, increased premium volume and cash received from reinsurance commutation agreements completed in 2006. The decrease in 2005 was primarily due to a decline in premium volume, higher claim payments on hurricane losses and higher commutation payments compared to 2004.

Invested assets increased to $7.5 billion at December 31, 2006 from $6.6 billion at December 31, 2005. The increase in invested assets was primarily due to our 2006 net cash provided by operating activities and an increase in net unrealized holding gains in 2006. See note 2(f) of the notes to consolidated financial statements for a discussion of restricted assets.

Net cash provided by financing activities was $58.5 million for the year ended December 31, 2006 compared to net cash used by financing activities of $29.2 million and net cash provided by financing activities of $83.4 million for the years ended December 31, 2005 and 2004, respectively. The net cash provided by financing activities during 2006 was due to $145.4 million of net proceeds on the August debt issuance, partially offset by $86.9 million of cash used to repurchase shares of our common stock and retire a portion of both our senior long-term debt and our 8.71% Junior Subordinated Debentures. During 2005, the $29.2 million of cash was used to repurchase shares of our common stock and retire a portion of both our outstanding senior long-term debt and our 8.71% Junior Subordinated Debentures. The net cash provided by financing activities during 2004 was primarily due to a debt issuance in that year.

Reinsurance recoverable on paid and unpaid losses was $1.4 billion at December 31, 2006 compared to $1.9 billion at December 31, 2005. The decrease was primarily due to claims settled on the 2005 Hurricanes during 2006 and the subsequent cash collected under our reinsurance agreements. In addition, we completed several reinsurance commutation agreements during 2006, which resulted in a reduction to reinsurance recoverable on paid and unpaid losses of approximately $150 million. The commutation agreements did not result in a material gain or loss to our results of operations in 2006.

Reinsurance commutations involve the termination of ceded or assumed reinsurance contracts. Our commutation strategy related to ceded reinsurance contracts is to reduce credit exposure and eliminate administrative expenses associated with the run-off of reinsurance placed with certain reinsurers. Our commutation strategy related to assumed reinsurance contracts is to reduce our loss exposure to

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long-tailed liabilities assumed under reinsurance agreements entered into prior to our acquisition of Markel International. We will continue to pursue commutations when we believe they meet our objectives.

We have credit risk to the extent any of our reinsurers are unwilling or unable to meet their obligations under our reinsurance agreements. We attempt to minimize credit exposure to reinsurers through adherence to internal reinsurance guidelines. We monitor changes in the financial conditions of our reinsurers and we assess our concentration of credit risk on a regular basis. At December 31, 2006, our reinsurance recoverable balance for the ten largest reinsurers was $972.5 million, representing 71% of our consolidated balance. Of the amounts due from the ten largest reinsurers, 89% was due from reinsurers rated A or better by A.M. Best. We are the beneficiary of letters of credit, trust accounts and funds withheld in the aggregate amount of $330.5 million at December 31, 2006, collateralizing reinsurance recoverable balances due from our ten largest reinsurers. Of the $330.5 million, $104.0 million relates to the reinsurers that had an A.M. Best rating of less than A , representing 93% of amounts due from those reinsurers. See note 14 of the notes to consolidated financial statements for further discussion of reinsurance recoverables and exposures. While we believe that reinsurance recoverable balances are collectible, deterioration in reinsurers ability to pay or collection disputes could adversely affect our operating cash flows, financial position and results of operation.

The following table reconciles case reserves and IBNR reserves, by segment, to unpaid losses and loss adjustment expenses reported in our consolidated financial statements.

(dollars in thousands)	Excess & Surplus Lines	Specialty Admitted	London Insurance Market	Other	Consolidated
December 31, 2006					
Case reserves	**$ 750,330**	**91,650**	**1,125,656**	**452,989**	**$ 2,420,625**
IBNR reserves					