2006 TO OUR BUSINESS PARTNERS

We are pleased to report record underwriting profit, superior investment returns and strong book value growth in 2006, our 20th year as a public company. Celebrating our success is especially rewarding because we have built an incredibly strong company that keeps getting better. A major effort throughout 2006 was to improve the management, pricing and control of our catastrophe exposures. While we believe we've been successful in this effort, we were not tested this year. As a result, our 2006 results include a large dose of good luck as the weather was extremely benign. We are not complaining.

However, good weather does not deserve all the credit for our exceptional 2006 performance. Our associates deserve the real credit as their combined energies produced stunning results. Gross written premiums increased 6% to $2.5 billion. Growth in our investment portfolio and higher interest rates produced net investment income of $271 million, a 12% increase over 2005. Realized investment gains were $64 million. Earned premiums were up 13% to $2.2 billion in 2006; and our underwriting results improved dramatically, producing a combined ratio of 87%. Net income was a record $393 million, more than double our previous record year. As a result of all this good news, book value per share increased 32% to approximately $230 per share.

In this letter, we will discuss our financial results, including our underwriting and investing operations. However, throughout this year's letter, we also want to focus on principles that underlie both our daily underwriting and investment decisions and are integral components of the Markel Style. At Markel, underwriting and investing are working from the same blueprint. The principles that support profitable underwriting are the same ones that lead us to superior investment returns and, in turn, help us build shareholder value. These important principles are: maintaining a long-term time horizon, discipline and continuous learning.

TWENTY-YEAR PERSPECTIVE

While we are delighted to discuss 2006, we recognize that in any one year fortuitous timing (good luck) influences our results just as much as, if not more than, our fundamental business discipline. Over longer time horizons, however, the effect of timing fades away. It is superseded by sound business principles and skilled application which becomes evident only with the passage of time. These facts help, in part, to explain why we focus on long-term measures at Markel. Anyone, including us, can get lucky in the short-term. However, over 10, 20 or more years, only companies with skill and discipline can consistently produce value for their shareholders.

The chart at the bottom of these pages shows some key numbers for Markel's first 20 years as a public company.

(in millions, except per share data)	**2006**	2005	2004	2003	2002	2001	2000	1999	1998
Gross written premiums	**$ 2,536**	2,401	2,518	2,572	2,218	1,774	1,132	595	437
Combined ratio	**87%**	101%	96%	99%	103%	124%	114%	101%	98%
Investment portfolio	**$ 7,535**	6,588	6,317	5,350	4,314	3,591	3,136	1,625	1,483
Portfolio per share	**$753.98**	672.34	641.49	543.31	438.79	365.70	427.79	290.69	268.49
Shareholders' equity	**$ 2,296**	1,705	1,657	1,382	1,159	1,085	752	383	425
Book value per share	**$229.78**	174.04	168.22	140.38	117.89	110.50	102.63	68.59	77.02
5-Year CAGR in book value per share[1]	**16%**	11%	20%	13%	13%	18%	21%	22%	23%

[1] CAGR—compound annual growth rate

For the 20 years, in every important category, we posted compound growth rates of higher than 20%, albeit from very modest beginnings. The measures on this chart reflect our core goals: underwriting profits and growth in book value per share.

Over the 20-year period, we missed our underwriting target six times on an annual basis. These shortfalls occurred due to acquisitions where we purchased companies in need of improvement, the events of September 11, 2001 and the hurricanes of 2005. Despite the periods of annual shortfalls, we are very proud of our underwriting results over time.

The 2006 year was also fantastic for our investment portfolio. We enjoyed a measure of good luck this year as we earned 25.9% on our equity portfolio and 5.2% on our fixed income portfolio for a taxable equivalent total return of 11.2%. Given the inherent investment leverage in our insurance operations, these levels of investment returns more than support our long-term goal of high returns on Markel's shareholders' equity.

More important than the returns of any one year though are the returns created over years and decades. Over long-term periods, when time and our investment discipline begin to outweigh good luck, our results have been wonderful as well. For the last five years we earned 13.9% on our equity investments and for the last ten years we earned 14.3%. By comparison, the S&P 500 over these time frames returned 6.2% and 8.4%, respectively. This is a dramatic out performance over meaningful periods of time.

Over the course of 20 years, you will notice annual volatility in growth in book value per share. As we have a long-term time horizon and focus our energies on economic earnings, sometimes to the detriment of quarterly and annual reported earnings, we have always been willing to accept some short-term volatility in book value growth. However, when examined over longer periods of time, volatility diminishes and the pattern of performance emerges. This can be seen over the past five and 20 years, as book value per share grew at a compound annual growth rate of 16% and 23%, respectively.

LONG-TERM TIME HORIZONS

The long-term view is critical to both our underwriting and investment decisions. It can be seen in our approach to investments, acquisitions, underwriting, organic expansion efforts and private equity opportunities.

Twenty years ago, when Markel went public, the investment portfolio totaled $31 million and shareholders' equity totaled $15 million or $3.42 per share. Over the last 20 years, investments grew to $7.5 billion and shareholders' equity grew to $2.3 billion, or approximately $230 per share. These represent compound annual growth rates of 32% and 23%, respectively.

1997	1996	1995	1994	1993	1992	1991	1990	1989	1988	1987	1986	20-Year CAGR[1]
423	414	402	349	313	304	406	412	44	43	32	35	24%
99%	100%	99%	97%	97%	97%	106%	81%	78%	84%	85%	78%	—
1,410	1,142	927	622	609	457	436	411	79	59	46	31	32%
257.51	209.20	170.95	115.45	112.55	84.64	81.77	77.27	14.54	11.35	10.67	7.07	26%
357	268	213	139	151	109	83	55	60	45	20	15	29%
65.18	49.16	39.37	25.71	27.83	20.24	15.59	10.27	11.69	9.22	4.66	3.42	23%
26%	26%	31%	17%	25%	34%	35%	—	—	—	—	—	—

In 1986, it would have been impossible to forecast the real estate troubles of the early 1990's and the collapse of the savings and loan system in our country. It would have been impossible to foresee the rise of the internet, the weakening and strengthening and weakening again of the dollar. It would have been impossible to foresee the swings in energy prices. It would have been impossible to foresee the nature of the geopolitical struggles we've seen in the Middle East. It would have been impossible to foresee the terrorist attacks of September 11, 2001. All of these things affected the world's economies temporarily, but no one could forecast them, or their effects, with any consistency.

At Markel, we didn't forecast them, and we didn't need to, in order to create excellent long-term returns for our shareholders. We simply took the capital we had and used it to the best of our abilities in the insurance and investment arenas following sound and proven business disciplines. We learned each year and continued to develop our knowledge in insurance, investments and acquisitions. The long-term results speak for themselves. Equally important, this approach suggests that our culture, systems, learning, skills and decision making should remain effective in our effort to earn superior returns on capital in the future.

After our purchase of the Terra Nova Group in the spring of 2000, we embarked on a methodical and deliberate process of dealing with the legacy issues that we inherited, while simultaneously re-underwriting certain segments of the portfolio that were unprofitable. In the short term, this was a painful exercise for Markel's associates and shareholders as our results fell short of our standards. However, we believed that by sticking with our discipline and instilling the Markel Style, Markel International's long-term prospects were bright. The results have steadily improved and in 2006 Markel International began to report underwriting profits. We are now fully focused on the future and are implementing initiatives to leverage our London presence and Lloyd's platform for international expansion. Markel International is now contributing to growth in shareholder value because we focused from the beginning on long-term, rather than short-term, goals.

Woody Allen once opined in a movie that "90% of life is just showing up." That may be true, but showing up on time is even more important. Before the horrible storm season of 2005 brought us Katrina, Rita and Wilma, we had made the decision to geographically diversify our off-shore energy business. When those events occurred, the losses in our marine and energy division, though painful, were significantly less on a relative basis than the rest of the market. As a result, we were able to expand those products in 2006 and are strategically positioned to do the same in 2007. Was there an element of luck involved in our decision? The short answer is yes. However, we constantly monitor and adjust our underwriting and pricing strategies, and luck can sometimes be confused with doing the right things over and over again.

Last year in our letter we discussed opening five new Markel International branch offices. They are located in Bristol and Cambridge, England; Edinburgh, Scotland; Madrid, Spain; and Toronto, Canada. We are pleased to report that all five are up and running and produced business that added to our bottom line this past year. We are extremely pleased with all five branches; but it will be some time before they have a major impact on results. We are patient and take a very long-term view in regards to expansion.

Our recent entry into private equity also represents a good example of our long-term view. While 2006 is only the first full year, we are extremely pleased with our private equity investments to date. AMF Bakery Systems and First Market Bank enjoyed solid years of profitability and should enjoy increased earnings going forward. More importantly, these deals, which we did directly with the principals rather than through intermediaries or fund structures, point the way towards additional investment potential over time.

Private equity and hedge funds are currently the white hot areas of the investment world. We expect that over the next several years many investors will become disenchanted with their returns due to the overwhelming headlong rush into this area by so many pension and endowment funds. We think that the high fee structures associated with this form of institutional investment and the short-term nature with which so many of the investee companies are being run will ultimately produce disappointing results. Following disappointing results, we expect many investors will seek to sell rather than buy private equity. Our measured approach to date has been to invest directly in businesses, support management teams with a long-term return on capital focus, and build the skills and relationships that should allow us to participate in this area in a more meaningful way as opportunities develop over the next several years.

DISCIPLINE

Whether it is our underwriting or investing operations, we believe that our discipline over long periods of time is what distinguishes us from our competitors. Many of our associates have long periods of service with Markel. At December 31, 2006, a quarter of our 1,897 associates have been with us for over ten years. These associates have experienced the hard and soft insurance markets and bull and bear investment markets. They have learned from their successes and, more importantly, their failures. They have embraced the Markel Style as a way to conduct business. These Markel veterans ensure that our underwriting and investing disciplines are consistently applied and are passed on to our newer associates.

At Markel, underwriting discipline represents both a philosophy and a process. Our philosophy is to work to achieve consistent underwriting profits in all products in all insurance market conditions. The process by which we achieve underwriting profits can be slightly different by underwriting unit but generally includes finding the answers to four questions: Can we assess the risk we are taking? Can we design the appropriate coverage for our client? Can we price the risk to earn an underwriting profit? Can we assess trends that may increase our risk in the future?

One of our first insurance products, the casualty product at Essex Insurance Company, is an excellent example of this discipline. We have been underwriting this product for 26 years with 10 or more points of underwriting margin the norm rather than the exception. Over the years, this product has become one of our largest as well as one of the most profitable. Much of this business is underwritten in the field by managing general agents who work within tightly defined "boxes" of authority that are set by Essex's underwriters. Average premiums per policy are less than $5,000 and typical accounts might be small artisan contractors and habitational risks. Many excess and surplus lines companies offer similar products but few have the underwriting results that Essex has enjoyed for decades. One of our most important daily disciplines is that each of the policies underwritten and issued by our agent partners in the field is re-underwritten and re-priced by an Essex underwriter prior to the policy receiving final approval and processing. This second set of eyes has proven invaluable; this extra step of discipline is directly responsible for a big portion of our underwriting profits.

When we first invested in the Shand/Evanston group in the late 1980's, their specialty offerings included a $50 million book of products liability business. As market conditions softened in the early 1990's and rates remained at depressed levels for almost a decade, sticking to our underwriting discipline required that we walk away from premium volume in this line. Annual premium volume ultimately fell below $10 million. Our underwriters worked side by side with our actuaries to continually define and understand when and where it was necessary to walk away from marginally priced business. Many of these underwriters were redeployed into other product areas that offered better opportunity and some even moved into other areas at the company outside of underwriting. However, when market conditions changed in late 2001 and pricing continued to harden during the following few years, Shand was there with market solutions and the necessary people and expertise to provide the customer service our clients demanded. For the last several years, Shand has written products liability premium volume that is a multiple of those levels from the late 1980's. While premium volume has necessarily changed with market conditions, Shand has generated significant underwriting profit margins over the years through consistent application of their underwriting discipline.

This same discipline is embodied in our investment philosophy. To review the catechism of our four part equity investment philosophy, we seek to invest: 1) in common equity of profitable businesses with good returns on capital, 2) with honest and talented management teams, 3) with reinvestment opportunities and capital discipline, 4) at fair prices. The north star provided by this time-tested discipline creates a guide to constant learning and improvement.

It is important to engrain this discipline in good years because we will need to remember it and stick to it during bad years. At some time in the future, we will have less than wonderful news to report from a single year's worth of investing activities. All good investors suffer years of underperformance. In those times, it is easy to lose your moorings and drift into different styles and methods of investing since whatever discipline or approach you were using didn't work out so well over the most recent twelve-month period.

If your basic discipline is sound, drifting away from it is a big mistake. This mistake is common among both amateur and professional investors. Most people simply cannot take the psychological pain of underperforming for very long. The inherent uncertainty in investing and thinking about the unknowable future, causes people to embrace the practices of what others are doing currently. Human nature seeks comfort in crowds rather than the relative isolation of remaining independent in thoughts and actions.

Our investment discipline also tends to create excellent tax efficiency over time. The items we focus on, such as basic profitability and good reinvestment attributes, are typically long-term attributes of a company. As such, we tend to buy and hold our equity investments for significantly longer periods of time than most institutional money managers. In fact, our ideal investment is one that we can own forever. The result is that we defer the payment of taxes into the future rather than paying them each and every year as a short-term trader would.

You can see this aspect of our investment philosophy on our balance sheet. As of December 31, 2006, we showed unrealized gains on our investment portfolio of $712 million. Against this gain, we showed a deferred tax bill of $249 million, as we have provided for the payment of our capital gains taxes someday when we sell the appreciated securities. In the meantime, that full unrealized gain is invested and earning a return for Markel shareholders. If we were shorter term oriented and chose to sell our securities due to a forecast of higher interest rates, unfavorable foreign exchange rates, geopolitical circumstances or weather patterns then we would have $249 million less to invest. This difference of having unrealized rather than realized gains has allowed pre-tax compounding to occur in the investment portfolio that would not have been possible without a long-term focused discipline.

CONTINUOUS LEARNING

Every underwriter in our company has a story about insurance risks that didn't work out. Each of them knows the importance of continually learning from these experiences in order to make better decisions the next time. While this is basic to running an insurance business, or any other business, the concept often seems to get lost. Fortunately, we work hard to keep this simple focus intact in both underwriting and investing at Markel. We concentrate on items we can control and we constantly seek to learn from and improve on the experiences of each year.

Continuous learning is critical to an organization such as Markel that underwrites and markets complex specialty products. Sometimes these learning experiences can be expensive as was demonstrated with the 2005 hurricanes (Katrina, Rita and Wilma). As of the end of 2006, we have incurred $301 million of underwriting losses from these storms.

During the fall of 2005 and throughout 2006, we have worked to learn from last year's experience. We have formed a central catastrophe exposure management team and have developed additional tools to monitor our coastal property and earthquake exposures. We have set insured value limits on the amount of business our underwriting units can write in catastrophe prone areas. We have increased our pricing and refined our coverage. We have established plans and procedures that will be put into action when the next major catastrophe occurs and we have geographically spread our catastrophe exposed business so that we can purchase less reinsurance in the future.

We believe that the lessons learned from the 2005 storms have helped us better manage our catastrophe exposure. While we were fortunate to have benign hurricane activity in 2006, we know that it is only a matter of time before we experience the next bad hurricane season. We also recognize that applying learning to underwriting is an iterative process.

While hurricane losses are an example of an expensive lesson, our environmental products at Markel Underwriting Managers are excellent examples of continuous learning. Several of our senior associates in this division have previous training as environmental consultants and as environmental engineers. This added level of expertise helps us better evaluate environmental assessments, environmental inspections and risks in general. This training has also enhanced our credibility with producers and clients and has allowed us to build this product over the last five or six years into a very significant portion of our writings in Red Bank, New Jersey.

Some of the best opportunities for learning come from listening. Listening may be one of the things that we do best. Most of our underwriters are charged with managing broker and client relations. It is not uncommon for our underwriters to spend up to 20% of their time on the road visiting and working with our clients in their offices. One of the sayings that we have at Markel is that while modern communication is great, nothing replaces eyeball to eyeball contact. This is particularly important in a relationship driven business like ours.

Having been in the insurance business for a long time has made us a good listener when it comes to adding extra service above and beyond the contract. At Markel Insurance Company, we have been market leaders in our camp and youth recreational business for almost two decades. One value added service we offer, that is seldom provided by our competitors, is our 24-hour response capability in case of emergency or catastrophe. Given the large amount of camp business that we write, we expect to receive claims during the camp season involving serious injury. These are devastating events for all involved. When these events occur, we provide our insureds with grief counselors, public relations advice and expert defense protection.

In our excess and surplus lines units, a high percentage of our policy forms are manuscripted, or tailored, to fit individual insureds' needs. It doesn't matter if we are helping an amusement park with coverage for a railroad, a chiropractor who needs a special malpractice rider or an asbestos abatement contractor who needs a knowledgeable environmental underwriter. Our people listen first, and then solve problems.

We also believe that our time tested and proven investment philosophy increases the odds of learning and replicating good results into the future. Recently Bill Miller, one of the most successful money managers in the last 20 years, made a comment that speaks to this point. He noted that an individual security oriented, value based discipline differs meaningfully from an investment approach based on the forecasting of events or circumstances. The important difference between the two is that good forecasting doesn't seem to lend itself to future success in accurate forecasting. By contrast a value based approach of working on business fundamentals such as understanding the reasons for returns on capital, management skill and integrity, reinvestment opportunities, and valuation, seems to offer better skills and results with longer practice.

As an example, suppose you base your investment actions on forecasts (fortune telling) regarding interest rates, oil prices, foreign exchange rates, new technology, the frequency of hurricanes, geopolitical factors or any other of the many macroeconomic factors that affect markets in the short term. Suppose you were right and you made some investment decisions which worked out well due to your correct forecast. What did you learn in that process that will make you equally or better skilled at making forecasts for next year?

Peter Lynch, the famed manager of the Fidelity Magellan fund, once joked that if any economist could predict interest rates correctly twice in a row they would not need to seek gainful employment. The fact that thousands of economists still toil away every day in finance, industry, government and academia ought to tell us something about the ability to make forecasts. It simply cannot be done reliably. Miller suggests that this is mainly because forecasting is not an activity in which one can learn from mistakes.

By contrast, our underwriting and investment disciplines allow us to learn from our inevitable mistakes and get better as time goes by.

When an underwriting decision does not work out, we ask ourselves why. Did we misunderstand the risk? Did we not appropriately build our coverage form? Did we under-price the risk? Did we overlook adverse claims trends?

When an investment doesn't work out, we go back to the four parts of our investment philosophy. Did the business or industry become less profitable due to new technology or competitive factors? Did the management team prove itself to be dishonorable or ineffective? Did capital get allocated to lower return projects or bad acquisitions? Was the price we paid for the stock just too high to allow us to earn a return?

In both underwriting and investing, answering all of these questions in an intellectually honest way allows us to make better judgments when faced with the task of evaluating today's and tomorrow's opportunities. Our investment and underwriting disciplines and the logical questions they suggest create a learning environment which increases our skills and odds of success for the future.

In this discussion, we largely focused on learning from our mistakes. Fortunately, we also have many successes from which we learn. When things go right, we work to apply these lessons on success to other aspects of our business. In both underwriting and investing, appreciating these lessons helps us capitalize on our successes and minimize our mistakes. To borrow an old saying, we want to water the flowers and pull the weeds.

2006 FINANCIAL REVIEW

Gross written premiums increased 6% to $2.5 billion as the result of higher premium rates in catastrophe-exposed property lines and growth in new product areas. With the exception of large rate increases on catastrophe-exposed business, rates were generally flat or down slightly compared to 2005. Earned premiums increased 13% to $2.2 billion as a result of higher gross written premiums and higher net retentions of gross written premiums (net retentions of 87% in 2006 compared to 82% in 2005, when our net retentions were impacted by reinsurance reinstatement premiums on the 2005 hurricanes).

Our combined ratio for 2006 was 87% compared to 101% in 2005. The combined ratio for 2006 included $55 million, or 3 points, of losses related to the 2005 hurricanes. The 2005 combined ratio included $246 million, or 12 points, of 2005 hurricane losses. In addition to the favorable impact of the benign hurricane season this year, the improved combined ratio for 2006 was due to an increase in favorable prior years' loss development, primarily in our Shand Professional/Products Liability unit and significant improvement in the results of Markel International (100% combined ratio in 2006 compared to 126% combined ratio in 2005).

Net investment income increased 12% to $271 million. The increase in 2006 was due to higher investment yields and growth in the investment portfolio as a result of $512 million of operating cash flows. Realized gains were $64 million for 2006. Investment returns were outstanding as our taxable equivalent total return for the portfolio was 11.2%.

Net income for 2006 was $393 million compared to $148 million in 2005. Shareholders' equity and book value per share grew to $2.3 billion and $230 per share, respectively. Compound annual growth in book value per share was 32% for the year and 16% for the five-year period.

BALANCE SHEET AND CAPITAL STRENGTH

Operating cash flow in 2006 was a strong $512 million. Premium volume growth and collections of reinsurance balances more than offset increased claims payments related to the 2005 hurricanes.

Our investment portfolio grew by 14% to $7.5 billion in 2006. At year end, the portfolio represented approximately $754 per share of common stock.

During 2006, our already strong balance sheet improved even further. Operating leverage improved as we reduced reinsurance recoveries by approximately $550 million to $1.4 billion by collecting balances due, retaining more of the business we write and successfully completing several commutations of legacy reinsurance balances. We continue to closely monitor the quality of our reinsurers and maintain significant collateral to support these balances. This is an area of increasing strength on our balance sheet.

In August, we issued $150 million of 7.50% senior notes due in 40 years with a five-year par call. We don't have any talent predicting future interest rates, so the call gives us the option to prepay or refinance this debt. Financial leverage declined and our capital structure was simplified as we forced conversion of our convertible notes during 2006 and retired our junior subordinated debentures in January 2007. Even without taking the latter transaction into account, our debt to total capital ratio at year end was 27%.

As a guideline, we believe that funding our business with roughly one-third debt and two-thirds equity represents a good balance. We think in terms of 25% to 35% as "roughly" one-third. We had slightly more debt than "average" over the past few years, so it is okay to have slightly less than "average" today. Having additional borrowing capacity will allow us to respond quickly when future opportunities arise.

We also repurchased approximately 140,000 shares of our stock for approximately $46 million during 2006. We believed that the $328 per share paid represented a good value.

The net effect of all of this is that our balance sheet is strong and getting stronger. We are particularly proud of our financial strength and the integrity of our balance sheet.

GROWTH AND OUR MODEL FOR PROFIT

Consistent underwriting profits, superior investment returns and managing our capital create growth in book value per share for our shareholders. A great and common danger in the insurance business is to seek premium growth at the expense of underwriting profits. In the short run, it is easy to sell the cheapest price and grow at the expense of underwriting discipline. In the long run, this always leads to disaster. By continuously improving and getting better at serving our customers and solving their insurance problems we can both grow and achieve good underwriting results. In fact, our record demonstrates precisely this ability.

Over the last 20 years, we've grown both organically and through acquisitions. Two of our acquisitions, one in 1990 and the second in 2000, virtually doubled the size of our company. In both of these cases and in other smaller transactions, we purchased companies in need of repair. These acquisitions required reorganization to focus on underwriting profits along with the Markel culture. The immediate results often included short-term volume reductions, followed in all cases by profitable growth.

While the insurance industry as a whole is very competitive and cyclical, individual products and markets within the industry often show different characteristics. Profitable growth potential exists when it is based on innovation, creativity, customer service and problem solving. As niche underwriters this is what we do. Opportunities always exist. However, these opportunities do not appear in smooth and exact intervals. There will always be periods of ups and downs as with many other aspects of this business. The key, as with most other things, is patience, discipline and constant focus on long-term results.

While we do not force growth at Markel, growth is important and desirable for several reasons, as long as it is accompanied by underwriting profits. First and foremost, we continue to build our capital and we desire to reinvest it in our business where we believe we can earn high rates of return. We're still a fairly small company in a very large industry, so plenty of growth opportunity exists. Meeting the needs of our clients is also important. As they grow and face new risks, we want to be there to solve their risk and insurance problems. Finally, we want to continue to provide intellectual challenges and development opportunities for our associates. All of these objectives are more easily accomplished when we grow as an organization.

To continue to grow in the future, we will increasingly emphasize continuous learning, new ideas, better ways of meeting customer needs, and other opportunities to build our business. We cannot let our high underwriting standards become an artificial excuse for us not to grow. We cannot let our success lead to complacency. We can, and expect that we will, both grow AND earn solid underwriting results.

LOSS RESERVE PHILOSOPHY

For decades, we've maintained a philosophy of attempting to establish loss reserves at levels which are more likely to be redundant than deficient. We also refer to this philosophy as attempting to establish a margin of safety. It's impossible to set loss reserves perfectly since they represent an estimate about the future outcome of unknown events. Given this uncertainty, we do our best to understand what drives these outcomes, monitor these drivers closely and try to be conservative. We attempt to create a margin of safety so that loss reserves will ultimately prove adequate.

The net unpaid losses and loss adjustment expenses at the end of 2006 totaled $4.3 billion. About 75% of this number is for losses and the remaining 25% for expected loss adjustment expenses. Less than half of this number (about 40%) is related to claims which have already been reported while about 60% is for claims which have not yet been reported even though the losses have occurred. In insurance jargon, this is called IBNR which stands for "incurred but not reported." Unpaid losses from the 2006 accident year are estimated to be $1.0 billion. Of this amount, only 19% are estimates for specific events that we know about today. In many cases, it can take years before an insured knows of, and reports, a loss to us.

Reserves are established for each product and for each accident year. New products and the most recent accident years contain the highest degree of uncertainty. New business is also more unpredictable than renewal business. As each accident year matures, we become more confident in our estimate of the final outcome.

We review our business each quarter using the best information available to estimate our future losses. For the most recent accident years, we base estimates largely on our historic experience and current business plans, along with a healthy dose of skepticism. We analyze the pricing trends and changes in underwriting approaches, the impact of inflation and changes in the legal environment. All of these items require significant judgment and adverse outcomes are possible. We want the reserves to include a margin of safety so that they will ultimately prove adequate. As the accident year matures, the reserves are increasingly based upon actual claims experience and estimates of the ultimate cost of specific claims. If the business progresses as we would hope, any conservatism or redundancy established in the earlier period will be released as the years go by and the actual results emerge.

While we have consistently tried to maintain a margin of safety in our reserves, our experience shows that we have not always been successful. In most years our reserves have proven to be more than adequate; however, we have had some surprises, and surprises are almost always bad in insurance.

Culturally, we emphasize the importance of dealing with bad news quickly. We tend to be a little slower in recognizing good news. Fortunately, we also find examples where our conservatism results in reserves being released. In the period 2000 to 2003 we increased our business in the specialty physicians' product from $14 million to almost $100 million. While pricing was strong and much of this business was first year claims made business, we were very cautious in estimating the ultimate claims costs. New business and fast growth often create problems. Fortunately, this business proved to be even better than our best expectations. In the past few years we have recognized about $75 million in reserve redundancies from this product and, if the current trends continue, there could be a bit more to come.

Consistent application of our reserving philosophy is more important to us than reported earnings. During periods of high growth, or after acquisitions, reported earnings suffer as we establish an appropriate margin of safety. In more normal periods, redundancies established in earlier periods will be released as those accident years mature. At the same time, the current accident year margin of safety is established at conservative levels. When surprises occur, they are accounted for and reported promptly. While the annual impact on the income statement will vary, we expect the loss reserves on the balance sheet to maintain a consistent margin of safety.

Converting this philosophy into practice is also not always simple. We have about 100 different products, each of which has many unique characteristics. Loss reserving starts with historical reviews, which in some of our products can be limited by lack of data. It involves judgments about current underwriting and pricing standards, expected loss frequency and severity, inflation, the legal environment, currency values and other trends.

The reserving process takes advantage of actuarial science using the principles of probability and statistics. Obviously all of the data points are in the past, yet we are trying to forecast the future. Many estimates and assumptions must be made and small variations in these can have a material impact. So while the systems and computers might be very robust, they cannot replace good judgment.

The most important aspects of our past successes and future prospects are that we approach issues and potential problems conservatively and with intellectual honesty. Our philosophy, principles and goals remain clear and guide us as we try to use good judgment in making daily decisions.

We encourage you to read Critical Accounting Estimates beginning on page 79 where we discuss our loss reserving process and philosophy in more detail.

BOARD APPOINTMENT

We are pleased to have added Lemuel E. Lewis to our board of directors effective February 22, 2007. Lem recently retired from Landmark Communications, Inc., a media holding company headquartered in Norfolk, Virginia, where he served as Executive Vice President and Chief Financial Officer. Lem remains a member of Landmark's board and also serves on the board of the Federal Reserve Bank of Richmond. We are excited that Lem has chosen to join our board. We look forward to having his counsel and the benefit of his experience. Lem will stand for election along with the other members of our board of directors at our 2007 Annual Shareholders' meeting on May 14, 2007.

CLOSING COMMENTS

Our first 20 years as a public company have been exciting and prosperous; 2006 was a great year and we are optimistic for the future.

This success is, in large part, due to our commitment to the Markel Style and a focus on maintaining a long-term time horizon, discipline and continuous learning. Like any business, we're here to make money. But more than that, we want to build a successful and sustainable organization that can continue to grow, serve its clients well, provide opportunities for its associates and generate financial success for its shareholders for decades and generations to come.

Another integral element to the way we do business is a sound incentive compensation system. Since our earliest days as a public company, management has always worked to put shareholders first. Management compensation at Markel has always been based on the idea that base salaries should be reasonable—but that meaningful incentives should be available when we achieve our lofty goals.

We believe in employee share ownership, but we do not believe that stock options are a good way to create it. Being "given" an option is simply not the same as buying stock. Under our incentive system, when Markel associates deliver exceptional results for our shareholders in the form of underwriting profits or growth in book value, they earn meaningful bonuses. For some of our senior executives, we pay part of their bonuses in restricted stock to tie their interests even more closely to those of our shareholders. For all associates, we have implemented incentives to buy Markel stock so they can choose to participate as owners in a sound and successful business.

These philosophies come together to create a virtuous cycle where success breeds success. Our ultimate goal at Markel is to achieve continued success for all our stakeholders.

We thank our associates, our shareholders and our clients for being part of our success.

Alan I. Kirshner
Chairman of the Board and Chief Executive Officer

Anthony F. Markel
President and Chief Operating Officer

Steven A. Markel
Vice Chairman

Paul W. Springman
Executive Vice President

Thomas S. Gayner
Executive Vice President and Chief Investment Officer

Richard R. Whitt, III
Senior Vice President and Chief Financial Officer

From left to right: Paul W. Springman, Anthony F. Markel, Thomas S. Gayner, Steven A. Markel, Alan I. Kirshner, and Richard R. Whitt, III.